UNITED STATES DEPARTMENT OF COMMERCE
National Telecommunications and Information Administration
Washington, D.C. 20230

DEC 18 2008

Mr. Peter Dengate-Thrush
Chairman of the Board of Directors
Internet Corporation for Assigned Names and Numbers
4676 Admiralty Way, Suite 330
Marina del Rey, CA 90292-6601

Dear Chairman Dengate-Thrush:

On October 23, 2008, the Internet Corporation for Assigned Names and Numbers (ICANN) posted for public comment a series of interrelated documents, including a draft applicant guidebook, related to ICANN's efforts to introduce new generic top level domains (gTLDs). The Department of Commerce (Department) appreciates this opportunity to offer the views of the United States government on such an important topic.

Understanding that the introduction of new gTLDs has been a long standing goal of the DNS Project, we believe it is critical to keep in mind the foundational Memorandum of Understanding between the Department and ICANN stipulating as a core principle the need to manage the Internet domain name and addressing system (DNS) in a manner that permits market mechanisms to support competition and consumer choice so that lower costs are realized, innovation is promoted, and user choice and satisfaction are enhanced. While we acknowledge the effort and hard work involved in producing the documents currently out for comment, it is unclear that the threshold question of whether the potential consumer benefits outweigh the potential costs has been adequately addressed and determined. In that regard, we would like to call to your attention a decision of the ICANN Board in October 18, 2006, that called for an economic study to address questions such as:

- whether the domain registration market is one market or whether each TLD functions as a separate market,
- whether registrations in different TLDs are substitutable,
- what are the effects on consumer and pricing behavior of the switching costs involved in moving from one TLD to another,
- what is the effect of the market structure and pricing on new TLD entrants, and
- whether there are other markets with similar issues, and if so how are these issues addressed and by who[sic]?[1]

ICANN needs to complete this economic study and the results should be considered by the community before new gTLDs are introduced.

[1] ICANN, Special Meeting of the Board Minutes (Oct, 18, 2006) (http://www.icann.org/en/minutes/minutes-18oct06.htm) (last visited Dec. 11, 2008).

The United States government recognizes that it is ICANN's intention to carefully consider the comments received in this process and initiate further consultations, including a revised applicant guidebook, before introducing new gTLDs. With that in mind, below is a specific list of initial items we believe need to be resolved in the current documents:

- Ensure that the introduction of a potentially large number of new gTLDs, including internationalized top level domains, will not jeopardize the stability and security of DNS;

- Revise the gTLD approval process, the applicant guidebook and the proposed registry agreement to: (1) consider, allow objections for, and retain authority to address any adverse competitive welfare effects that may arise during the approval of new gTLDs applications or the renewal of subsequent contracts; (2) employ mechanisms such as competitive bidding whereby prospective gTLD operators would compete by proposing registry terms, including price and quality commitments, that provide consumer benefit; and (3) impose maximum price caps or other terms that would redound to the benefit of consumers in those cases where competitive bidding mechanisms will not adequately limit the ability of registry operators to exercise market power;[2]

- Demonstrate that ICANN has sufficient capacity to enforce contract compliance with an as-yet-unknown number of new contracting parties, especially in light of outstanding questions regarding existing contracts (such as the proposed amendments to the Registrar Accreditation Agreements and problems with the WHOIS data accuracy reporting system);

- State how ICANN will conduct legal reviews of applications, consider legal objections from third parties, and discharge its responsibility to ensure that the process of introducing new gTLDs respects all relevant national and international law, including intellectual property rights;

- Focus on coordinating technical functions related to the management of the DNS and not on matters more appropriately addressed by governments, such as adjudication of morality, public order and community objections in accordance with international human rights law. The proposed mechanisms to address these topics are inappropriate;

- Create a mechanism that provides for the expansion of the gTLD reserved names list, as appropriate, for technical or infrastructure-related names; and,

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[2] See attached letter from Acting Assistant Attorney General Deborah A. Garza, U.S. Department of Justice, Antitrust Division to Acting Assistant Secretary for Communications and Information Meredith A. Baker, NTIA (dated Dec. 3, 2008).

- Articulate a clear rationale for the proposed fee structure as well as a transparent mechanism, that includes community agreement, for the disposition of excess revenues, should there be any, given ICANN's status as a non-profit entity.

The United States government shares ICANN's commitment to promote competition in the domain name marketplace while ensuring Internet stability and security and looks forward to continuing to participate in this process so that the collective concerns of the community are addressed prior to ICANN moving forward with the introductions of new gTLDs.

