

**MEMORANDUM**

TO: Cross-Community Working Group on Enhancing ICANN Accountability

FROM: Sidley Austin LLP and Adler & Colvin

RE: Constraining the Sole Member's Exercise of Statutory Member Rights

DATE: October 2, 2015

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You have asked that we provide more detail about the mechanisms that can be used to limit the exercise of a membership body's powers under California law.

Under California law, members in a California public benefit corporation have certain "statutory rights" – rights that are provided by the California Nonprofit Corporation Law (California Corporations Code, Title 1, Division 2). We have previously provided to you guidance on those statutory rights. See [Responses to Questions from Samantha Eisner from June 8, 2015](#) ("Statutory Rights Memo"). We have also addressed statutory member rights in various discussions of the Community Mechanism as Sole Member (CMSM) model.

The Board, in its response to the CCWG-Accountability 2nd Draft Proposal on Work Stream 1 Recommendations dated August 3, 2015 ("Second Proposal"), and at least two other comments received to the Second Proposal, have expressed misgivings about the Sole Member Model because of what they view as risks to ICANN associated with the ability of the Sole Member to exercise certain statutory powers, and in particular the power to unilaterally amend the Bylaws. The Board has also expressed concerns about the power to approve dissolution of the corporation. We have advised that while these statutory rights cannot be taken away from the Sole Member under the applicable law, it is possible to severely limit the Sole Member's ability to exercise these statutory rights since the Sole Member only acts as instructed by the participants in the community mechanism.

In this memorandum, we elaborate further on how the Sole Member's exercise of unwanted statutory member rights can be constrained. We conclude that with fairly simple and straightforward bylaw provisions, it is possible to constrain the community's internal decision-making so that it is limited in its ability to direct the Sole Member to act on unwanted statutory powers. This can be done by providing very high decision thresholds – even unanimity requirements – for community decisions directing the Sole Member to act. In addition, the CCWG could consider a shared approach under which the Bylaws that define how community decisions are made to direct the Sole Member could require both community *and* ICANN Board

involvement with respect to unwanted statutory powers, such as by providing that community consideration of such powers can only be triggered by a formal resolution of the ICANN Board. In this manner, any risks associated with the potential exercise of unwanted statutory powers by the Sole Member can be eliminated.

Note that this type of shared decision-making on a matter as important as dissolution is arguably more in line with the multi-stakeholder values of ICANN than is the current decision-making structure which leaves a decision on dissolution to a simple majority vote of the ICANN Board at a properly called and noticed Board meeting at which a quorum is present. Given that the currently applicable quorum requirement is a simple majority – or 9 out of 16 directors – in the event that a meeting was properly called and noticed and only 9 directors participated, a vote of just 5 directors in favor of dissolution would be sufficient to approve dissolution (see Article VI, Section 17, of the ICANN Bylaws). (It is unclear whether this situation was specifically intended. We do not know whether those who drafted and amended the Bylaws to date have considered the matter of decisions regarding dissolution. We only note that the current Bylaws do not provide any grounds for arguing that a different quorum requirement and/or decision threshold applies.)<sup>1</sup>

### **Summary of The Community Mechanism as Sole Member (CMSM) Model**

In the CMSM model, the Sole Member would be created as an entity with legal personhood (as an unincorporated association) for the express purpose of holding and exercising member rights in ICANN through new provisions in the ICANN Bylaws. These Bylaw provisions would be designated as “fundamental” so that any change to them would require approval of the community through the CMSM. The Sole Member would only be able to act as directed by community consensus as defined in the Bylaws. While the specific details are for CCWG to further determine, it is contemplated generally that details of the Sole Member’s internal governance would be set forth in ICANN Bylaws, including:

- A statement establishing the Sole Member as an unincorporated association, specifying the key participants (the various bodies and individuals with a role in its governance), and identifying it as the only member of ICANN.
- A description of each of the enumerated community empowerment/accountability rights. For each right, this would include a description of the mechanism for how the Sole Member would be directed to exercise that right, including:
  - how community consideration of a matter is triggered,
  - any notices and time limits applicable to steps in the process,

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<sup>1</sup> While Article VI, Section 17, of the Bylaws indicates that a higher quorum or voting requirement may be required by law, the relevant dissolution provisions in the California Corporations Code do not impose a higher voting requirement. Cal. Corp Code Section 6610(b) provides that in a corporation without members, a corporation may elect by approval of the board to wind up and dissolve; no higher voting requirement is provided. After board approval and filing of an officers’ certificate to evidence the board’s decision, the winding up and liquidation process commences. On completion of winding up corporate affairs and liquidating corporate assets, a last formality is required by Cal. Corp Code Section 6615, the filing of a Certificate of Dissolution. This document must be signed by the majority of the directors then in office, which at that late stage can often consist of a very small number of directors.

