

MEMORANDUM

TO: CWG-Stewardship (“CWG”)
FROM: Sidley Austin LLP
RE: PTI: Board Duties and Subsidiary Costs
DATE: April 28, 2015

I. Overview and Qualifications

The CWG has requested our advice on (i) the required duties and responsibilities of the board of directors of the Post-Transition IANA (“PTI”), the separate legal entity in the proposed CWG stewardship model that would hold the IANA naming functions department, administrative staff and related resources; and (ii) the legal costs associated with forming and maintaining PTI as a separate legal entity. This memorandum considers the foregoing under the two legal entity structures under consideration for PTI: a nonprofit corporation or a limited liability company (“LLC”).

Please note that our legal analysis is based on our understanding of the facts and the goals and priorities of CWG, and is provided on a general level in keeping with the level of the discussions to date. This memorandum is provided for the benefit of CWG, and should not be relied upon by any other persons or for any other purpose. Unless otherwise stated, the legal analysis contained below is based on the laws of California and Delaware, and in particular, the laws governing California nonprofit corporations (*California Corporations Code, Title 1, Division 2*) and Delaware limited liability companies (*Delaware Code, Title 6, Chapter 18*).

II. Role and Duties of the PTI Board

CWG has discussed forming PTI as either a nonprofit corporation or an LLC. Accordingly, this memorandum considers the responsibilities of the PTI board of directors under each of those structures. As discussed below, if PTI were formed as a California nonprofit corporation, its directors would be subject to broad fiduciary duties and required to undertake certain specific responsibilities. Alternatively, if PTI were formed as an LLC, in particular under the laws of the State of Delaware, there would be a high degree of flexibility to shape the directors’/managers’ responsibilities.

a. PTI as a California Nonprofit Corporation

A California nonprofit corporation is required to have a board of directors, which may be comprised of a single director. Under the “interested person” rule, no more than 49% of the

directors may be “interested persons”. “Interested persons” include any person compensated for services rendered to the corporation (i.e., PTI), whether as a full or part-time employee or independent contractor (other than compensation for services as a director). As a result, no more than 49% of the PTI board could be comprised of PTI employees. Individuals compensated by ICANN would not be “interested persons”.

The board of directors of a California nonprofit corporation is responsible for managing and directing the corporate power and affairs and activities of the nonprofit corporation in compliance with its articles of incorporation and bylaws. Each director is bound by fiduciary duties to the corporation. Directors must act in good faith in what they believe to be in the corporation’s best interests (the “duty of loyalty”), with such care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under the circumstances (the “duty of care”). In addition, in a nonprofit corporation, directors have a duty to carry out the mission expressed in the articles of incorporation (the “duty of obedience”).

If PTI is formed as a California nonprofit corporation, at a minimum, the board of directors will have the following specific responsibilities:

- (1) record-keeping, including maintaining adequate and correct written books and records of account, minutes of the proceedings of the board and members and a membership list, if applicable;
- (2) issuance of an annual report and financial statements to its members;¹
- (3) election of officers, including a chair of the board or president, secretary and chief financial officer or treasurer;
- (4) adoption of an annual budget;
- (5) action on members’ request for inspection of records;²
- (6) designation of corporate depository and authorized signatories;
- (7) initiation or defense of legal actions on behalf of the nonprofit corporation;
- (8) approval of certain significant transactions like sales of corporate assets, mergers or dissolutions; and
- (9) if the nonprofit corporation’s annual revenue is in excess of \$2 million, the board will be required to have an audit committee and provide audited financial statements in its annual report. The duties of the audit committee members include: (i) recommending auditors to the full board of directors; (ii) negotiating the compensation for auditing services; and (iii) reviewing and

¹ This would only be ICANN, as sole member.

² This would only be ICANN, as sole member.

approving audited financial statements. There is no statutory requirement as to how often the board of directors must meet; typically, a board would meet at least once per year.

