SIDLEY AUSTIN LLP

SIDLEY

Initial Discussion Draft 1

MEMORANDUM

TO: Cross Community Working Group to Develop an IANA Stewardship Transition Proposal on Naming Related Functions ("CWG")

FROM: Sidley Austin LLP ("Sidley")

RE: Preliminary Response to CWG Questions Identified in Scoping Document Initial Discussion Draft 1

DATE: March 18, 2015

Overview and Qualifications

You have asked that we respond to a list of 12 questions set forth in the document entitled "CWG-IANA: Issues for Independence Legal Advice" (the "Scoping Document," attached as Annex A) that have arisen as the CWG has worked to develop proposals for the transition of NTIA's oversight of the IANA functions.

Please note that the draft responses below are preliminary in nature and are provided on a general level in keeping with the general level of the questions posed in the Scoping Document. Our draft responses are tailored to the questions posed by the CWG and provided for the benefit of the CWG, to help facilitate its consideration of the transition proposals as outlined in the Scoping Document and should not be relied upon by any other persons or for any other purpose. These draft responses reflect Sidley's preliminary independent reactions regarding the questions, and have not been reviewed by any third parties.

Unless otherwise expressly stated, the draft responses contained in this memo are based on California law, and in particular, the laws governing California non-profit corporations (*California Corporations Code, Title 1, Division 2*). In our effort to prepare these responses for the CWG under a very short and limited time frame, we have not completely and fully explored and researched all of the potential options and nuances posed by each of the questions. Also, please note that where we were uncertain as to underlying concerns reflected in a particular question, we have made certain assumptions about the focus of the question.

Finally, we also received today a supplemental document entitled "Integrated IANA model outline and legal questions" (the "Integrated Model Document") that is self-described as an attempt to reconcile the previously proposed internal and external models. The Integrated Model Document contains further questions directed to Sidley. Given the timing of our receipt of this document, however, we have not included any responses in this draft. We will supplement this memorandum with a further response to the questions posed in the Integrated Model Document.

Preliminary Draft Responses:

Our preliminary draft response follows each of the numbered questions set forth in italics below.

1. ***Board Decisions****: What are the options available to allow a multi-stakeholder body to (a) mandate, (b) overrule, or (c) take a binding appeal from, a particular Board decision?*

   (a) *If these options are not legally available in California, what are the closest available alternative options in California?*

   (b) *If these options are not legally available in California, are there other jurisdictions (foreign or US) where they may be available (or where there are better alternative options)?*

   (c) *What are the types of situations where it is appropriate (or inappropriate) for the acts of a Board to be subject to binding oversight, be it through mandate, overrule or binding appeal, etc.? (i.e., are there particular levels or types of decisions for which that would be appropriate?)*

   (d) *Could that binding oversight requirement be incorporated into the Bylaws or Articles of Incorporation? If so, how and to what it extent can it be protected from being changed by the Board or not implemented by the Board?*

   (e) *What would the characteristics of that "oversight" accountability group look like (multi-stakeholder body, non-profit members, arbitral panel, other options)?*

   (f) *Can a bylaw be drafted that cannot be changed by the Board? If so, must there be some method to change such a bylaw? In a non-member corporation, what are accepted methods to do so?*

   (g) *NOTE: All options should be under consideration, including changing the form of the corporation (e.g., membership organization, moving away from Public Benefit Corporation), changing bylaws (e.g., "golden share/bylaw"; requiring "consensus against" by the Board to reject a change mandated by the "community"), change in jurisdiction, creation of additional mechanism available to the community, etc.*

Sidley Response:

- Generally, a multi-stakeholder body is limited in its ability to mandate that a board of a corporation take or forego a particular lawful action, or otherwise overrule, or take a binding appeal from, a board decision. However, under California law depending how the relation of the multi-stakeholder body to the corporation is structured, there are means to provide a multi-stakeholder body with certain approval rights, for example, as "members" (defined in footnote 2 below) of the non-profit corporation or, as discussed in Response #4 below, through a "golden bylaw" that provides that a key provision of a corporation's charter documents cannot be altered without a third party's approval.

- Thus, limitations on board action may arise from specific provisions in a corporation's articles of incorporation and bylaws with which the board of directors must comply, or from a specific contractual agreement with the corporation (breach of which, in limited circumstances, could give rise to a remedy of specific performance of the contract).

- Note that how the multi-stakeholder body is organized has bearing on the issue of what options may be available to provide the multi-stakeholder body with rights. As explained in greater detail in Response #2 below, to have legally cognizable rights, the multi-stakeholder body must be organized in some legally cognizable form.

- As a general concept of corporate law, the board of directors of a corporation is the body with the authority and responsibility for managing and directing the affairs of the corporation in compliance with the corporation's articles of incorporation and bylaws, whether the corporation is organized as a for-profit or as a non-profit entity. As an accountability mechanism, each director is a fiduciary and is obligated to act prudently (duty of care) and in good faith and in the best interests of the corporation (duty of loyalty). In addition, in a non-profit corporation, an additional "duty of obedience" – a duty to carry out the mission expressed in the articles of incorporation – applies.

