



The Internet Corporation for Assigned Names and Numbers

25 October 2011

Commissioner Neelie Kroes
Vice President of the European Commission
Rue de La Loi 200
B-1049 Brussels, Belgium

Dear Commissioner Kroes,

Enclosed please find a response to the letter signed by Mr. Gerard de Graaf, Director in the Directorate-General for Information Society and Media, and Ms. Lindsey McCallum, acting Director in the Directorate-General for Competition, which Mr. de Graaf emailed to me and ICANN's former Chairman, Peter Dengate Thrush on 15 June 2011, relating to ICANN's decision on cross-ownership between registrars and registries.

Following an exchange of correspondence in September between our counsel and Mr. de Graaf and Ms. McCallum, we are providing you this substantive response in advance of an anticipated meeting on these topics. I hope that you find this information helpful and illuminating. As ICANN's decision on cross-ownership has been one of the most documented and debated decisions of an ICANN Board, we wanted to provide you with as much detail as possible.

We look forward to hearing from you so that we can schedule a meeting to further discuss these matters.

Sincerely,

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Response of ICANN to EC “Non-paper”

Regarding Cross-Ownership Between Registries and Registrars

I. Introduction

On 15 June 2011, Mr. de Graaf and Mrs. McCallum (respectively Director of Audiovisual, Media and Internet at DG Infso and Acting Director of Information Communication and Media at DG Comp of the European Commission) sent an email to ICANN’s CEO and Board Chair attaching a letter and “Non-paper” that addressed the issue of “Vertical Separation” of Internet Registries and Registrars in conjunction with ICANN’s new gTLD program. “Vertical Integration” also is referred to as “cross-ownership” because the issue relates to the extent to which Internet Registries can have ownership interests in Internet Registrars, and vice versa.

On 19 June 2011, Mr. de Graaf participated in a public meeting held between the Governmental Advisory Committee (GAC) and the ICANN Board to discuss GAC advice relating to the New gTLD Program. On 20 June 2011, the ICANN Board voted to proceed with the New gTLD Program, including the guidelines for cross-ownership that the Board had previously articulated in conjunction with the version of the gTLD Applicant Guidebook that ICANN had posted on its website on 30 May 2011.

Following a further exchange of emails and letters during the first week of September 2011, this paper provides a substantive response to the non-paper.

II. Background

A. History of the Cross-Ownership Issue

When ICANN was formed in 1998, one of its primary purposes was to promote competition in the domain name system, which prior to that date consisted of a single entity (Network Solutions, Inc., which became VeriSign, Inc.) that operated the .COM, .NET, and .ORG registries and also was the sole registrar for those entities. The memorandum of understanding that ICANN signed with the United States Department of Commerce in November 1998 contained the following provision:

This Agreement promotes the management of the DNS in a manner that will permit market mechanisms to support competition and consumer choice in the technical

management of the DNS. This competition will lower costs, promote innovation, and enhance user choice and satisfaction.

<http://www.icann.org/en/general/icann-mou-25nov98.htm>. ICANN's Bylaws and other foundational documents articulate that the promotion of competition in the registration of domain names was (and remains) one of ICANN's core missions. *See* ICANN Bylaws, Article 1, section 2.6.

Within a short period of time after ICANN was formed, ICANN created significant competition at the registrar level, which has resulted in enormous benefits for consumers, including dramatically reduced prices for domain name registrations. ICANN has taken fewer steps to create competition at the registry level.

Some have had the misperception that ICANN adopted a formal policy that restricted any registry from owning more than 15% of any registrar. That is not the case. ICANN has never adopted any overarching policy that restricts the ability of a registry to own an interest in a registrar. Although ICANN's agreement with VeriSign (and certain other registries) does limit VeriSign's ability to own an interest in a registrar, ICANN has long permitted registrars to own interests in registries (and several registrars today do own interests in registries). The "15%" limitation referenced in the Non-paper was the product of negotiation (not any policy development process) and was intended to apply only to the parties to that particular contract (signed in 1999), at which time Network Solutions was the only commercial Internet registry and the only commercial Internet registrar.¹