Sincerely,

MABaker

Meredith A. Baker
Acting Assistant Secretary
for Communications and Information

cc: Dr. Paul Twomey, President and CEO, ICANN

DEPARTMENT OF JUSTICE
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December 3, 2008

Meredith A. Baker
Acting Assistant Secretary for Communications
and Information
National Telecommunications and
Information Administration
United States Department of Commerce
Washington, D.C. 20230

Re: <u>ICANN's Draft RFP for New gTLDs</u>

Dear Ms. Baker:

This letter responds to the United States Department of Commerce's ("DOC") request for advice regarding competition issues raised by the draft request for proposal ("RFP") that would govern the issuance of new generic top level domains ("gTLDs") published by the Internet Corporation for Assigned Names and Numbers ("ICANN"). The Antitrust Division has reviewed the RFP and related materials published on ICANN's website, including a proposed registry agreement that ICANN will require successful applicants to execute. Our analysis of the issues raised by these materials is informed by our extensive experience with competition matters as well as the analysis we conducted in connection with our 2006 review of the revised .com registry agreement.[1]

As we explain below, some new gTLDs envisioned by the RFP likely would have market power, the exercise of which is not adequately addressed by the RFP or other constraints. Moreover, the creation of additional gTLDs is unlikely to constrain the exercise of market power by existing TLDs, especially the .com registry operated by VeriSign. Contrary to ICANN's apparent assumption, competition from existing TLDs – or from new gTLDs created pursuant to the RFP – is not likely to prevent the exercise of market power by new or existing TLD registries.

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[1] *See* Letter from Thomas O. Barnett to John M. R. Kneuer, dated September 6, 2006.

As a result, although new gTLDs may generate some consumer benefits, ICANN should take additional steps to ensure that the process of creating new gTLDs incorporates to the maximum extent possible competition-based mechanisms and also imposes other constraints on the exercise of market power by gTLD operators.

The Division makes two specific recommendations. First, ICANN's general approach to new gTLDs should be revised to give greater consideration to consumer interests. ICANN should more carefully weigh potential consumer harms against potential consumer benefits before adding new gTLDs and renewing new gTLD registry agreements. Second, the RFP process and proposed registry agreement should include provisions that would enable ICANN to constrain new registry operators from exercising market power. In particular, ICANN should establish competitive mechanisms for authorizing new gTLDs and renewals of gTLD registry agreements whereby prospective gTLD operators would compete for gTLDs by proposing registry terms – including maximum fee schedules – that would provide consumer benefits.

Background:
Introducing New gTLDs Likely Would Enable the Exercise of Market Power by gTLD Operators and Likely Would Not Constrain the Exercise of Market Power by .com and Other Existing TLDs

Our investigation of the proposed .com agreement generated several findings that bear on the likely effect of creating new gTLDs. First, we found that VeriSign possesses significant market power as the operator of the .com registry because many registrants do not perceive .com and other gTLDs (such as .biz and .info) and country code TLDs ("ccTLDs," such as .uk and .de) to be substitutes. Instead, registrants frequently purchase domains in TLDs other than .com as *complements* to .com domains, not as substitutes for them. In other words, registrants of a particular .com domain (e.g., google.com) will frequently also perceive a need to register the same domain in all or most available TLDs (e.g., google.info and google.biz) because of a desire to expand their presence on the Internet and to protect their brands from being exploited by others.[2]

We also concluded that existing gTLDs likely would not become a competitive threat to .com registrations because the network effects that make .com registrations so valuable to consumers will be difficult for other TLDs to overcome. Due to a first-mover advantage and high brand awareness, .com registrations account for the overwhelming majority of gTLD registrations. As a result, when users do not know the TLD in which a domain is registered, they most often simply append ".com" to a product or company name when attempting to find the

[2] In this regard, we discovered that .info often seems to have little value as a stand alone gTLD. Many of the increased domain registrations in .info while those registrations were offered for free were simply bundled with purchases of the same domain in other TLDs or registered to existing users of the same domain in .com.

desired website. This phenomenon creates a strong preference for .com.[3] Accordingly, there will continue to be a need for Section 7.3 of the .com registry agreement to replace the discipline that market competition does not provide in this setting, as well as continuing DOC oversight of the .com registry under the Cooperative Agreement, which precludes VeriSign from amending or renewing the .com agreement without DOC approval.

