RATIONALE FOR BOARD DECISION ON ECONOMIC STUDIES ASSOCIATED WITH THE NEW gTLD PROGRAM

Executive Summary

ICANN was formed to foster user choice, consumer trust and competition in the domain name system (DNS) marketplace, as recently reaffirmed in the Affirmation of Commitments. After creating competition with respect to Internet registrars, which ICANN accomplished shortly after it was formed in 1998, ICANN turned its attention to creating competition with respect to Internet registries and, in particular, allowing for additional Top Level Domains (TLDs) to be created. ICANN's first efforts in this respect was the proof of concept round of a limited number of new generic TLDs (gTLDs) in 2000, followed by the addition of a limited number of sponsored TLDs in 2004-05. These modest additions to the root demonstrated that additional TLDs could be added without adversely affecting the security and stability of the domain name system.

ICANN's Board then turned its attention to possible additional TLD expansions, and the Board sought direction from the GNSO. In August 2007, the GNSO issued a lengthy report, following an extensive policy development process, in which the GNSO recommended that ICANN permit a considerable expansion in the number of new gTLDs.

Subsequent to the issuance of the GNSO's report, ICANN has commissioned several economic studies to inform the development of implementation procedures on a number of issues, including whether additional gTLDs would create competition at the registry level, whether new gTLDs should have price caps, and whether there should be restrictions on registry-registrar cross-ownership. ICANN intended the economic studies to address questions from the community (including the NTIA) about how to understand and balance costs and benefits of the new gTLD program.

Ultimately, ICANN obtained reports from several economists, including some of the world's leading economists who specialize in competition issues. Those economists generally supported an open approach in which new gTLDs would continue to be added to the root, subject to appropriate restrictions to address trademark and other competition concerns that ICANN has included in the gTLD Guidebook. Those studies greatly improved ICANN's understanding of the marketplace. Further, the studies made clear that the economists did not anticipate that the costs that might be associated with new gTLDs would outweigh the overall benefits of their introduction, and determined that it was too difficult to predict.

ICANN operates on the basic premise that competition law throughout the world is based upon, which is that increased competition is almost always valuable in order to stimulate innovation and consumer benefits. The studies that ICANN has commissioned have not demonstrated otherwise.

As a result, ICANN's Board has concluded that there is no economic basis that would justify stopping the New gTLD Program from proceeding and no further economic analysis will prove to be any more informative in that regard than those that have already been conducted.

Furthermore, the Board has determined that the numerous economic studies have sufficiently identified the key issues that require safeguards in the Applicant Guidebook and that it is now the responsibility of the Community and the Board to finalize the appropriate rules that will maximize benefits and reduce potential costs.

I. History

ICANN's mission statement and one of its founding principles is to promote user choice, consumer trust and competition. ICANN has created significant competition at the registrar level, which has resulted in enormous benefits for consumers, including dramatically lower prices for second level domain names and considerable innovation in the registrar community. To date, however, ICANN has not enabled any meaningful competition at the registry level.

The ICANN Board is committed to making decisions based on solid factual investigation and expert analysis and ICANN has declared in the Affirmation of Commitments that it would continue to evaluate and analyze economic effects of the New gTLD Program.

The Board therefore commissioned several economic studies to inform its decision making on the New gTLD Program. This section contains a brief history of significant actions taken by ICANN to consider economic issues associated with the gTLD program.

In December 2005, the GNSO commenced a rigorous policy development process to determine whether (and the circumstances under which) new gTLDs would be added. A broad consensus was achieved in community deliberations that new gTLDs should be added to the root in order to stimulate competition further and for numerous other reasons.

In October 2006, unrelated to the proposal to develop new gTLDs, during a special telephonic meeting of the Board, the Board passed a resolution that requested that ICANN's President commission an independent study by a reputable economic consulting firm or organization to deliver findings on economic questions relating to the domain registration market. https://community.icann.org/display/tap/2006-10-18+-+Review+of+.BIZ%2C+.INFO+and+.ORG; http://www.icann.org/en/minutes/minutes-18oct06.htm. The Board's request for this study had nothing to do with the anticipated policy for new gTLDs, which the Board had not yet acted upon because the GNSO's report had not been completed.

