

MEMORANDUM

TO: Cross-Community Working Group on Enhancing ICANN Accountability
FROM: Adler & Colvin and Sidley Austin LLP
RE: Current Corporate Status of ICANN under California Law
DATE: October 11, 2015

Question Presented

This memorandum responds to the following question certified to us on October 6, 2015: *Under ICANN's current structure, do SOs and ACs have legal rights to select directors in line with designator rights under the California statute?*

Summary Conclusion¹

Yes. Under ICANN's current structure, SOs and ACs have legal rights to select directors in line with designator rights under the California statute. We believe that the best interpretation of ICANN's current Bylaws is that they construct a designator model under the California Nonprofit Public Benefit Corporation Law, but with a number of gaps that create ambiguity and leave ICANN vulnerable to legal attack.²

Analysis

In discussion of the Sole Designator Model as a potential alternative to the Sole Member Model that was presented in CCWG's Second Draft Proposal, questions have arisen about the degree to which a model that relies on designator rights to support the community powers is fundamentally different from ICANN's current structure. For example, in an October 5 e-mail message the Chair of the ICANN Board of Directors, Steve Crocker (writing on behalf of the ICANN Board of Directors) asserted that the Sole Designator Model is unacceptable as a means to create an accountable multi-stakeholder corporate structure for ICANN because "[t]he Designator model still introduces a *new legal structure* with powers that are *intrinsically beyond*

¹ Note as a general matter that our legal analysis is provided on a level in keeping with the question posed. Our legal analysis is tailored to the context in which the particular question arises. It is provided to inform and help facilitate your consideration of the governance accountability models under discussion and should not be relied upon by any other persons or groups for any other purpose. Unless otherwise stated, our legal analysis is based on California law and in particular the laws governing California nonprofit public benefit corporations (California Corporations Code, Title 1, Division 2). In our effort to respond in a limited time frame, we may not have completely identified, researched and addressed all potential implications and nuances involved.

² Memos from the firm of Caplin & Drysdale, which has a prominent practice in tax-exempt organization law, addressed to the American Registry for Internet Numbers (ARIN), dated March 31, May 25, and July 15, 2015, reach a similar conclusion: ICANN's current Bylaws contain designator rights and powers for the ASO as well as for the other SOs, ALAC, and the NomCom, but the ICANN Bylaws should be amended to clarify those rights under California corporate law.

the structure we have been using.”³ (Emphasis added.) In assessing the degree to which any proposed model differs from the current ICANN structure, clarity about the legal status of the current ICANN structure is necessary.

California Corporations Code Provisions on Designators

California law contemplates three mechanisms for choosing directors to serve on the board of directors of a public benefit corporation such as ICANN:

- Directors may be elected *by a corporation’s members*;⁴
- Directors may be chosen *by the current directors* (sometimes referred to as a self-perpetuating board);⁵
- Directors may be selected *by one or more designators* who are given the right to select one or more directors by the corporation’s articles or bylaws.⁶

Where a designator has the right, provided in the articles or bylaws, to select a director, that designator also has the right, provided in Section 5222(f), to remove that director (whether or not such a right is expressly provided to the designator in the articles or bylaws). In addition, that director can be removed by the board only with the designator’s written consent.⁷

Current ICANN Bylaws

ICANN’s current Bylaws (in Article VI.2 (1.b – 1.e)) provide for seven members of the Board to be “selected” by three Supporting Organizations (SOs) and by the At-Large Community, each with director seats assigned to them:⁸

| | |
|--|---------|
| Address Supporting Organization (ASO) | 2 seats |
| Country-Code Names Supporting Organization (ccNSO) | 2 seats |
| Generic Names Supporting Organization (GNSO) | 2 seats |
| At-Large Community (At-Large Advisory Committee, ALAC) | 1 seat |

The ICANN Bylaws use the same term that the Code uses with respect to designator rights – “select” -- to describe the power granted to each of these groups. The Bylaws go further

³ E-mail from Steve Crocker, Chair of the ICANN Board of Directors to CCWG-Accountability, “Message from ICANN Board re Designator Model,” October 5, 2015. (“The Designator model still introduces a new legal structure with powers that are intrinsically beyond the structure we have been using. We understand that many believe it is possible to constrain these powers in order to provide established protections, accountability and thresholds: This is unproven territory and will require more detail and time to understand and test the impact on our bedrock multi-stakeholder balance.”)

⁴ California Corporations Code (the “Code”) Sections 5056 and 5510(b)..