Finally, our investigation of the .com agreement found evidence that other gTLD registry operators may possess a degree of market power. The market power inherent in the other gTLDs is less than the market power in .com, but is still material. The need of many registrants to purchase domains in many or most gTLDs allows each gTLD registry operator to impose costs on registrants that purchase domains simply because a gTLD exists. With respect to existing gTLDs, this power is constrained to some extent by the registry agreements applicable to the other gTLDs. Without those constraints, the gTLD operators likely could profitably charge even higher fees that reflect their market power as to registrants that are willing to pay a premium for their domains, since it appears that the operators may be able to identify those customers and charge discriminatorily high domain registration prices.[4] The fact that some registrants might view different gTLDs as substitutes would not necessarily constrain the gTLD operators from selectively exercising market power vis-à-vis those that are willing to pay a premium.

In light of these findings, we believe that the introduction of new gTLDs under the RFP could impose substantial additional domain registration costs on many consumers and that many new gTLD registry operators may have market power over registrants. Further, the introduction of new gTLDs is not likely to constrain the exercise of market power by existing gTLDs or ameliorate the continuing need for restraints to prevent VeriSign from exercising market power in the sale of .com domains.

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[3] VeriSign has argued that the increasing use of search engines will cause the importance of .com to diminish, but "direct navigation" continues to be a common practice. Computer users who type Internet destinations into their browser bars often assume that a domain is in the .com TLD whenever they are uncertain, due to the greater prevalence of .com names relative to other TLDs. As a result, new registrants often search for alternative domains in .com when their preferred .com domain is unavailable, rather than selecting their preferred domain in another TLD because investment in developing the domain in the new gTLD would likely benefit the owner of the domain in .com.

[4] Registrants that are willing to pay a premium would include those that engage in defensive registrations to protect their trademark or trade name and registrants that make significant investments in their domain names. A registry operator's ability to impose increased prices on registrants willing to pay a premium for domain names in a new gTLD assumes that the registry operator can identify these registrants. The antitrust laws likely would not constrain the unilateral pricing decisions of a gTLD operator whose market power derived from the creation of a new gTLD by ICANN.

Recommendations

1. *ICANN Should Give Greater Consideration to Consumer Interests before Creating New gTLDs and Renewing Registry Agreements*

ICANN is obligated to manage gTLDs in the interests of registrants and to protect the public interest in competition.[5] ICANN appears to have assumed that the introduction of new gTLDs necessarily will enhance competition and promote choice and innovation, without offering any evidence to support that assumption. To our knowledge, ICANN has neither studied competition among gTLDs at the registry level, nor commissioned such a study, despite the ICANN Board of Director's specific direction to do so.[6] On October 18, 2006, the ICANN Board directed ICANN's President to commission an economic study to address questions such as:

- whether the domain registration market is one market or whether each TLD functions as a separate market,
- whether registrations in different TLDs are substitutable,
- what are the effects on consumer and pricing behavior of the switching costs involved in moving from one TLD to another,
- what is the effect of the market structure and pricing on new TLD entrants, and
- whether there are other markets with similar issues, and if so how are these issues addressed and by whom[7]

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[5] *See* Articles of Incorporation of ICANN, 4, as revised November 21, 1998 (http://www.icann.org/en/general/articles.htm); Joint Project Agreement Between the U.S. Department of Commerce and ICANN, Section II.C., dated Sept. 29, 2006 (http://www.icann.org/en/general/JPA-29sep06.pdf).

[6] ICANN has periodically referenced an OECD report published in 2004 as support for its position that introducing new gTLDs may enhance competition at the registry level. The OECD authors relied on data showing a decline in .com, .net, and .org registrations combined with a significant number of registrations in the new .info, .biz, and .name gTLDs during the six-month period immediately following the introduction of the new gTLDs in 2002. S. Paltridge and M. Matsui, OECD's Directorate for Science, Technology and Industry, *Generic Top Level Domains: Market Development and Allocation Issues*, 4, 22 (July 13, 2004). However, the authors acknowledge that the reduction in .com, .net, and .org registrations was at the end of the "internet bubble," and that registrations in those three gTLDs resumed growth during the succeeding six-month period, while registrations in the new gTLDs tailed off and actually declined in .info during the last six months of 2003, the last period for which registration data was available. *Id.* Indeed, with the benefit of additional, more recent information in our investigation of the new .com agreement, we found no indication that the other gTLDs impose a competitive constraint on sales of .com domains or on VeriSign's ability to charge the maximum .com registry price.

[7] ICANN, Special Meeting of the Board Minutes (Oct. 18, 2006) (http://www.icann.org/en/minutes/minutes-18oct06.htm) (last visited Nov. 17, 2008).