Subsequent to this 2006 Board meeting, ICANN commissioned CRA International (CRAI) to perform an economic study. (For more information about CRAI, *see* http://www.crai.com.) By the time CRAI began its study, however, several other important economic issues had arisen in conjunction with the ongoing development of the New gTLD Program. As a result, ICANN Staff asked CRAI to focus on those issues in particular, including issues associated with common ownership of registries and registrars.

In August 2007, the GNSO issued its final report regarding the introduction of new gTLDs. http://gnso.icann.org/issues/new-gtlds/pdp-dec05-fr-parta- 08aug07.htm.

In June 2008, the ICANN Board approved implementation of the new gTLD program. http://www.icann.org/en/minutes/resolutions-26jun08.htm.

In October 2008, CRAI issued its report. http://icann.org/en/topics/new- gtlds/crai-report-24oct08-en.pdf.

After CRAI issued its October 2008 report, several members of the ICANN community requested that ICANN commission economic studies that would specifically address the possible economic consequences of new gTLDs. Although this was not the focus of the Board's resolution in October 2006, some commentators argued that ICANN should not proceed with new gTLDs until the Board received the results of the study the Board had requested in 2006. Accordingly, ICANN retained the services of economist Dennis Carlton, who recently had served as the chief economist to the United States Department of Justice Antitrust Division. Professor Carlton is one of the world's leading economic experts; he is based at the University of Chicago and is a member of the highly-regarded Compass Lexecon consulting firm.

In March 2009, Professor Carlton issued his first report, which states that ICANN retained him to analyze from an economic perspective ICANN's anticipated introduction of new generic top level domain names (gTLDs), and to identify and address the benefits and costs associated with ICANN's proposal. http://www.icann.org/en/topics/new-gtlds/prelim-report-consumer-welfare- 04mar09-en.pdf.

Also in March 2009, Professor Carlton issued a second report, which specifically addresses the question of whether new gTLDs should have price caps. http://www.icann.org/en/topics/new-gtlds/prelim-report-registry-price-caps- 04mar09-en.pdf.

In April 2009, economist Michael Kende submitted a report to ICANN entitled Assessment of Preliminary Reports on Competition and Pricing, on behalf of AT&T. Dr. Kende's report comments on Professor Carlton's March 2009 papers.

In June 2009, Professor Carlton submitted a report responding to Michael Kende's April 2009 Assessment of Preliminary Reports on Competition and Pricing. http://www.icann.org/en/topics/new-gtlds/carlton-re-kende-assessment- 05jun09-en.pdf.

Also in June 2009, Professor Carlton issued his fourth and final report, entitled Report of Dennis Carlton regarding ICANN's Proposed Mechanism For Introducing New gTLDs. http://www.icann.org/en/topics/new-gtlds/carlton-re- proposed-mechanism-05jun09-en.pdf.

On 30 September 2009, ICANN committed (via its Affirmation of Commitments with the U.S. Department of Commerce) to further analyze the effects of new gTLDs within one year of their introduction. http://www.icann.org/en/documents/affirmation-of-commitments-30sep09- en.htm.

In the fall of 2009, ICANN retained the services of well-respected economists, Professor Michael Katz from the University of California Berkeley and Professor Greg Rosston from Stanford University to conduct even further economic analysis.

On 16 June 2010, Professors Michael Katz and Greg Rosston issued their first report. http://icann.org/en/topics/new-gtlds/economic-analysis-of-new-gtlds- 16jun10-en.pdf.

On 3 December 2010, Professors Michael Katz and Greg Rosston issued their second report. http://icann.org/en/topics/new-gtlds/phase-two-economic- considerations-03dec10-en.pdf.

II. The Main Issues Addressed in the Economic Studies

A. CRAI October 2008 Report

CRAI's report focuses on economic issues related to the new gTLD program, including issues associated with common ownership of registries and registrars. http://icann.org/en/topics/new-gtlds/crai-report-24oct08-en.pdf.

B. Professor Carlton's March 2009 Consumer Welfare Report

Professor Carlton's first report states that ICANN retained him to analyze from an economic perspective ICANN's anticipated introduction of new generic top level domain names (gTLDs), and to identify and address the benefits and costs associated with ICANN's proposal. http://www.icann.org/en/topics/new-gtlds/prelim-report-consumer-welfare-04mar09-en.pdf. Professor Carlton reached three primary conclusions:

- ICANN's proposed framework for introducing new TLDs is likely to improve consumer welfare by facilitating entry and creating new competition to the major gTLDs such as .com, .net, and .org. *See* Carlton March 2009 Consumer Welfare Report, page 2.