- Under California law, the board is responsible for conducting the corporation's affairs and for exercising the powers of the corporation. Directors may delegate some of their powers to officers, employees, experts and others (including designated committees). However, the board bears ultimate responsibility for corporate decisions and must provide oversight of the exercise of those powers it has delegated.[1]

- A California public benefit (non-profit) corporation may be organized with or without members.[2]

---

[1] Note that the Model Nonprofit Corporation Act ("MNPCA") (model legislation proposed by the American Bar Association) contains a new section entitled "designated body", which allows the board of directors to vest a portion of their power in a designated group so as to relieve themselves of their duties and liabilities with respect to those powers. *Model Nonprofit Corporation Act*, Third Edition 2008, §8.12. This vesting of power is in conflict with the California Corporate Code, which relies on directors to have ultimate authority for the actions of corporations. *California Corporations Code* §§ 5210, 7210. Only a minority of states have modeled their corporate laws after the MNPCA. *See* http://nonprofitorganizations.uslegal.com/state-laws-governing-nonprofit-corporations. A further minority of states have adopted corporate codes featuring the "designated body" concept. *District of Columbia Code* §29-406.12(a); Pennsylvania, *Consolidated Statutes*, Title 15, § 5103 (referring to the concept as "other bodies")." Commentators have been concerned that the "designated body" concept undermines the purpose of a board to ensure operational oversight and monitoring of management. See, Boozang, Kathleen M., *Does an Independent Board Improve Nonprofit Corporate Governance*, 75 Tenn. L. Rev. 83, 119-22 (2007).; Fremont-Smith, Marion R., *The Search for Greater Accountability of Nonprofit Organizations: Recent Legal Developments and Proposals for Change*, 76 Fordham L. Rev. 609, 615-16 (2007).

[2] As used in this memorandum, references to "members" are intended to refer to members in a legally recognized non-profit corporation, or to members of an unincorporated association, in each instance in a legal sense under California statute. "Members" is not intended to refer to participants under an informal group setting.

- In a California public benefit corporation with members, certain decisions may be reserved to the members, who may be individuals or entities. Depending on the articles and bylaws, such members may be vested with significant voting and other statutory rights, similar to those that may be reserved to a shareholder in a for-profit corporation. Rights commonly reserved to members include:

    - the election of directors (whether by common vote, or through classes or designations);
    - the removal of directors without cause;
    - bylaw amendments materially and adversely affecting rights on voting of member interests or transfer;
    - amendments to bylaws changing the number of directors;
    - amendments to the articles of incorporation; and
    - the transfer of all or substantially all of the assets of a corporation, outside the ordinary course.

- Other significant decisions of the corporation also may be conditioned upon both board and member approval, as enumerated in the articles or bylaws, as appropriate. These controls may provide a further lever for the members of the corporation to hold the board accountable for the conduct and affairs of the corporation.

- Note that California provides a private right of action to members of a corporation to enforce the terms of the corporation's articles and bylaws. In some situations, these actions must be brought as representative suits in the name of the corporation.

- In a public benefit corporation, the articles and bylaws can designate committees or groups, as the ICANN Bylaws do (e.g., Ombudsman, Independent Review Board, etc.), with powers to undertake certain actions or make certain recommendations to the board. These provisions, may include specific approval rights over certain decisions delegated to such committee or group by the board. These provisions generally do not compel the board to act in a certain way however. Rather they are in the nature of powers designated to others or approval rights over board actions.

- Short of specified approval rights, in a public benefit corporation where the board is either elected by members, or key stakeholders have rights to select directors, the ability to elect or select the directors provides a means to hold directors – and by extension, the board -- accountable to the interests of the stakeholders. The potential for removal of directors if provided for in the articles puts additional strength in this accountability mechanism.

2. ***Replacing the Control and Binding Nature of a Contract****: Currently, ICANN is under contract to the NTIA to perform the IANA Functions. If the NTIA (in the role of contracting party) is replaced by the "global multi-stakeholder community," how can that community have an arrangement with ICANN (or the IANA Functions Operator directly) that replicates the control and binding nature of the IANA Functions Contract?*

   (a) *What documentation would be needed (and why)?*

   (b) *What structures would be needed (and why)?*

Sidley Response:

- In California and other U.S. jurisdictions, to be a counterparty to the IANA Functions Contract with ICANN, the "global multi-stakeholder community" − or the representatives of such community authorized to act on behalf of that community − would have to be organized as a cognizable legal entity, for example, as a corporation (including a non-profit corporation), a partnership, a limited liability company, or an unincorporated association.

- Non-Profit Corporations: California recognizes three distinct types of non-profit corporations: public benefit corporations, mutual-benefit corporations and religious corporations, all of which may qualify for federal tax exempt status. These corporations are the most well-recognized and common entities for charitable and public purposes and are subject to regulation by the California Attorney General and state statute.

- Public benefit corporations (like ICANN) may be formed for public or charitable purposes and may or may not have members. They may not make distributions of corporate assets to members of the corporation, and are subject to more stringent government regulation than mutual benefit non-profit corporations. Public benefit corporations require articles and bylaws and must have a board of directors and their articles must be filed with the California Secretary of State.