Over time, and as ICANN has moved toward development of a program aimed at introducing competition into the TLD space, which in turn presents the need for more diverse business models in the marketplace, the community expressed interest in revisiting cross-ownership contractual limitations. ICANN initially commissioned an

¹ The negotiations occurred among ICANN, Network Solutions, Inc. (now VeriSign), and the United States Department of Commerce, addressing the fact that Network Solutions was, at the time, the sole registry and registrar for .COM, .NET, and .ORG. ICANN was in the process of creating competition within the registrar market, and Network Solutions was required to separate its registrar operations from its registry operations. The result of the negotiations was that Network Solutions was permitted to own only 15% of the surviving registrar business (and Network Solutions agreed that it would no longer serve as the operator for .ORG). At no time has there ever been a policy development process that resulted in a proposal (or ICANN acceptance of a proposal) to generally limit the ability of registries to own registrars, or vice versa.

economic study to address issues relating to cross-ownership and the potential effects of eliminating any perceived restrictions. *See* 23 October 2008 Report from CRA International <http://www.icann.org/en/topics/new-gtlds/crai-report-24oct08-en.pdf>. CRAI concluded by encouraging ICANN to “re-examine the economic case for the separation requirement, and in particular to consider whether it might be possible to relax the requirement, initially only in limited cases.” CRAI suggested that ICANN should move “slowly, but deliberately and in consultation with the industry, towards permitting integration of registry and registrar services under many, but not all, circumstances.”

Thereafter, at the 22 June 2009 ICANN meeting in Sydney, Australia, the ICANN Board conducted a lengthy workshop entitled “Vertical Integration Between Registries and Registrars – The Economic Pros and Cons,” which included presentations by economists and outside legal counsel. *See* <http://syd.icann.org/files/meetings/sydney2009/presentation-vertical-separation-22jun09-en.pdf>. The Board again discussed the issue at its 27 October 2009 ICANN meeting in Seoul, South Korea. *See* <http://sel.icann.org/node/6768>.

On 28 January 2010, in response to a request from the community, the Generic Names Supporting Organization (the “GNSO”) Council decided to initiate a policy development process on cross-ownership between registries and registrars on an expedited basis. *See* <http://gnso.icann.org/resolutions/#201001>.

At the 12 March 2010 ICANN meeting in Nairobi, Kenya, the Board passed a resolution indicating that, as a default position only, no cross-ownership would be allowed in the new gTLD program, but that if the GNSO were to develop a policy recommendation on the subject prior to the launch of new gTLDs, the Board would consider that policy. *See* <http://www.icann.org/en/minutes/resolutions-12mar10-en.htm#5>. This “default” position was intended to encourage the community to develop a policy so that the Board would not have to address the issue on an implementation level. However, the default position set forth in Nairobi was not meant to be the Board's final position on cross-ownership; the Board's Nairobi resolution was clearly intended to be a placeholder only.² The Board's hope was that setting out an extreme position of strict

² Specifically, the Draft Applicant Guidebook included a note indicating that the Board encouraged the GNSO to recommend a policy on this issue, and explaining that the Board would review the cross-ownership issue again if the GNSO did not make recommendations in time for launch of the new gTLD program. *See* <http://www.icann.org/en/topics/new-gtlds/draft-agreement-specs-clean-28may10-en.pdf> at page 5.

cross-ownership would help the community arrive at a consensus position on registry/registrar cross-ownership that would be beneficial for all involved.

In May 2010, ICANN published version 4 of the Draft Applicant Guidebook, which included a note indicating that the Board had encouraged the GNSO to recommend policy on the cross-ownership issue, and explaining that the Board would review and revisit the issue again if the GNSO did not submit recommendations in time for launch of the new gTLD program. *See* <http://www.icann.org/en/topics/new-gtlds/comments-4-en.htm>. At the 22 June 2010 meeting in Brussels, Belgium, the Board again discussed cross ownership issues. *See* <http://brussels38.icann.org/node/12470>.