The Board recognized that such a study could help in future negotiations with TLD registry operators.[8] Now, more than two years later, ICANN has proposed to introduce a new gTLD approval process, complete with a new gTLD registry operator agreement, apparently without having even begun the requested study.

ICANN should revise its general approach to give greater consideration to potential consumer harms and benefits. The creation of new gTLDs could generate consumer harm. First, approval of new gTLDs would proliferate the number of TLDs in which registrants feel that they must purchase registrations to protect their domain names, increasing their costs.[9] Second, new gTLD operators may be able to exercise market power vis-a-vis some group of customers (e.g., because of a desire to register for defensive purposes or because of investments they make in a domain name).

At the same time, new gTLDs could generate benefits. It is possible, for example, that they would intensify competition among gTLDs other than .com for customers that do not feel compelled to register their domain names in multiple gTLDs. Whether this is likely would require further analysis. In addition, new gTLDs may benefit unique registrant populations that might value a domain in a particular gTLD. An example of this could be a new gTLD that represents a particular community of people, a type of application that ICANN anticipates receiving in response to the RFP. However, we are unaware of any effort by ICANN to quantify this consumer benefit. ICANN has not attempted to distinguish the registrants that might value having a domain in a gTLD other than .com, including a new gTLD, from those registrants that would feel compelled to purchase one or more domains in the new gTLD only because the gTLD was created.

The RFP neither provides for any evaluation of what effect, if any, the new gTLDs will have on competition at the registry level nor allows for objections based on the likely adverse competitive effects of the gTLD. The RFP also does not establish any mechanisms or processes that would minimize the potential for harm from new gTLDs while enabling the potential benefits to be realized. For example, the proposed registry agreement (unlike the .com agreement and other existing gTLD registry agreements) does not include any price caps that would limit the ability of new gTLD registry operators to charge the highest possible prices for domains in the new gTLDs. Similarly, the proposed agreement does not include any restrictions against price discrimination, bundling, and tying. It also does not require registry operators to offer domains pursuant to long term contracts, meaning that registry operators would be free to raise

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[8] *Id.*

[9] The circumstances under which registry operators may impose additional costs on registrants willing to pay a premium for a domain name depends on the registry operator's ability to price discriminate as well as their pricing strategy. The magnitude of the overall increase in costs will likely to some extent depend on the number of new gTLDS introduced as a result of the RFP process.

prices to registrants willing to pay a premium for specific domain names. The proposed registry agreement also allows for the perpetual renewal of every new gTLD registry agreement without regard to competitive effects or consumer-based objections.

ICANN should recognize that new gTLDs, while providing a desired choice for some registrants, are unlikely to restrain the exercise of market power by the .com registry operator and may impose significant costs on registrants, particularly those that will feel compelled to register their domains in the new gTLDs. ICANN should explicitly include this type of analysis as part of its evaluation of each new gTLD application, and should proceed cautiously in authorizing new gTLDs, attempting to assess both the likely costs and benefits of any new gTLD.[10] If ICANN is not prepared to act now to address the competition-related issues identified in this letter, it should at a minimum postpone the introduction of new gTLDs and the adoption of additional perpetually renewing gTLD agreements until it receives and reviews the study that the ICANN Board requested over two years ago.

2. *ICANN Should Revise the RFP Process and the Proposed Registry Agreement to Protect Consumers from the Exercise of Market Power*

ICANN should take steps to protect consumers from the exercise of market power by gTLD operators. First, the new gTLD approval and management process should be amended to reduce the potential adverse results of new gTLDs. The RFP process should require ICANN to consider, allow objections for, and retain authority to address any adverse consumer welfare effects that may arise during the new gTLD approval process and registry agreement renewal process. For example, ICANN should be sensitive to complaints that consumers may feel compelled to register domains in a new gTLD for defensive purposes, without expectation of receiving meaningful value from the new registration other than avoidance of even higher costs that would be incurred to combat third parties' improper use of the registrant's trade name in the new gTLD.