In addition to the board, a nonprofit corporation must also have certain statutory officers, including a chair of the board or president, a secretary and a chief financial officer or treasurer.

b. PTI as a Delaware LLC

Under Delaware law, limited liability companies are permitted a great deal of flexibility in how they are managed. Delaware limited liability companies may be managed by the members, or by one of more managers (who may have a function similar to a board member). We would expect that PTI would have an operating agreement or LLC agreement which would be the contract that would serve as its governing document. This agreement could provide for a board of managers, in which case the managers will possess the authority and responsibility for managing and directing the affairs of the company in compliance with the operating agreement. There is a high level of flexibility under Delaware law to expand, restrict or eliminate managers' responsibilities under its operating agreement, including the ability to eliminate managers' fiduciary duties (except for the implied contractual covenant of good faith and fair dealing, which cannot be eliminated). All other duties and requirements of the board of managers of PTI can be dictated by the operating agreement, including, if desired, any matters discussed above in Section II.a, any other responsibilities of the PTI board and the frequency of board meetings.

III. PTI Entity Formation and Maintenance Costs

The following provides an overview of the types of legal costs associated with the formation and maintenance of a separate legal entity (either as a California nonprofit corporation or Delaware LLC). As a general guide, the legal costs associated with formation of a separate legal entity and the general corporate upkeep are fairly minimal. This memorandum does not take into account the one-time costs that are associated with a separation of the IANA functions from ICANN. In addition, ICANN Finance or another appropriate body should advise on the anticipated costs associated with operating PTI as a stand-alone legal entity.

a. PTI as a California Nonprofit Corporation

As described in Annex A, upon incorporation, California nonprofit corporations are required to make initial filings with the Secretary of State, the Franchise Tax Board and the California Attorney General. There are also minimal costs associated with appointing directors, audit committee members and a registered agent as required by the California Corporations Code. In addition, there would be some ongoing costs required to maintain PTI as a California nonprofit corporation in good standing, such as annual regulatory filing requirements, preparation of audited financial statements and certifications and distribution of the annual report to members. PTI must hold a regular member meeting in each year in which directors are scheduled to be elected. Except for this requirement, frequency of member meetings can be stated in the bylaws. There is no statutory requirement for how frequently a board of directors must meet.

b. PTI as a Delaware LLC

As detailed in Annex A, the costs associated with forming and administering a Delaware LLC are similar, though possibly even less onerous. If formed as an LLC, PTI would be required to make simple filings in Delaware and register as a foreign LLC doing business in California. In addition, PTI would need to appoint registered agents in both Delaware and California. PTI may also choose to adopt an operating agreement and appoint managers and officers. As an on-going matter, PTI would be required to make annual corporate and tax filings in California and annual Delaware corporate filings (including payment of a nominal annual franchise tax). There is no statutory requirement regarding frequency of holding meetings of the board of managers or members – this can be provided for in the operating agreement.

ANNEX A

I. Forming a new legal entity

The following outlines the primary legal costs associated with the formation of a new entity.

a. California Nonprofit Corporation

(i) *Corporate*

- (a) File Articles of Incorporation with the California Secretary of State – \$30.00 fee (excluding any agent fees).
- (b) File Statement of Information with the California Secretary of State (Form SI-100) – \$20.00 fee (excluding any agent fees).
- (c) Appoint registered agent in California.¹
- (d) Adopt simple form of bylaws – no filing necessary with the California Secretary of State.
- (e) Appoint directors by resolution of sole member.
- (f) Appoint audit committee to oversee audit of annual financial statements by resolution of the board, if necessary.
- (g) Elect officers by resolution of the board. Nonprofit corporations must have a chair of the board or a president (and may have both), a secretary, and a chief financial officer or treasurer (and may have both).