- To the extent that the introduction of new gTLDs gives rise to intellectual property concerns, they can be addressed through existing legal mechanisms and appropriately designed ICANN procedures for protecting intellectual property. It would not be sensible, from an economic perspective, to block entry of gTLDs to prevent potential trademark concerns. . . . The likely adverse effects such a strategy would have on consumer welfare would likely be greater than any potential harm, especially since appropriate steps can be taken if needed to address concerns regarding intellectual property rights. *See* Carlton March 2009 Consumer Welfare Report, page 3.

- Even if new gTLDs do not compete with .com and the other major TLDs for existing registrants, it is likely that consumers would nonetheless realize significant benefits from new gTLDs due to increased competition for new registrants and increased innovation that would likely be fostered by entry. *See* Carlton March 2009 Consumer Welfare Report, page 4.

C. Professor Carlton's March 2009 Price Cap Report

Also in March 2009, Professor Carlton issued a second report, which specifically addresses the question of whether new gTLDs should have price caps. http://www.icann.org/en/topics/new-gtlds/prelim-report-registry-price-caps-04mar09-en.pdf. His answer was negative:

- I conclude that price caps or ceilings on prices charged by operators of new gTLD registries are unnecessary to insure competitive benefits of the proposed process for introducing new gTLDs. I further conclude that imposing price caps on the registries for new gTLDs could inhibit the development and marketplace acceptance of new gTLDs by limiting the pricing flexibility of entrants to the provision of new registry services without generating significant benefits to registrants of the new gTLDs. *See* Carlton March 2009 Price Cap Report, pages 2-3.

D. Michael Kende's Assessment of Preliminary Reports on Competition and Pricing

In April 2009, economist Michael Kende's released his "Assessment of Preliminary Reports on Competition and Pricing" (http://forum.icann.org/lists/competition-pricing-prelim/pdfo06MgHdyxb.pdf), which was submitted to ICANN on behalf of AT&T. Although the Board did not commission the Kende report, the Board was provided with a copy of the report, which it considered together with Professor Carlton's response.

The Kende report had commented on Professor Carlton's March 2009 papers evaluating the likely impact on consumer welfare of ICANN's proposed framework for authorizing new gTLDs, and the appropriate role for price caps in services provided by new gTLDs. Dr. Kende opined that:

- [T]here is no evidence of the type of beneficial competition that Professor Carlton argues that the proposed gTLD framework will introduce. *See* Kende Report, page 11.

- The economic study that the Board directed the staff to undertake in 2006 [...] pointed the way to an appropriate and informed approach by ICANN, which would provide the answers to the questions that were addressed by Professor Carlton in his two preliminary studies. *See* Kende Report, page 19.

- New gTLDs would impose costs on trademark holders by requiring defensive registrations and Professor Carlton's March 2009 reports ... failed to analyze the present status and satisfaction of trademark holders with the current safeguards... *See* Kende Report, page 11.

- Price caps for new gTLDs would be appropriate due to the ...possibility that registries might [set prices] aimed at customers registering defensively, who may be less price sensitive See Kende Report, page 19. The absence of price caps for new gTLDs could result in the elimination of price caps for existing registries. See Kende Report, page 13.

Professor Carlton responded to Dr. Kende's paper (http://www.icann.org/en/topics/new-gtlds/carlton-re-kende- assessment-05jun09-en.pdf.) with the following points:

- There is no basis for Dr. Kende's claim that the study authorized by the ICANN Board in 2006, which proposed to analyze the scope of the market for registration services, is necessary for evaluating whether consumers would benefit from ICANN's proposed framework for introducing new gTLDs. Even if .com (or, for that matter, any other TLD) today exercises market power, new gTLDs could enhance consumer welfare by creating new products and fostering innovation, and promoting future competition with .com and other TLDs. That is, entry of a new gTLD can be desirable even if the gTLD does not erode any of the market power that .com may possess. *See* Carlton Response Paper, page 3.