Second, once it has decided to authorize a new gTLD, ICANN should implement a process by which prospective gTLD operators compete for the privilege of operating a particular gTLD by offering terms that benefit consumers. Effectively implementing such a process would require

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[10] ICANN has consistently told us that its primary concern is with DNS management from a technical perspective and that it does not have the expertise or inclination to protect or preserve the public interest in competition and low domain costs, preferring instead to allow government competition authorities to take whatever action might be necessary to address issues of competitive abuse. The problem with ICANN's preferred approach is that the antitrust laws generally do not proscribe a registry operator's unilateral decisions made under the processes established by ICANN – such as, for instance, pricing decisions. *See, e.g., Verizon Commc'ns Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398, 407 (2004) ("The mere possession of monopoly power, and the concomitant charging of monopoly prices, is not . . . unlawful . . . ."). Accordingly, ICANN should create rules fostering a competitive environment to the greatest extent possible.

that ICANN evaluate bids from the perspective of the benefits they provide consumers, not merely the amount bidders are willing to pay to ICANN for the right to operate the gTLD. ICANN's requests for bids should expressly call for bids to specify an initial maximum price that would be charged by the operator for domain registrations, as well as limitations on price increases over time. ICANN should also encourage improved performance by asking bidders to propose any operating specifications that exceed the minimum standards established by ICANN. ICANN's requests for bids should also solicit other proposals for providing consumer benefit, such as commitments not to discriminate in price across registrants (in order to avoid the ability to "hold up" registrants that have made investments in a domain name) and not to require the purchase of other services from the registry operator as a condition of registration (to limit price cap evasion). All such terms should be incorporated in the registry agreement so that ICANN can enforce them.

Third, although a competitive bidding mechanism likely is the best mechanism for simulating a competitive outcome in most circumstances, it may not be effective in all cases. Because ICANN's proposed registry agreement lacks any of the kinds of safeguards included in Section 7.3 of the new .com agreement or other gTLD agreements, ICANN should consider revising the proposed registry agreement, at least for instances where there is not competitive bidding to operate a new gTLD, to include provisions designed to limit the ability of the registry operator to exercise market power, i.e., price caps and commitments against price discrimination and tying. In addition, it may be preferable to require long-term agreements (the .com agreement, for example, requires that the operator offer domains for terms of up to 10 years). If a competitive bidding mechanism is infeasible, protections of this sort would prevent the exercise of market power by the operators of many of the contemplated gTLDs. Even if a competitive bidding mechanism is implemented, moreover, it might still be appropriate to incorporate some protections into the standard registry agreement, to anticipate the possibility that there is not effective competition for a particular gTLD.

Finally, ICANN should require competitive bidding for renewals of a gTLD registry agreement, rather than granting the incumbent operator a perpetual right to renew without competition. Such a mechanism would both assist in disciplining the conduct of the incumbent during the initial term insofar as the incumbent would want to maximize the likelihood of renewal, and ensure the benefits of competition when potential operators bid for the right to operate the gTLD in the renewal term. Instead, ICANN has conformed the proposed registry agreement to the existing gTLD agreements, effectively granting perpetual renewal rights to registry operators without the prospect of periodic rebidding, and without regard to potential adverse competitive effect. Experience with the .net TLD and other gTLDs has shown that competitive bidding in the award of gTLD registry agreements, and periodic rebidding, has served as an effective tool for managing the interests of registrants in gTLDs. Indeed, competitive bidding has resulted in lower domain prices and higher operating specifications than what ICANN has achieved through non-competitive negotiations. In particular, competitive bidding prompts bidders to propose and accept registry improvements, higher operating standards, and lower registration fees to win the contract.

Opponents of competitive bidding on renewals have contended that ICANN needs to grant perpetual registry contracts in order to motivate registry operators to invest in their registries. However, incumbent registry operators have an incentive to make investments in order to maintain their competitive advantage in a rebid situation.[11] Thus, the effect on innovation of potential termination of a registry agreement is at worst inconclusive. Further, experience demonstrates that any concern about the risk of transferring a new gTLD registry after a rebid is misplaced. Management and operation of many gTLDs and ccTLDs have been successfully transferred without imposing undue burdens on DNS stability or security. For example, VeriSign successfully transferred the .org registry to the Public Interest Registry in January 2003.

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ICANN's approach to TLD management demonstrates that it has adopted an ineffective approach with respect to its obligation to promote competition at the registry level. We respectfully suggest that the DOC refrain from expressing satisfaction with ICANN's progress toward the goal of promoting competition among TLDs unless and until ICANN develops a credible and effective policy that compels it to employ tools such as competitive bidding to manage TLDs in a manner that safeguards the interests of registrants in obtaining high quality domains at the lowest possible prices. To date, we believe that ICANN has not come close to fulfilling its obligations to employ competitive principles in its management of TLD registry operations.

Sincerely,

Deborah A. Garza

Deborah A. Garza

cc: Kathy D. Smith, Esq.

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[11] We have identified no registry operator that reduced investment because of potential termination.