- Unincorporated Associations: California recognizes unincorporated associations, defined as a group of two or more persons joined by mutual consent for a common lawful purpose, as separate legal entities, and affords an association the power to enter into contracts, and sue or be sued under the name it has assumed. Unincorporated associations may also qualify for federal tax exempt status, but must have appropriate levels of governance and financial controls. Unincorporated associations require governing documents similar in substance to articles and bylaws (but without strict requirements as to form), namely to define membership and govern voting rights of the members, membership termination or suspension, amendments, dissolution, etc.

- See Response #4, below, for further discussion of using a Contract Co. organized as a California non-profit corporation to reflect the global multi-stakeholder community, or similar interests, as the transition vehicle for the NTIA's interests in the IANA Functions Contract.

- See Response #5, below, for further discussion of the liability of non-profit corporations and unincorporated associations and their members, directors, officers and agents.

3. ***Jurisdictional Issues:*** *While this is not an initial focus of our request for legal advice, if a "Contract Co." is to be established, we will need to explore whether California, another US jurisdiction (e.g., Delaware or New York), or another country would be the most appropriate domicile for Contract Co. As such, we will need to understand the "pro's and con's" of several jurisdictions. Also, as noted in Section 1 above, we may need to determine whether other jurisdictions will allow greater multi-stakeholder control of the Board, if California does not offer sufficient avenues for such control.*

Sidley Response: This issue is best addressed once the CWG provides more direction as to which particular structures should be examined.

4. ***Structure of Contract Co.:***

   (a) *How can Contract Co. be created and continue to exist as a "bare bones" entity with little or no staff, and with a Board that has no mandate to do anything but implement the decisions of the MRT?*

   (b) *If the above is not possible as stated, how can Contract Co. be structured to come as close as possible to this model?*

   (c) *Could Contract Co. be an unincorporated association? What would the benefits of this be?*

   (d) *If Contract Co's Articles and Bylaws are drafted to give it a very narrow remit, and to ensure that its Board cannot change that remit, how can Contract Co. change to adapt to unforeseen circumstances?*

   (e) *What steps should be taken to protect Contract Co. from capture or acquisition at any time?*

   (f) *How (and to what extent) can Contract Co. be protected from bankruptcy?*

   (g) *How (and to what extent) can Contract Co.'s financial liability be limited?*

   (h) *How can Contract Co. retain its right to act as the IANA Functions Operator if it enters bankruptcy?*

Sidley Response:

- Contract Co. could be created as a California public benefit corporation with or without members and with a board of directors and certain specified officers, but it need not have

any employees. Contract Co. could be organized to be "bare bones" with operations limited to being the contracting party for the IANA Functions Contract. Any specific operational activities required to be performed by Contract Co. not undertaken by the board and or the officers could be delegated to be performed by third party consultants on an as needed basis.

- Board Mandate and MRT Oversight: As discussed in greater detail in Response #1, with respect to the board's mandate, under California law, the board of directors of the corporation is generally responsible for direction of the affairs of the corporation, subject to restrictions imposed by the corporation's articles of incorporation and bylaws. Having the board take direction from the Multi-stakeholder Review Team ("MRT") as to all corporate decisions is inconsistent with this requirement. However, the members of the MRT could constitute the board of Contract Co., thereby positioning the MRT members to act collectively as the ultimate authority and decision maker. Alternatively, the MRT could be the sole member of Contract Co. with authority to select and remove directors and otherwise exercise the rights of the member articulated in the articles and bylaws, including approval rights over board action that those documents reserve to the member. See Response #5, below, for further discussion of the inter-connected relationship that could be created between the MRT and the board of a non-profit corporation (i.e., Contract Co. or ICANN). Also refer to Response #1 for a discussion of article and bylaw provisions that could be used to provide MRT with approval rights.

- Changes to Articles and Bylaws: If Contract Co. were structured as a public benefit corporation, the articles and bylaws could be drafted to provide for a narrow mandate.

    - Under California law, the power to amend the articles and bylaws resides with the board and the members (if any) of the corporation (although an entity can elect to have the power to amend the bylaws reside solely with the members of the corporation).

    - Under California law, the articles of the non-profit corporation may also grant the right to a third party to approve amendments to the articles or bylaws. This could be used as a so-called "golden bylaw" to ensure that a key provision of Contract Co.'s articles or bylaws could not be altered without a third party's approval.

    - To ensure oversight, Contract Co. could provide that certain amendments to the articles and bylaws would require third party approval, such as by the MRT. Alternatively, if the MRT were the member and board of Contract Co., then the MRT could determine all changes to the articles and bylaws.

- Unincorporated Association: As discussed in Response #2 above and Response #5 below, in California an unincorporated association is able to enter into contracts and is recognized by courts. The benefits of an unincorporated association are that there are fewer statutory requirements and they can be more informally operated. However, there are a number of disadvantages to structuring Contract Co. as an unincorporated association, including the following:

- Limitations on the personal liability of directors, officers, members and agents of an unincorporated association is unclear, especially in the area of torts. This uncertainty may expose these individuals to the risk of personal liability, which may make it difficult to recruit individuals to serve in these roles.