- While concerns about consumer confusion and defensive registrations need to be considered, Dr. Kende provides no basis for concluding that restricting the entry of new gTLDs is the best solution to reducing these costs. Alternative mechanisms exist, and others are actively being studied by ICANN, to protect trademark holders while preserving the procompetitive benefits of entry. *See* Carlton Response Paper, page 3.

- Dr. Kende exaggerates costs associated with ICANN's gTLD proposal. He defines defensive registrations as those which direct traffic to other sites, but this definition fails to distinguish between productive registrations which attract and maintain traffic as well as those undertaken only to protect trademarks. *See* Carlton Response Paper, page 3.

- [T]here is no basis for Dr. Kende's claim that the absence of price caps for new gTLDs will require elimination of price caps for existing TLDs. *See* Carlton Response Paper, page 4.

E. Professor Carlton June 2009 Report

In June 2009, Professor Carlton issued his fourth and final report, entitled Report of Dennis Carlton regarding ICANN's Proposed Mechanism For Introducing New gTLDs. http://www.icann.org/en/topics/new-gtlds/carlton-re-proposed-mechanism-05jun09-en.pdf. In this report, Professor Carlton responded to many of the comments that ICANN had received to his earlier reports, in particular comments from trademark interests, which expressed concerns that the cost of protecting their interests should overcome the desirability of expanding the number of gTLDs. Professor Carlton disagreed:

- This possibility [of the need for defensive registrations to protect trademark interests], and the harm to consumer welfare that results, is recognized by existing trademark law and in economic analyses of intellectual property. But to the extent that the introduction of new gTLDs gives rise to intellectual property concerns, they can be addressed through existing dispute resolution mechanisms and appropriately-designed modifications of ICANN procedures for protecting intellectual property. Given the availability of these alternative mechanisms for resolving trademark related disputes, the draconian remedy of restricting entry would be likely to harm consumer welfare compared to approaches based on these alternatives. *See* Carlton June 2009 Report, page 4.

Professor Carlton's report continued:

- Given the availability of alternative mechanisms to address concerns about consumer confusion and defensive registrations, which are discussed below, ICANN's plan to introduce new gTLDs is likely to benefit consumers by facilitating entry which would be expected both to bring new services to consumers and mitigate market power associated with .com and other major TLDs and to increase innovation. As a result, the proposal by DOJ, NTIA and others to delay or even preclude deployment of new gTLDs is likely inconsistent with consumer interests. I conclude that such output restrictions are unnecessary and that the concerns motivating these restrictions can be addressed without resorting to draconian restrictions on entry, which essentially would freeze the number of TLDs less than fifteen years after the first commercial development of the Internet. *See* Carlton June 2009 Report, page 10.

F. Professors Katz and Rosston June 2010 and December 2010 Reports

Professors Michael Katz and Greg Rosston issued their first report in June 2010 and their second report in December 2010. http://icann.org/en/topics/new-gtlds/economic-analysis-of- new-gtlds-16jun10-en.pdf; http://icann.org/en/topics/new-gtlds/phase-two-economic- considerations-03dec10-en.pdf.

The Katz/Rosston studies are lengthy reports that include theoretical and empirical analysis. They undertake a comprehensive economic analysis of the market; they review prior economic studies on the subject; they conduct various empirical analyses; and they propose additional analysis that could be conducted once new gTLDs are introduced. In their second report, Katz and Rosston conclude:

- By definition, a new gTLD will benefit the community if the incremental benefits generated by introduction of the gTLD outweigh the incremental costs that it triggers. Incremental benefits refer to the benefits created by a new gTLD relative to alternatives. The case studies—particularly .mobi—demonstrate that, in at least some instances, there can be viable alternative means of achieving the stated objectives of a gTLD application and consequently, the incremental benefits of the new gTLD might be low. The case studies also highlight the fact that, at the time an application for delegation of a new gTLD is submitted, the magnitudes of both incremental benefits and incremental costs will very likely be uncertain and will vary by application. The case studies also demonstrate that there is a range of processes and policies that can be implemented to reduce the costs associated with the misappropriation of trademarks and other intellectual property. The lessons from the experiences with different intellectual property protection regimes in the gTLDs introduced to date can usefully inform future decisions about intellectual property protection mechanisms. Lastly, the registration behavior we examined in community-based gTLDs and the registration behavior by brand owners provides useful information about the value of new gTLDs and the value to brand owners of registering in different TLDs. The existence of substitutes is important to the evaluation of both benefits and costs. For example, the incremental costs of misappropriation may be lower than they first appear because a large number of third-level names already can be used to engage in misappropriation. The incremental costs come from the possibility that second-level domains have more powerful effects than third-level domains. *See* Katz/Rosston December 2010 Report, pages 74-75.