On 12 August 2010, the public comment period on the GNSO's initial report on the issue ended. *See* https://st.icann.org/data/workspaces/vert-integration-pdp/attachments/vertical_integration_pdp:20100818171812-0-28944/original/Summary%20of%20public%20comments%20for%20Initial%20Report%20on%20VI_rev%204.pdf. On 18 August 2010, the GNSO submitted an initial report, offering the Board multiple proposals that were diametrically opposed. *See* https://st.icann.org/data/workspaces/vert-integration-pdp/attachments/vertical_integration_pdp:20100818172144-0-27930/original/Revised%20Initial%20Report%20Vertical%20Integration%20PDP%20WG%2018%20Aug%202010%20Final.pdf.

As a result, by the September 2010 Board retreat, the GNSO had failed to develop a consensus policy on the issue of cross-ownership. The Board asked the GNSO to state whether consensus was possible (*see* <http://icann.org/en/minutes/resolutions-25sep10-en.htm#2.11>), and on 8 October 2010, the GNSO informed the Board that it was unable to reach a consensus (*see* <http://gns0.icann.org/mailling-lists/archives/council/msg09754.html>.) Accordingly, the Board had to make a final determination on cross-ownership without benefit of a GNSO consensus recommendation, and it took the matter up during its retreat in November 2010, and it adopted a resolution at that meeting on the issue of cross-ownership. <http://www.icann.org/en/minutes/resolutions-05nov10-en.htm>

B. Economic Analysis Considered by the Board

In addition to CRAI's 2008 economic report, and in response to the community's request for further economic analysis on the subject of cross-ownership, the ICANN Board obtained extensive economic analysis from Professors Steven C. Salop and Joshua D. Wright, two highly-regarded economists who specialize in competition issues

Professors Salop and Wright participated in a public forum during the June 2009 Board meeting in Sydney, Australia, interviewed a number of Internet registries and registrars in August 2009, and conducted a thorough analysis of the possible pros and cons of allowing complete cross-ownership of registries and registrars. In a paper published on 28 January 2010 (*see* <http://www.icann.org/en/topics/new-gtlds/registry-registrar-separation-vertical-integration-options-salop-wright-28jan10-en.pdf>), Professors Salop and Wright wrote:

- “Vertical integration frequently benefits consumers and competition. It can lead to lower prices, higher quality and better service. It can also facilitate innovation. In some circumstances, however, vertical integration could also harm competition.”
- “We believe that, given all of the circumstances, the most reasonable approach to this issue would be to permit an existing registry to apply to acquire a significant ownership interest in any registry.” Professors Salop and Wright strongly rejected any blanket rule for prohibiting cross-ownership and suggested that registries and registrars be permitted, without any further evaluation, to acquire a 20-25% interest in one another.” They further suggested that ICANN “choose a market share threshold in the 40-60% range” before any prohibitions on cross-ownership would be imposed.

On 12 September 2000, after the GNSO issued its report that identified six competing proposals for the cross-ownership issue, Professors Salop and Wright issued a further report in which they evaluated those proposals. *See* <http://www.icann.org/en/minutes/board-briefing-materials-2-25sep10-en.pdf> (pages 34-50). Professors Salop and Wright were particularly critical of the proposals that would completely restrict all cross-ownership, one of which was concerned in particular with the risk of misuse of competitive information, which they believed could be addressed using various conditions and/or firewalls. They also rejected proposals that adopted a “default” that would prevent cross-ownership unless the Board or a competition authority specifically authorized it, arguing that such a “default” obviously was anticompetitive by specifically discouraging competition.

C. Other Significant Materials Reviewed by the Board

In addition to the extensive materials referenced above, the Board also reviewed the following materials that were generated during the discussion on cross-ownership. We simply identify them here.