- The standard of care for a member of a governing body of an unincorporated association is unclear. Individuals serving in such capacity may not be comfortable without clear guidance on what their fiduciary duties are. In contrast, the duties of directors of a non-profit corporation are well understood.

- As noted in Response #2 above, a number of non-U.S. jurisdictions do not recognize the existence of an unincorporated association. As a result, these jurisdictions may look through the association and hold individual members of such association liable.

- Protection from Capture and Acquisition: Contract Co. could be protected from capture and acquisition in a number of ways:

  - If organized with members, membership requirements could be designed to ensure a balance of multi-stakeholder representation.

  - Similarly, the board composition could be designed to ensure appropriate balance in representation of stakeholder interests and geographic and other types of diversity.

  - In addition the board could be classified (or staggered), with directors divided into multiple classes (e.g., three) with one class elected (or selected) each year.

  - Other anti-takeover analogs could also be considered, such as a golden bylaw that would require approval of a designated body of stakeholders for any decision that would significantly change the governance structure and control of the organization.

- Protection from Bankruptcy:

  - Under U.S. federal law, non-profit corporations, unincorporated associations and business trusts are eligible to commence a voluntary Chapter 7 or 11 bankruptcy case. However, an involuntary bankruptcy proceeding may not be commenced against a corporation or unincorporated association "that is not a moneyed, business, or commercial corporation." As a result, assuming Contract Co. is properly structured to fall within this exclusion, Contract Co.'s creditors may not be able to commence an involuntary federal bankruptcy case against it.

  - In addition to federal bankruptcy proceedings, bankruptcy-like proceedings may also occur under federal receivership law and state law. California has legislation that expressly permits the involuntary dissolution of a corporation and the

appointment of a receiver. As a result, while Contract Co. may be immune from an involuntary proceeding under federal bankruptcy law, as a California corporation, it could still be subject to an involuntary proceeding under state law.

- Once a bankruptcy proceeding is commenced under federal law, there are numerous restrictions and requirements pertaining to the assets of the debtor and its contracts. In general, assets of the debtor at the time of a bankruptcy filing are included within the bankruptcy "estate" such that they may be available to satisfy the claims of creditors. Certain property may be excluded from the "estate," however, if held in trust by the debtor for the benefit of third parties or subject to certain restrictions precluding its alienation. In addition, the federal bankruptcy law recognizes state law restrictions on asset transfers for certain types of non-profit corporations. Generally the debtor 's contracts and leases may either be assumed, assumed and assigned or rejected by the debtor in bankruptcy, subject to certain limitations.

- Absent specific statutory language prohibiting a particular type of entity from commencing a bankruptcy proceeding, it is generally extremely difficult to create a bankruptcy "proof" legal entity; however, there are various structuring considerations that can improve the bankruptcy "remoteness" of a particular entity. For example, the hallmarks of bankruptcy "remote" entities often include: (i) limitations on the ability of the entity to incur liabilities other than specific types of liabilities; (ii) limiting the purpose of the entity and the activities that the entity may engage in; (iii) prohibiting the entity from consolidating or combining with another entity, selling its assets, liquidating or winding up; and (iv) restrictions on the commencement of a bankruptcy proceeding. These types of restrictions should be included in the organizational documents.

- Protecting Contract Co. from Financial Liability: Contract Co.'s financial liability, as an entity, cannot be limited as a matter of law. However, operationally, its liability can be limited by limiting the scope of its operations and activities. Individual directors, members and agents of Contract Co. can be protected from liability through exculpatory provisions of the articles and bylaws, as well as through indemnification agreements between Contract Co. and the individual. See Response #11 below, for additional information.

5. ***Structure of MRT****: The MRT is not expected to be an incorporated entity, but rather a "committee" (or something similar) with no specific parent or legal status, if possible.*

   (a) *How can the MRT's multi-stakeholder character be ensured (e.g., by Charter, Contract Co. bylaws, etc.)?*

   (b) *Could members of the MRT be held individually liable in the event of litigation (e.g., a losing bid in an RFP), and how can that liability be minimized?*

   (c) *Would the MRT need to have a particular legal structure in order to be the source*

of Contract Co.'s instructions?

(d) *What types of structures could the MRT adopt? Could these be applied to the CSC?*

Sidley Response:

- If the MRT is not organized as an incorporated California non-profit corporation it could organize as an unincorporated association, a recognized legal entity in California. As discussed above in Response #2, there are fewer statutory requirements and formalities for an unincorporated association, so it is incumbent on the members of an unincorporated association to draft appropriate governance provisions and similar rules in their organizing documents.

- The rights, obligations and authority of the members, directors, officers and agents of an unincorporated association are governed largely by the principles of contract law, and by statute. If organized as a California non-profit unincorporated association, the MRT would have the power to hold the IANA Functions Contract and enter into an agreement with ICANN (or a successor entity) for administration of the IANA functions. Alternatively, the MRT could serve as the sole member of Contract Co., or its members could serve as the directors of Contract Co. (so that the membership of the MRT and the Contract Co. board are identical).

- The MRT, if organized as an unincorporated association, in theory is able to limit the liability (including contractual liability) of the MRT members, and their directors and agents. Indemnification agreements and insurance arrangements can be put in place to give effect to this principle. Of course, there may be situations in which a member or director of the unincorporated association could be personally liable, e.g., if they expressly assume such liability, receive personal benefit under the contract at issue, or engage in fraud.