In short, while Professors Katz/Rosston note that there will, undoubtedly, be certain costs associated with the introduction of new gTLDs, there are a variety of mechanisms that are available to address those costs, and one cannot conclude that the costs of new gTLDs will, in fact, be greater than the undoubted benefits of the new gTLD program.

III. Board Determinations

In order to assess whether additional economic studies were still necessary at that stage, as requested by some members of the Community, the Board has considered the independent economic reports listed above and the extensive comments provided by the Community.

A. Benefits of continuing to open the gTLD space has been extensively addressed.

The economists generally support an open approach in which new gTLDs would be added to the root, subject to appropriate restrictions to address trademark and other competition concerns, which ICANN has now included in the gTLD Guidebook.

There is no economic support for the notion that ICANN should block all new gTLD proposals or conduct economic analysis of every new proposed gTLD in order to determine whether the theoretical benefits of that gTLD outweigh the theoretical costs.

ICANN's default position should be to foster competition as opposed to having rules that restrict the ability of gTLDs to innovate. Blocking all new gTLDs would be contrary to the basic economic principle that innovation and efficient competition is good and is highly likely to result in long-run benefits to consumers.

Whether new gTLDs will provide competition for .COM is not particularly relevant to the question of whether new gTLDs would promote competition in the marketplace generally. Empirical studies on this question would be extremely difficult, and it seems impossible to conclude that, less than fifteen years after the introduction of the commercial Internet, ICANN should make the decision to block all efforts to create competition at the registry level, including with respect to .COM absent absolute proof that the benefits associated with those gTLDs would not outweigh their costs.

As a result, ICANN's Board has concluded that there is no economic basis that would justify stopping the New gTLD Program from proceeding and no further economic analysis would prove to be any more informative in that regard than those that have already been conducted.

B. The three main economic issues that require attention have been clearly identified and discussed, namely:

- Ownership of registries and registrars
- The need for price caps
- The potential risks to trademark owners

The Board believes that the introduction of detailed rules and safeguard mechanisms based on extensive Community interaction in the successive versions of the draft applicant guidebook is the appropriate way to minimize the potential costs related to the implementation of this policy and optimize the use of the domain name space as a common global resource.

In particular, to the extent that there are costs to trademark owners or others, ICANN has worked extremely hard with the community to address those concerns, and ICANN pledges to continue that effort and review the newly developed rights protections mechanisms on a regular basis to ensure they are working or, if necessary determine what revisions to be made to improve those mechanisms.

As a consequence, at this stage, and in order to limit the opportunity costs of further delays, the Board considers that there is no benefit in commissioning further studies on these issues and that efforts should now be focused on finalizing the appropriate mechanisms, in particular during the Board-GAC meeting in February and the community interaction at the Silicon Valley meeting in March.

IV. Impact Assessment

A. Are there Positive or Negative Community Impacts to this decision?

Determining that no further ICANN commissioned economic studies will inform the Board's ultimate decision on moving forward with new gTLDs will likely have a neutral impact on the community. Such a decision will merely inform the community that the Board is not expected to delay the New gTLD Program for any further ICANN commissioned economic studies. Such a decision is likely to be seen positively by some in the community, and negatively by some in the community. In any case, the overall balance of costs and benefits in the new gTLD program will be determined through the implementation of the final rules and safeguards included in the Applicant Guidebook.

B. Are there financial impacts on ICANN, the Community and/or the Public?

The decision to commission no further economic studies will have a positive impact on ICANN operating budget and plan. It is now intended that ICANN will not be spending any further money on economic studies before launching the New gTLD Program and thus no further delays to the New gTLD Program will be based on the need to complete any further studies. There could be a financial impact on proponents or opponents of the New gTLD Program given that no more delays will be at the hands of a further commissioned economic study, but such impacts are not known at this time.

C. Security, Stability and Resiliency

The decision not to commission further economic studies is not likely to have any direct impact on the security, stability or resiliency of the DNS.