⁵ Code Section 5310(b).

⁶ Section 5220(d) of the Code provides: “[A]ll or any portion of the directors authorized in the articles or bylaws of a corporation may hold office by virtue of *designation or selection by a specified designator* as provided by the articles or bylaws rather than by election [by the board or the members].” (Emphasis added.)

⁷ Section 5222(f) of the Code provides: “If by the provisions of the articles or bylaws a designator is entitled to designate one or more directors, then: (1) Unless otherwise provided in the articles or bylaws at the time of designation, any director so designated may be removed without cause by the designator of that director. (2) Any director so designated may only be removed under subdivision (a) with the written consent of the designator of that director.”

⁸ For example: “The Directors shall consist of: ... b. Two voting members selected by the Address Supporting Organization according to the provisions of Article VIII of these Bylaws.”

and, in Articles VIII through XI, prescribe the internal process to be used by each group in making its selection. The Bylaws do not indicate that there is any discretion residing in the ICANN Board for the directors selected by these groups not to be seated. We conclude that these four identified groups have designator powers under California Code Section 5220.

The ICANN Bylaws (Article VI.2 (1.a)) also provide for eight members of the Board to be “selected” by the Nominating⁹ Committee (NomCom) established by Article VII of the Bylaws. The NomCom has fifteen voting delegates allocated as follows:¹⁰

| | |
|--|---|
| ALAC | 5 |
| GNSO - Registries Stakeholder Group | 1 |
| GNSO - Registrars Stakeholder Group | 1 |
| GNSO - Business Constituency, small business users | 1 |
| GNSO - Business Constituency, large business users | 1 |
| GNSO - Internet Service Providers Constituency | 1 |
| GNSO - Intellectual Property Constituency | 1 |
| GNSO - Non-Commercial Users Constituency | 1 |
| ccNSO Council | 1 |
| ASO Council | 1 |
| Internet Engineering Task Force | 1 |

This provision gives the NomCom the collective power to designate these directors, consistent with Code Section 5220(d). There are two legal interpretations of this:

- The ten groups represented by voting delegates could each legally be a designator, but with the ten required to act collectively to select eight directors to the Board. In that case, the NomCom is a “council of designators” -- each one cannot act alone, but together they exercise designation power.
- Alternatively, the NomCom could be construed as a single designator, with ten participating groups represented by 15 voting delegates, using an internal process to accomplish the designator’s selection.

In sum, 15 of ICANN’s 16 directors are neither chosen by the sitting Board, nor elected by a membership body; they are designated as described above. This model gives the selecting designators more limited roles and rights as compared to the power of members, but greater than in a self-perpetuating board model, in which no outside stakeholder rights for director selection exist.

Under Code Section 5056(a), anyone who has the right to vote for the election of a director or directors is defined as a “member.” However, Section 5056(d)(2) states that one is

⁹ The term “nominating committee” is not defined and has no legal import under the California Code. Commonly the term is used to refer to a body that recommends candidates to another body or authority that makes the final choice of directors from among them. Under the ICANN Bylaws, the NomCom actually makes the final selection of the eight directors; no confirmation by anyone else is required. The label “Nominating” seems to be a misnomer.

¹⁰ The NomCom’s selection process includes participation by five non-voting liaisons, two appointed by the ICANN Board (Committee Chair and Chair-Elect), and one from each of the Root Server System Advisory Committee (RSSAC), the Security and Stability Advisory Committee (SSAC), and the Governmental Advisory Committee (GAC).

not a member by virtue of “[a]ny rights ... to *designate or select* a director or directors.” (Emphasis added.) Article XVII of the ICANN Bylaws states that “ICANN shall not have members as defined in the California Nonprofit Public Benefit Corporation Law” In expressly rejecting the possibility that the groups with the right to select directors are statutory members,¹¹ and with no evidence in the Bylaws that the Board selects directors or must approve or may reject the choices of these groups, the Bylaws leave only one legal possibility: the groups must be designators.