- Comments from the Community:
 - The Public Forum: *See* <http://icann.org/en/public-comment/#vi-pdp-initial-report>.
 - Summary of Comments: *See* https://st.icann.org/data/workspaces/vert-integration-pdp/attachments/vertical_integration_pdp:20100818171812-0-28944/original/Summary%20of%20public%20comments%20for%20Initial%20Report%20on%20VI_rev%204.pdf.
- Comments from the At Large Advisory Committee (the "ALAC"): <http://www.atlarge.icann.org/announcements/announcement-10sep10-en.htm>.
- Comments from the Governmental Advisory Committee (the "GAC"): *See* <http://www.gac.icann.org/press-release/gac-comments-new-gtlds-and-dagv3>.
- Board Briefing Materials:
 - 25 September 2010: *See* <http://icann.org/en/minutes/board-briefing-materials-1-25sep10-en.pdf>.
 - 28 October 2010: *See* <http://www.icann.org/en/minutes/board-briefing-materials-1-28oct10-en.pdf> (pages 137-142) and <http://www.icann.org/en/minutes/board-briefing-materials-2-28oct10-en.pdf> (pages 69-100).
- Board Meeting Minutes & Transcripts: *See* <http://www.icann.org/en/minutes/>.

D. The Board's 5 November 2010 Decision

At its 5 November 2010 meeting, the Board noted that it "had over six months since Nairobi to consider the issue [of cross-ownership], including consideration of the GNSO VI working group's deliberations, and community comment including at the ICANN meeting in Brussels in June 2010." (*See* <http://icann.org/en/minutes/resolutions->

05nov10-en.htm.) The Board went on to state that it had "carefully considered available economic analysis, legal advice and advice from the community" in making its determination. As noted above, the Board considered all the information contained in each of the community proposals, as well as independent economic analysis, public consultations, public comment forums and Board briefings that were provided during the Board's decision making process. Based on all of this information, the Board adopted its final resolution on the issue of cross-ownership. *See* <http://www.icann.org/en/minutes/resolutions-05nov10-en.htm>.

In adopting its resolution, the Board concluded that – so long as certain restrictions were put into place on the conduct of registries and registrars, specifically as they relate to data, and so long as competition review remained available in the event of concerns regarding market power – there was no economic or competition rationale to prohibit, on an across-the-board basis, registries from holding ownership interests in registrars, and vice versa. In particular, the Board determined that:

- None of the proposals submitted by the GNSO reflected a consensus opinion; as a result, the Board supported a model based on its own factual investigation, expert analysis, and concerns expressed by stakeholders and the community.
- ICANN's position and mission must be focused on creating more competition as opposed to having rules that inhibit competition and innovation.
- Rules permitting cross-ownership foster greater diversity in business models and enhance opportunities offered by new TLDs.
- Rules prohibiting cross-ownership require considerable enforcement and can easily be circumvented.
- Rules permitting cross-ownership enhance efficiencies and almost certainly will result in benefits to consumers in the form of lower prices and enhanced services.
- Preventing cross-ownership would create more exposure to ICANN of lawsuits, including antitrust lawsuits, which are costly to defend even if ICANN believes (as it does) that it has no proper exposure in such litigation.

- The new Code of Conduct, which is to be part of the base agreement for all new gTLDs, includes adequate protections designed to address behavior the Board wants to discourage, including abuses of data and market power. Data protection is best accomplished by data protection tools, including audits, contractual penalties such as contract termination, punitive damages, and costs of enforcement, as well as strong enforcement of rules. By contrast, market construction rules can be circumvented and cause other harms.
- Case-by-case re-negotiation of existing contracts – including of course the contract with the registry for .COM and .NET – to reflect the new cross-ownership rules will permit ICANN to address any specific or particularized risk of abuse of market power that could result from cross-ownership on an individual basis, as opposed to an across-the-board prohibition.
- In the event ICANN has competition concerns with any particular cross-ownership proposal or situation, ICANN has the ability to refer those concerns to relevant antitrust authorities, which also have the ability to conduct investigations without such a referral.
- ICANN can amend contracts to address any harms that may arise in the future as a direct or indirect result of the new cross-ownership rules.

On 12 November 2010, ICANN published the Proposed Final Applicant Guidebook including language conforming to the Board's 5 November 2010 resolution. (See <http://www.icann.org/en/topics/new-gtlds/draft-rfp-clean-12nov10-en.pdf>.) The Proposed Final Applicant Guidebook attached the November 2010 Draft gTLD Agreement, which included a new Specification 9 entitled the "Registry Operator Code of Conduct." See <http://www.icann.org/en/topics/new-gtlds/draft-agreement-specs-clean-12nov10-en.pdf>.