- California case law, however, is not as well settled on damage limitations for unincorporated associations (versus corporations), especially when it comes to tort liability (i.e., extra-contractual harms), so there is potentially greater exposure for the members, directors or officers of unincorporated associations, versus incorporated non-profits. Note also that we can imagine at least one scenario where the appearance of individual benefit might be found, specifically if the members of the MRT also benefited from downstream decisions regarding pricing and fees payable from domain name registrations or other IANA functions (either as payor or recipient of fees). Of course, this is fact specific and would require more analysis of the actual organization of the governing bodies and their respective mandates, but this is an observation for consideration.

- As further noted in Response #4 above, the standard of care for a director of an unincorporated association is unclear. Directors may not be comfortable without clear guidance on what their fiduciary duties are, though presumably the standard could be articulated in the governing documents for the association.

- Additionally, although the California Attorney General could exercise supervision over an unincorporated association, the California courts are reluctant to intervene in private disputes among the members of an unincorporated association regarding their rights and obligations, or regarding governance. Without recourse to the courts, it may be more difficult to impose checks and balances on the decision-making of an MRT that is an unincorporated association. For this reason, and for the potential liability exposure, we would caution that any responsibilities that are delegated to an unincorporated association be narrowly and specifically prescribed.

- As an alternative to a separate legal entity, the members of the MRT could be the same as the members of the board of, or a special committee to, a non-profit corporation overseeing the IANA Functions Contract. This could occur in three ways: (i) at the level of a newly created Contract Co. that functions to let the contract; (ii) as a committee within ICANN; or (iii) at the level of an ICANN subsidiary to perform the IANA functions. In any event, the organization and authority of MRT would need to be articulated in the articles or bylaws of the entity housing it, and a charter or similar statement of principles would need to define the organization and operation of the MRT. This would need to include any instructions regarding the consideration to be given to the actions and recommendations of the MRT and the escalation and recourse procedures should MRT recommendations not be followed.

- LLC Structure: An LLC structure could be adopted to establish MRT's role in supervising the IANA functions. In the LLC structure: (i) ICANN could create a wholly owned subsidiary limited liability company ("LLC-Sub") and move the IANA functions staff and related resources into the LLC-Sub; (ii) NTIA could transfer the IANA Functions Contract to ICANN, which would then contract with its LLC-Sub to administer the contract and be the IANA functions operator; and (iii) ICANN could delegate to the MRT oversight of the LLC-Sub. The MRT could have the ability to review and recommend changes, as appropriate, regarding the performance of the LLC-Sub and its status as a counterparty to the IANA Functions Contract. The Bylaws of ICANN could be amended to determine how much binding authority would be delegated to the MRT.

- Further exploration of how best to provide liability protection to the MRT members is deferred until a more focused set of proposals is developed. In most scenarios, it is likely that a means could be developed to shield MRT members from personal liability including through indemnification and insurance.

- The discussion above generally applies as to considerations regarding the organization of the Customer Service Center ("CSC").

6. ***Relationship of MRT to Contract Co.:***

   (a) *How can Contract Co. be obligated to take the direction of the MRT? Through By-Laws, by contract or otherwise?*

(b) *Should the MRT be a part of Contract Co. (e.g., a committee, or its members, or even its Board)?*

Sidley Response:

- There are several ways in which Contract Co. can be subject to the direction of the MRT:
    - The members of the MRT could also be the directors of Contract Co.
    - Contract Co.'s board could designate MRT as a body with certain delegated authority. Our Response #5, above, discusses this scenario in more detail.
    - Contract Co could be organized as a non-profit corporation with members, and the members could be the same as the various stakeholders comprising the MRT. Or, if organized as an entity, the MRT could be the sole member of Contract Co. The members (or sole member) would elect the board, and certain decisions of Contract Co would be subject to member approval (e.g., the decision to assign, transfer or terminate the IANA Functions Contract). The process and governing principles would be prescribed in the articles of incorporation and bylaws of Contract Co.
- In each of these situations MRT sits within the organization of Contract Co, rather than as an external body, or comprises the members (or sole member) of Contract Co.
- Finally, as we discussed above in Response #5, MRT itself could be a standalone entity, perhaps as an unincorporated association, with a narrow remit to be the member of Contract Co. to hold the IANA Functions Contract directly, let it to third parties to administer, and provide oversight and related activities directly or through an internal delegation of authority.

7. ***Potential Trust Structures***.

(a) *Could ICANN, or another entity, hold the right to act as the IANA Functions Operator (or the IANA functions and methods themselves) "in trust"?*

(b) *Must a trust involve an "asset" or "property"? If so, does the "right to act as IANA Functions Operator" (or the IANA functions and methods) constitute an asset? What other relevant definitions of "assets" can be held in trust?*

(c) *Under what circumstances would a trust be considered an entity? A legal entity?*

(d) *Could Contract Co. be replaced by a trust in the "external to ICANN" proposal described above?*

(e) *Can a trust be registered with a U.S. court? Will this ensure that the terms of the Trust Agreement (or Declaration of Trust) will at all times in the future be met?*

(f) *Can a trust enter into a contract?*

(g) *Can a trust domiciled (or registered) in a different national jurisdiction establish*

a contract with a US corporation?