Removal Rights and Powers

The ICANN Bylaws (Article VI.11) provide that a director may be removed by a supermajority vote constituting three quarters (3/4) of all directors, not counting the vote of the director in question. The Bylaws further provide that if the director was selected by an SO or by the At-Large Community, advance notice of the removal must be given to them. No other methods of removal or prerequisites to removal are set forth in the Bylaws, even though Code Sections 5221 through 5227 stipulate other methods and requirements that apply by statute and cannot be varied. As cited above, Section 5222(f) grants two removal rights to designators:

- A designated director may be removed by the designator of that director under subsection (f)(1), “[u]nless otherwise provided in the articles or bylaws at the time of designation....” The ICANN Bylaws contain no language that deprives any designator of the power to remove its director, and thus that power remains in the hands of the designator.
- If the board votes to remove a designated director without cause (“cause” is defined in Section 5221), that director may only be removed with the designator’s written consent. The ICANN Bylaws provide for notice to the SO or ALAC,¹² but do not mention the requirement for its consent. The designator’s right to block board removal without cause, by withholding written consent, is statutory and cannot be taken away in bylaws.

In sum, under the Code, regardless of the silence in the Bylaws as to these matters, ICANN’s designators possess rights to:

- Reject a Board removal without cause of the directors they designate, and
- Directly remove such a director themselves.

These rights are protected by statute.

Regarding vacancies on the Board created by removal, death, or resignation, the ICANN Bylaws (Article VI.12) provide that if the director was selected by an SO, that SO fills the

¹¹ Code Section 5056(d) also provides that a person is not a member by virtue of having rights as a delegate (representing members) or as a director, circumstances that are not pertinent here.

¹² No notice is specified in Section 11, Article VI, of the ICANN Bylaws to be given to the NomCom where the director in question was designated by the NomCom.

vacancy. All other vacancies are filled by the NomCom.¹³ This is generally consistent with California Code Section 5222(e)(1) which states that if a removed director was chosen by designation, and a bylaw provision allows a different person to be designated, a new designation shall be made.

Protection of Designator Rights and Powers

California Code Section 5150 permits a nonprofit public benefit corporation like ICANN, including one with designators, to constrain its bylaw amendment process so that the amendment or repeal of the entire bylaws, or specified portions of the bylaws “...may occur only with the approval in writing of a specified person or persons other than the board or members.”

The ICANN Bylaws, Article XIX, generally allow the Bylaws to be altered, amended, or repealed by a 2/3 vote of all members of the Board. No special provision is made for those parts of the Bylaws that confer designator rights and powers on the SOs, ALAC, and the other groups that have voting rights within the NomCom. That means that currently the Board could eliminate the rights of one or all of the current designators and the designators would have no recourse. It is a more common practice for bylaws to protect designator status from unilateral board action by requiring all or at least a majority of the designators to consent to a bylaw amendment affecting their rights or powers.

Conclusion

We believe that the best interpretation of the ICANN Bylaws is that ICANN functions under a designator model, for which the Code prescribes certain statutory rights and powers to designators that cannot be taken away as long as the ICANN Bylaws give director selection powers to identified stakeholder groups, acting separately or collectively.

We believe that the designator structure currently set forth in the ICANN Bylaws has several serious gaps that expose ICANN to potential legal challenge and associated instability. These arise because although the Bylaws provide designator rights, the Bylaws do not specifically expressly acknowledge the legal position of the SOs, ALAC, and the NomCom as designators under California corporate law. While we believe that is the best interpretation of these Bylaws and the state statutes and the most likely outcome of a court test, a dispute on that issue could be very protracted, taking months or years to resolve, including the possibility of trial and appellate proceedings, before a final decision is rendered.¹⁴ Such a suit could arise, for example, if the Board tried to remove a director selected by an SO or ALAC as the Bylaws contemplate but without that appointing body’s consent as required by statute, or if an SO or ALAC tried to remove a director it appointed as the statute contemplates even though that right is not mentioned in the Bylaws.

¹³ The exception is the President, who would be replaced by Board election of a new President. The Bylaws do not say that a vacancy in the seat selected by ALAC would be filled by ALAC; by default, then, the vacant ALAC seat would be filled by the NomCom (we do not know if this was intended or the result of an oversight).

¹⁴ The legal personhood status of each of the designators is also unclear, under the Bylaws or otherwise, creating further uncertainty in the legal outcome. The Code is ambiguous concerning whether designators must be legal persons; in any event, they must be legal persons to be able to bring suit to enforce their designator rights.

Whether ICANN moves to a member model or keeps and improves its designator model, these gaps should be addressed. For the benefit of both ICANN and the multi-stakeholder community, the Bylaws should be clear on how the separate and collective rights and powers related to selection, removal, and replacement of directors given to the ten groups are to be exercised and protected, consistent with California corporate law. ICANN may have a corporate structure that is innovative, expansive, and adaptive, but the Bylaws must be firmly grounded in the existing California nonprofit statutory framework to minimize the disruptive effect of conflicting interpretations.