On 20 June 2011, the ICANN Board voted to proceed with the gTLD program, including the guidelines for cross-ownership that the Board had adopted on 5 November 2010. ICANN incorporated this resolution into the draft gTLD Applicant Guidebook in April 2011 and then again into the version that ICANN posted on its website on 30 May 2011. See <http://www.icann.org/en/minutes/resolutions-20jun11-en.htm>.

E. Subsequent GAC Discussions

After the Board adopted its 5 November 2010 resolution, and in conjunction with a number of other issues that the GAC had identified for discussion, members of ICANN's Board communicated with and/or met with, representatives of the GAC on multiple occasions. The GAC identified cross-ownership as one of 12 issues it wished to discuss, and ICANN responded in writing on each of those issues. *See* <http://www.icann.org/en/correspondence/dengate-thrush-to-dryden-05mar11-en.pdf> (item 5) and <https://gacweb.icann.org/download/attachments/1540128/board-notes-gac-scorecard-clean-15apr11-en.pdf?version=1&modificationDate=1312465845000> (item 5).

Immediately before the ICANN meeting in Singapore, the GAC issued a letter summarizing the state of the discussions on three open issues, including registry-registrar separation. *See* <https://gacweb.icann.org/download/attachments/1540128/GAC+communication+on+new+gTLDs+and+Applicant+Guidebook-+20110618.pdf?version=2&modificationDate=1312364027000>).

After the Board elected to proceed with the New gTLD Program, which incorporated its decision with respect to cross-ownership, the GAC issued a Communiqué in which it noted that the issues of cross-ownership remained outstanding. The GAC stated that it expected “that the implementation of the new gTLD programme will respect applicable law in order to avoid detrimental consequences to parties involved, in particular to applicants.” Discussions with the GAC on this subject no doubt will continue.

III. Responses to Certain Specific Assertions in the Non-paper

The Non-paper makes several assertions, or identifies various areas of concern, that are addressed in large part above. In addition, ICANN augments its response to some of the specific paragraphs of the Non-paper as follows:

1. Paragraph 1 of the Non-paper suggests that complete separation of registries and registrars has been an official ICANN policy and that ICANN has “demonstrated its firm commitment to the principle of vertical separation. . . .” As explained above, this is not the case. And, in fact, the Board made clear that the positions on cross-ownership contained in the early versions of the gTLD Applicant Guidebook were interim or “placeholder” implementation requirements only. The Board hoped that the GNSO would adopt a consensus policy, but the failure of the GNSO to do so obviously did not bar the Board from adopting implementation requirements.

2. Paragraph 10 of the Non-paper states that the absence of meaningful cross-ownership of registries and registrars has “to date, had a key role in insuring a level playing field for competition at the registrar level.” ICANN agrees that there is significant competition at the registrar level, but it is not at all clear what or how much of that can be attributed to the relative absence of cross-ownership (given that there are in fact several instances of registrar ownership interests in registries). There has, however, been much more limited competition at the registry level to date; the gTLD program will (and is intended to) create much more registry competition (as Professors Salop and Wright have noted). Indeed, while paragraph 14 of the Non-paper notes and expresses concerns regarding the fact the registry for .COM and .NET represents approximately 85% of all domain name registrations, it would seem that a policy that prevented registrars from owning interests in registries – which has never been ICANN’s policy – would be particularly anticompetitive, because Internet registrars undoubtedly present meaningful potential competition for registries in the new gTLD program.

3. Paragraph 11 of the Non-paper notes that the economic studies that ICANN commissioned identified potential harms of permitting cross-ownership, but as explained above, the thrust of literally every economic study that ICANN commissioned in conjunction with the New gTLD Program has found that the weight of the evidence firmly supports proceeding with the New gTLD Program in order to foster competition. The reports of CRAI and Professors Salop and Wright unambiguously supported allowing cross-ownership, and Professors Salop and Wright came out in favor of extremely few restrictions on cross-ownership.