- who can participate,
- what consultation is required,
- the minimum level of community participation needed for valid action (quorum),
- the threshold level of community agreement needed to direct the Sole Member to exercise a power (whether through a voting mechanism along the lines contemplated in the Second Proposal or some other measure of consensus),
- veto rights (if any), and
- how the Sole Member's decision is documented and communicated, including by whom and to whom, and any verification process desired. (The goal would be to make this process simple, built on current decision-making mechanisms and structures, and as self-effectuating as possible, for example using the same process that ACs and SOs used to express their decision in Buenos Aires on whether the CWG proposal was to be forwarded to the next level. This could involve having each AC or SO indicate in an official and transparent communiqué in writing to the Board its decision. If the collective decision threshold across the applicable quorum of participants is met, the Sole Member would be deemed to have decided.)

Where an SO or AC has the right to designate or remove a director, the action of that SO or AC will be defined as sufficient to cause the Sole Member to act with respect to that matter. However, most matters will require far broader community participation, along the lines described in the Second Proposal. The point is that different Sole Member rights may have different procedures, different quorum requirements, and different agreement thresholds – and even different participants.

Any statutory right provided to members under California law that is inconsistent with the intended and specifically enumerated community powers could be addressed in a similar manner. Those statutory rights that are unwanted could be subject to very high quorum and decision thresholds – and could even require unanimity. In addition, the Bylaws could provide that the community decision process on unwanted statutory powers can only occur if triggered by a decision by the ICANN Board. This would eliminate the possibility of unilateral Sole Member action regarding statutory powers.

### **Discussion and Analysis**

The Sole Member's rights in relationship to ICANN will be subject to California corporate law as described in the Statutory Rights Memo, and as set forth in that memo, certain rights provided by the statute cannot be taken away from a Member because they are mandated by the Corporations Code. For example, under the Corporations Code members have the right to dissolve a corporation by a simple majority vote and that vote threshold cannot be altered. With regards to the Sole Member, since it has only one vote, however it exercises that vote will satisfy the simple majority requirement. Under the CMSM model, the key protection constraining the Sole Member's exercise of its rights is that the Sole Member can only act as the community directs, and *there are no limits under California law in providing how the community decisions directing the Sole Member are made.*

In other words, the community can choose to impose on itself very high thresholds, up to and including unanimity, for directing the Sole Member how to exercise the Sole Member's decisions, and can further provide that those rules cannot be amended without an equally high level of consensus, or even external approval, such as by the ICANN Board; the community can apply very high decision thresholds and even provide the Board with trigger rights or veto/approval rights with respect to any and all unwanted statutory rights.

Specifically, although ICANN's Bylaws cannot provide that the Sole Member does not have the right to amend ICANN's Bylaws or approve dissolving the corporation, or take other actions that are within the mandated rights of a member, the Sole Member's internal governance set out in ICANN's Bylaws is not subject to such a limit. The internal decision-making of the Sole Member can legally be constrained such that the Sole Member could rarely, if ever, exercise those rights.

It is helpful to remember that the Sole Member is *not* a forum of members. It would be the one and only member of ICANN. There are three distinct layers of decision-making in the CMSM Model Sole Member:

- Level 1: Each SO and AC that participates must determine its own internal consensus (whether under existing procedures in each SO/AC, which could remain unchanged, or using the community voting mechanism described in the Second Proposal).
- Level 2: A consensus among all participating SOs and ACs (based on the Level 1 decisions of each participant) is then required to meet whatever decision threshold for a particular matter has been set in the Bylaws; it is at this level, Level 2, where it is entirely lawful to impose severe limits on the ability to direct the Sole Member with respect to any statutory rights that are of concern.
- Level 3: Then and only then does the Sole Member exert its right as a corporate member, as directed by the Level 2 decision. And it is only at this level, Level 3, that corporate member rights cannot be limited, for example by providing for a supermajority vote among members. Of course, the Sole Member only has one vote (and hence all Sole Member votes are "unanimous" because it is the only entity with member voting rights in ICANN).

In summary, it is our conclusion that as a legal matter under California law, decision thresholds for Level 2 decisions can be set at a very high threshold – even requiring unanimity among participating SOs and ACs – for directing the Sole Member how to vote on statutory powers. It is also possible to require that for specified decisions such as dissolution or amending the Bylaws, additional participants could be required to be included. Just as an example, the Bylaws could provide that all SOs and ACs must approve specific decisions in order for the community to direct the Sole Member with respect to the unwanted statutory right. This could even include involving the Board of Directors (for example with a trigger right, or an approval or veto right) with respect to dissolution and other statutory rights of concern. The goal of such an approach would be *to assure shared as opposed to unilateral governance* of specifically-identified critical decisions.

As the CCWG evaluates the public comments in response to the Second Proposal, it may determine that certain statutory member rights are the subject of particular concerns in the

community. By setting triggers, quorum requirements and consensus levels, we believe that the CMSM model can be designed to fully address these concerns and eliminate any risk that the Sole Member could act without Board and community approval with respect to statutory powers.

We note that a concern raised with us by Jones Day is that the process for communicating the decisions of the SOs and ACs regarding how Sole Member power is to be used could be hijacked in some fashion. We believe that processes and procedures can be readily designed to practically eliminate such risk, for example by providing a fully transparent process and transparent communication of the decisions of each AC and SO, and by requiring that the Board is required to implement as the Sole Member directs. Any danger that the Board would hijack the process can be addressed by providing for the ability to access dispute mechanisms and to recall the Board.