(ii) *Tax-Related*

- (a) File for federal employer identification number (EIN).
- (b) Application to the California Franchise Tax Board on Form 199 – \$10.00 fee (excluding any agent fees).
- (c) File Charitable Registration with the California Attorney General's Office (Form CT-1) – \$25.00 fee (excluding any agent fees). Include copy of Articles of Incorporation furnished to the Secretary of State.

¹ Agent fees will vary depending on who is appointed.

b. Delaware LLC

(i) *Corporate*

- (a) File Certificate of Formation with the Delaware Secretary of State –\$89.00 fee (excluding any agent fees).
- (b) File Application to Register in California with the California Secretary of State (Form LLC-5) – \$70.00 (excluding any agent fees).²
- (c) File Statement of Information (Form LLC-12) with the California Secretary of State – \$20.00 (excluding any agent fees).
- (d) Appoint registered agents in Delaware and California.³
- (e) Adopt simple form of limited liability agreement – no filing necessary with the Delaware Secretary of State.
- (f) Appoint managers by resolution of sole member.
- (g) Appoint officers by resolution of the board of managers.

(ii) *Tax-Related*

- (a) File for federal employer identification number (EIN).

2. Ongoing administration of a separate legal entity.

The following outlines the primary legal costs associated with the ongoing administration of a separate legal entity.

a. California Nonprofit Corporation

(i) *Corporate*

- (a) Statement of Information must be filed biennially – \$20.00 fee (excluding any agent fees).
- (b) Ongoing registered agent fees (usually annually).⁴

² Must attach a valid certificate of good standing issued by Delaware within last 6 months (up to \$1,000 for 1 hour turnaround).

³ Agent fees will vary depending on who is appointed.

⁴ Agent fees will vary depending on who is appointed.

(ii) *Tax-Related*

- (a) Annual Registration Renewal Fee Report Filed with the California Attorney General's Office (Form RRF-1 – Annual Registration Renewal Fee Report) – Gradual fee up to \$300.00 depending on gross annual revenue (excluding any agent fees).
- (b) IRS Form 990 to be filed with Form RRF-1.
- (c) Annual Franchise Tax Board Filing. (FTB Form 199 – California Exempt Organization Annual Information Return) – if gross receipts over \$25,000 - \$10.00 fee (excluding any agent fees).

(iii) *Governance and Reporting*

- (a) Annual Report to Members and Board of Directors required.
- (b) Accountant's Certification required if gross revenue exceeds \$2 million.
- (c) Can be delivered to members by personal deliver, mail, electronic transmission or inclusion in news letter.
- (d) Prepare audited annual Financial Statements (if annual revenue in excess of \$2 million). Must be made available to the California Attorney General and public within 9 months.
- (e) Board meetings.
- (f) Member meetings. Corporation must hold a regular members meeting in each year in which directors are scheduled to be elected for the purposes of conducting the election and transacting any other proper business. Except for this requirement, the date, time, location, and frequency of membership meetings are as stated or fixed in the bylaws. Minutes should be kept for any member meetings.

b. Delaware LLC

(i) *Corporate Filings*

- (a) Pay annual business entity tax to the Delaware Secretary of State – annual charge of \$300.00, which is the minimum for most small companies.
- (b) File biennial Statement of Information (Form LLC-12) with the California Secretary of State – \$20.00 (excluding any agent fees).

(c) Ongoing registered agent fees (usually annually).⁵

(ii) *Tax-Related Filings*

(a) California imposes an \$800.00 annual minimum tax and an annual LLC fee on all limited liability companies that are doing business in California (even those LLCs that are treated as disregarded entities for federal income tax purposes), based on the LLC's gross income from California sources. For LLCs with gross income exceeding \$5,000,000 or more, the annual LLC fee maxes out at \$11,790. The \$800.00 annual tax and LLC fee are each paid in connection with the LLC's filing of Form 568.

(iii) *Governance and Reporting*

(a) There are no statutory requirements for meetings of the board of managers or members to be held. The frequency of meetings can be mandated by the limited liability agreement of the company.

⁵ Agent fees will vary depending on who is appointed.