(h) *Can a Trust have a Board of Trustees?*

(i) *If a Trust has a Board of Trustees, does the Board of Trustees need to be incorporated?*

(j) *Is the concept of a trust "Guardian" recognized under California law (or the law of other U.S. jurisdictions), perhaps under another name (e.g., "trust protector")?*

(k) *What kind of group or organization can serve as a "Guardian"?*

(l) *Could the Trust (or the Trustee) receive an assignment from the NTIA of the IANA Contract or of all the US government's rights and duties under the "IANA contract"?*

(m) *Could a trust be set up to hold the right to the IANA Functions Operator role, and have the ability to select an IANA Functions Operator (presently ICANN), for a term of years (subject to termination for cause), subject to other terms, conditions, and covenants necessary or convenient to carry out the purpose of the Trust?*

Sidley Response:

- A trust is a fiduciary relationship with respect to property in which one person (the trustee) holds legal title to the property, subject to an equitable title held by another (the beneficiary). This equitable title is often referred to as the beneficial interest in the trust. The person or entity who causes the trust to come into existence is referred to, among other terms, as the settlor. Generally, a trust is established by a written instrument that defines the interests of the beneficiaries and the powers and duties of the trustee.

- A trust cannot be created without trust property. Under California law, any property that can be voluntarily transferred by the owner can be held in trust. This includes intangible personal property, such as a right to do something.

    - Accordingly, it should be the case that the right to act as the IANA Functions Operator is an interest that can be held in trust. One caveat is that the NTIA's right to designate the IANA Functions Operator exists, in part, because the global internet community elects to recognize that right, but some might argue that the right is not inherently exclusive to the NTIA, which could call into question whether it is an interest that can be held in trust. At this stage it appears that the NTIA's authority to designate the IANA Functions Operator is a cognizable right that could be held in trust. California law (and the laws of most other states) provides that a non-profit public benefit corporation can act as a trustee, so ICANN could hold the right in question as trustee, as could some other entity. If ICANN were to act as initial trustee, thought would have to be given to its role in determining selection of the IANA Functions Operator. If ICANN, as trustee,

were to have the authority to select itself as the IANA Functions Operator in future contracts, issues of self-dealing would arise, but that concern could be addressed. Because trust property must be some transferable interest, it is unlikely that the IANA functions and methods themselves, which do not appear to be independent property interests, would constitute trust property.

- As discussed above, a trust must have one or more beneficiaries. Where the purpose of the trust is to confer a benefit upon the public at large, the trust is characterized as a charitable trust. All other trusts are considered private. In general, private trusts require definite and ascertainable beneficiaries, while charitable trusts can have indefinite beneficiaries. The identity of the beneficiaries of a trust, even if those beneficiaries are charitable in nature, is significant in part because the trustee owes its fiduciary duties, including a duty of loyalty, to the beneficiaries. The identity of the beneficiaries also implicates questions relating to the enforcement of the trust.

    - The class of charitable trusts includes so-called "governmental trusts," which provide benefits to all the inhabitants of a community by making life safer, more comfortable, or happier. The question of who would be the beneficiaries if a trust structure were to be adopted is a significant one. If the trust is a private trust, the beneficiaries of the trust have the power to enforce its terms. If the trust is a charitable trust, in the United States the relevant state attorney general will have enforcement power.

    - If the trust were deemed to be a charitable trust, a related question would be who would enforce the terms of the trust. As discussed above, in the United States, the relevant state attorney(s) general would typically have the authority to enforce the terms of a charitable trust. If the potential trust structure involves global beneficiaries, thought would have to be given to what enforcement mechanism would exist outside the United States. It may not be possible in the case of a charitable trust to establish or control the enforcement mechanism by the terms of the trust alone.

- A trust is not traditionally viewed as a legal entity, but rather a relationship. However, it is understood that the intent behind the question is to ascertain whether in a trust structure there would be someone who could, on behalf of the trust, do the sorts of things that an individual or corporation can do, such as enter into a contract, and further, whether that someone could sue or be sued. The answer to those questions is yes. It is well established under California common and statutory law that a trustee has the power to prosecute or defend actions, claims, or proceedings for the protection of trust property. A trustee can be held fully and personally liable only if he is personally at fault – to the extent there is personal fault, the trustee would generally have no right to be indemnified from the entrusted property, and to the extent there is no personal fault, the risk of liability generally falls on the trust estate. Many trust instruments contain exculpatory language that relieves a trustee acting in good faith of liability except for willful default or gross negligence. This sort of clause often mirrors the

common law regarding the liability of trustees. The settlor can expand or contract such liability by the terms of the trust instrument.

- Assuming that the potential trust structure is a workable structure, as appears to be the case conceptually, then the alternative under which Contact Co. is replaced in the external solution by a trust appears feasible.

- Depending on the state, a trust may or may not need to register with the state court. Where mandated by statute, such a registration typically fixes the venue to the county of registration and creates public access to basic trust information. The existence of statutory registration requirements does not make it more or less likely that the terms of the trust instrument will be met in the future. California does not have trust registration requirements, but there is still a statutory process for protecting the interests held in trust.