5. Paragraph 13 of the Non-paper expresses concern that ICANN has not provided sufficient economic data to support its decision on cross-ownership. This concern is tantamount to asking ICANN to prove a negative. There are only a handful of Internet registries today, and the market is relatively concentrated. By contrast, there are over 1,000 Internet registrars, and that market is competitive. There simply is not available data that would, in the words of the Non-paper, “indicate that the existing wholesale and retail markets are sufficiently competitive to cushion the competition concerns that may result from the full removal of vertical separation . . . ,” even assuming there are such competition concerns. As for the suggestion in paragraph 13 that ICANN needs to demonstrate that allowing cross-ownership is “likely to benefit consumers in the form of lower prices and enhanced services,” Professors Salop and Wright made clear in their analyses that relaxing these restrictions almost certainly would benefit consumers.

6. Paragraph 16 of the Non-paper asserts that a “majority of stakeholders thus favor maintaining the existing cross-ownership restrictions” As explained above, this assertion is inaccurate; the record indicates that there is a wide range of views on this issue among the ICANN stakeholders. Indeed, the GNSO came up with six different recommendations, only one of which would prevent all forms of cross-ownership.

7. Paragraph 18 of the Non-paper addresses concerns associated with the fact that ICANN reserves the right to refer possible competition concerns to applicable competition authorities, including of course the EC. While ICANN recognizes that the various competition authorities throughout the world have their own limitations in terms of process and ability to address global competition concerns, the logical extension of the views set forth in the Non-paper would be that ICANN should never approve guidelines that might conceivably result in arguably anticompetitive activity simply because there is no governmental agency that can, on short notice, block that activity. As a practical matter, other than with respect to certain merger activity, commercial activity is evaluated under national or regional competition laws on an “ex post enforcement of competition rules on the basis of a case by case market analysis” (quoting paragraph 18 of the Non-paper). ICANN, which is an administrative body and not a regulator of competition activity, is obviously limited in its ability to evaluate competition concerns, although ICANN has competition counsel on staff and has retained outside competition counsel from a law firm that is regularly ranked among the top five competition law firms in the world, as well as some of the world’s leading competition economists to advise it on competition issues. ICANN will continue to evaluate competition concerns even after new cross-ownership rules are implemented, as in fact ICANN has pledged to do both in the gTLD Applicant Guidebook and in its Affirmation of Commitments with the United States government. In short, ICANN pledges to do its best in attempting to monitor potential anticompetitive activity associated with the New gTLD Program, and ICANN is confident that the relevant governmental competition authorities will actively monitor competition within the Domain Name System as well.

8. Paragraph 19 of the Non-paper notes that ICANN’s Board includes members of registries and registrars and that those entities provide a substantial amount of ICANN’s funding. This is a true statement, but no entity consisting of Internet stakeholders could possibly exist without representation of Internet registries and registrars. By the same token, ICANN’s Board members have a fiduciary obligation to ICANN, they disclose their conflicts of interest, and they are forbidden from voting on certain issues as a result of any conflicts. *See* ICANN’s Conflicts of Interest Policy at <http://www.icann.org/en/committees/coi/coi-policy-30jul09-en.htm>. There has been no

hint of impropriety with respect to the 5 November 2010 vote of the Board with respect to cross-ownership.

IV. Conclusion

ICANN, community members and experts have done a thorough analysis of the cross-ownership issue, and ICANN's decision to permit cross-ownership, as set forth in the Board's resolution of 5 November 2010, was based on – and strongly supported by – the relevant facts, the law, community input, and careful economic analysis.

In the end, one of ICANN's key missions is to create competition in the registration of domain names. A rule that flatly prohibits competition based on speculative economic harms that might result from domain name registration thus seems inimicable to ICANN's mission. No data supports a flat prohibition on cross-ownership, and there is considerable economic basis to believe that permitting cross-ownership (based on the rule that the ICANN Board adopted) will, in fact, stimulate competition and innovation at the registry level.