- As discussed above, a trustee of a trust can enter into a contract that is binding upon the trust. The trust instrument, a state statute or a court order may empower the trustee to enter into a contract with a third person (including a beneficiary).

- It is likely that the laws of some non-U.S. countries would permit a trustee of a trust governed by such country's laws to enter into a contract with a U.S. corporation. A soft line can be drawn between common law countries (e.g., the United Kingdom, Canada and Australia) and civil law countries (e.g., most countries in Europe and in Latin America). Whereas in common law countries statues often govern the creation and administration of trusts, and courts play an important role in trust administration, relatively few civil law jurisdictions recognize a trust for local law purposes, either by statute or court decision, and the courts in civil law countries have shown some difficulty or reluctance in applying or enforcing a trust created in another country.

- A trust can have a Board of Trustees. The law affords a great deal of latitude in terms of how a trust can be structured. Therefore, a trust can have multiple trustees and from those trustees the trust instrument could establish a Board of Trustees that could be granted powers and duties unique to the trustees on the Board. A designated Board of Trustees would not have to be incorporated.

- The concept of "trust protector" is recognized under the laws of some U.S. jurisdictions. A "trust protector" is a person appointed under the trust instrument and endowed by the settlor with limited authority to engage in specified actions, separate and apart from the overall management of a trust by the trustee, such as the power to remove and replace the trustee. California has no directed trust statute or statute recognizing trust protectors. Although drafting attorneys in those states frequently draft trust instruments that include a trust protector, the effectiveness of such designations is unpredictable. In states that employ the concepts of a trust protector, in general any one or more persons and entities may serve. It would be possible, for example, to vest a trustee removal power in a committee identified as the trust protector. That committee could be composed of the members of what would otherwise be a Multi-stakeholder Review Team.

- Whether a trustee could receive an assignment from the NTIA of the existing IANA Contract or the government's rights and duties thereunder appears to be a question different from the earlier question of whether the right to the IANA Functions Operator could be held in trust, but the answer appears to be the same. Assuming that the IANA Functions Contract does not include provisions restricting its transfer (or restricting the transfer of rights and duties granted under the contract), the NTIA should be able to transfer such rights and duties to a trustee under a trust.

- Based upon, and subject to, the foregoing analysis, a trust could be set up to hold the right to act as the IANA Functions Operator, and the trust instrument could provide that the trustee has the power to select an IANA Functions Operator and enter into a contract on the terms described.

8. ***Potential Community Organization Structure***. *Could Contract Co. be replaced in the "external" proposal by an "Internet Community Association" ("ICA")?*

   (a) *Could the ICA be a lightweight, unincorporated organization, with a specific very limited purpose to award an MoU to an entity to act as the IANA Functions Operator?*

   (b) *Can an unincorporated organization enter into an MoU?*

   (c) *What is the difference between an MoU and a contract?*

   (d) *Could the members of the ICA be limited to registry operators?*

   (e) *Would it be appropriate for registry operators, acting alone to determine which entity, if chosen as IANA Functions Operator, can best serve the technical requirements of the Registry operators (ccTLDs and gTLDs) and the multi-stakeholder community? How can the multi-stakeholder community have input into this decision?*

   (f) *Would this "ICA" be less of a legal target than an incorporated Contract Co.?*

Sidley Response:

- The multi-stakeholder community could organize as an unincorporated association, as discussed above in Response #2.

- For example, an Internet Community Association ("ICA") could be organized and it could replace Contract Co., albeit with certain limitations and vulnerabilities, as discussed in Response #4 and Response #5.

- As a very general matter, a "memorandum of understanding" ("MoU") can be used to refer to an effort to memorialize the intent of two parties to come to an agreement, often setting forth key terms or principles of a potential agreement between the parties, the details of which are

subject to further negotiation. As such an MoU may include some contractual elements such as a binding confidentiality obligation and an agreement to engage in due diligence and negotiate in good faith. In contrast, a contract is a binding agreement between two separate legal entities, backed by consideration, such as payment, that reflects an offer, acceptance, and an intention to be bound. Parties may also use an MoU if there is no intention to reach a future agreement or be bound in an enforceable manner, because of the absence of consideration, because the parties to the MoU are not separate legal entities, or because formal legal approval could not be obtained for a formal agreement, such as a treaty. In contrast, a contract is a binding enforceable agreement between two separate legal entities, backed by consideration, such as payment, that reflects an offer, acceptance, and an intention to be bound. An MoU could also be a binding contract if it is a signed written agreement backed by consideration and reflecting an intention to be bound. For example, two subcommittees of the same legal entity could not contract with each other, but they could sign an MoU.

- Non-profit corporations and unincorporated associations have the power to enter into MoUs and contracts under California law.

- The membership of an ICA could be limited to registry operators or any other group that is desired as a legal matter, although significant limitations on its membership may undermine its practical ability to represent stakeholders in a legitimate fashion. If the membership of the ICA were limited to registry operators, it could determine the best technical performer of the IANA functions, although it would need to obtain and hold the right to do so.

- If the ICA were organized as an unincorporated association, it would not be less of a litigation target, as such entities can sue or be sued under California law. See further Response #4 and Response #5 for a discussion of an individual person's liability.

9. ***Antitrust Risk****: If the CSC is primarily made up of registries, does the CSC risk being considered a "cartel" that violates antitrust/competition law by acting or even by meeting? If the MRT is "captured" by registry interests, does the MRT risk violating antitrust/competition law by acting or even by meeting?*

Sidley Response:

- An illegal antitrust cartel is a combination of separate economic competitors who join together to fix prices, restrict output, rig bids or allocate markets, customers or territories. Under the laws of many jurisdictions, including the U.S. and California, cartels are considered *per se* illegal restraints of trade. For a *per se* illegal cartel to exist, however, the combining actors must be competitors or potential competitors, and the combination must seek to achieve one of the illegal, anticompetitive objectives mentioned above. Here, the registries may well be competitors but the purposes of the CSC and MRT are legitimate and pro-competitive. Courts have held that combinations of competitors, for example trade

associations and joint ventures, are not illegal so long as they pursue lawful and pro-competitive objectives.

- To protect against antitrust/competition liability, if formed, the CSC and MRT should adopt formal antitrust/competition guidelines and their meetings be attended by counsel familiar with antitrust/competition law.

10. ***Accountability without the "Nuclear Option":*** *How can ICANN be held accountable for its performance as IANA Functions Operator if there is no possibility of removing ICANN from the role of IANA Functions Operator, with the same strength as a system where the "nuclear option" is available? Are there models where ICANN would be subject to punitive and corrective directives, "terms of commitments, whereby ICANN would be subjected to corrective and punitive directives but never removed from the assigned role of IANA functions operator?*

Sidley Response:

- Under any internal solution, the accountability mechanisms within ICANN are of considerable importance, including both internal governance systems and mechanisms for third party recourse.

- This is an issue that requires further study and consideration, including: (i) consideration of whether the current means of selecting the ICANN board provides appropriate accountability to and representation of the multi-stakeholder community; (ii) whether additional means are needed to provide for removal of directors and (ii) whether the current means for third party recourse should be strengthened. It also requires further study and consideration of mechanisms to pressure the relevant ICANN personnel and potentially the board if concerns arise around the quality of performance under the IANA Functions Contract.

- If ICANN is not performing in its capacity as the IANA Functions Operator, there needs to be a meaningful mechanism for interested parties to bring this to the attention of appropriate decision makers within ICANN and, ultimately, the ICANN board. Consideration needs to be given to applying the article and bylaw mechanisms of delegation and designation and approval rights so as to hold the ICANN board accountable in redressing concerns.

- The ultimate "nuclear option", if the board fails to take action, is for the stakeholders, via the director selection process, to select other directors who are more in tune with stakeholders' views. Additional consideration needs to be given to whether, as described above, there are ways of strengthening these processes, for example by providing additional removal rights to the current selecting bodies or by expanding removal rights more broadly to a defined multi-stakeholder community.

11. ***Protection or Immunity from Litigation****: Can Contract Co. (or other entities, such as the MRT, CSC, Trust or ICA) be insulated from some or all litigation? If so, what is the effect on accountability of these entities?*

Sidley Response:

- "Immunity from litigation" is not generally available to charitable or non-profit entities simply because of their charitable or public benefit function.

- As a general matter, Contract Co, the MRT, CSC, etc. cannot, as recognized legal entities limit their financial liability under law. However, such entities can undertake to shield their members, directors, officers, agents and employees from liability through indemnification agreements and through the procurement of insurance. There are exceptions, of course, for fraud and criminal acts, for which individuals still may be held personally liable.

- The legal protections against liability are well recognized and more settled when using a California Corporation. However, as we have noted in Response #5 above, it is not as well settled whether individual members, directors or officers of unincorporated associations could be held liable for the acts of the association, especially with regard to tort liability. Moreover, numerous international courts and governments do not recognize the existence of non-statutory entities, and thus would look through the entity to the individual members of the unincorporated association for liability purposes. Therefore it is advisable to have in place a corporation as a true "blocker" against liability for non-corporate entity that is going to engage in substantive operations.

12. ***Contract****: Can one party indemnify the other relating to the costs of litigation between the parties? Will this be enforceable if the litigation relates to the validity of the contract and the contract is found to be invalid?*

Sidley Response:

- An indemnification provision is generally a question of contract law, and so long as the behavior that is being indemnified is not against public policy (e.g., a party cannot be indemnified against its own fraud or criminal behavior) the parties generally are free to contract the terms. However, if an insurance policy is going to be required to fulfill the indemnification obligations, then the insurer must also agree to provide coverage against such claims. Indemnity between the parties to a contract, to protect one party against claims brought by a third party (e.g., a violation of due process in rejecting an RFP bid) is common and generally indemnifiable, and could be written to cover a claims of invalidity of a contract (so long as the parties acted in good faith in forming the contract and believed it to be of a lawful purpose). Again, the limitations for indemnity are more focused on the public policy

concerns that may or may not be implicated by providing indemnity for particular acts or omissions.

Annex A
Scoping Document

[Attached]