



**EUROPEAN COMMISSION**

Information Society and Media Directorate-  
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Audiovisual, Media, Internet  
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Markets and cases II: Information, Communication and  
Media

**Acting Director**

Brussels,  
INFSO/A3/JS/

Rod Beckstrom, CEO  
Internet Corporation for Assigned  
Names and Numbers

Peter Dengate Thrush, Chair of the  
Board of Directors  
Internet Corporation for Assigned  
Names and Numbers

**Subject: Removal of vertical separation between registries and registrars for  
new and existing gTLDs**

Dear Mr Beckstrom,  
Dear Mr Dengate Thrush,

Please find attached a non-paper regarding the envisaged removal of vertical separation  
between registries and registrars for new and existing gTLDs.

This non-paper is being sent, for information purposes, to the Department of Commerce  
and the Department of Justice of the US Government.

In view of the ICANN meeting in Singapore, we are looking forward to your response as  
soon as possible.

Gerard de Graaf  
*(e-signed)*

Director

Linsey McCallum  
*(e-signed)*

Acting Director

Encl: Non-paper regarding the envisaged removal of vertical separation between registries and registrars for new and existing gTLDs by ICANN

**CC:**

**Larry Strickling**

Assistant Secretary for Communications and Information and Administrator  
National Telecommunications and Information Administration  
Department of Commerce

**Christine Varney**

Assistant Attorney General, Antitrust Division  
Department of Justice

# **Non-paper regarding the envisaged removal of vertical separation between registries and registrars for new and existing gTLDs by ICANN**

## **A. Background**

### **I. ICANN's position with regard to vertical separation**

1. Vertical separation between registries and registrars has been widely considered a key feature of ICANN's mission to promote competition in the domain name system. The implementation of this principle has been particularly crucial to ensuring a level playing field for competition at the registrar level for the initial three new generic Top-Level Domains (gTLDs) “.com”, “.net” and “.org”. Even though some of the agreements for the new gTLDs introduced in 2000 have featured some degree of registry-registrar cross-operation or cross-ownership, ICANN's subsequent policy has demonstrated its firm commitment to the principle of vertical separation, with the newer gTLD registry agreements generally restricting established registries from owning registrars.
2. On 12 March 2010, the ICANN Board adopted a resolution<sup>1</sup> reiterating its commitment to this principle in the context of the forthcoming introduction of new gTLDs. It stated that *"within the context of the new gTLD process, there will be strict separation of entities offering registry services and those acting as registrars. No co-ownership will be allowed."* It also flagged, however, that *"if a policy becomes available from GNSO, and approved by the Board prior to the launch of the new gTLD program, that policy will be considered by the Board for adoption as part of the New gTLD Program."*
3. On 18 August 2010, the Vertical Integration Working Group of ICANN's Generic Names Supporting Organisation (GNSO) issued an initial report<sup>2</sup> in which it made a number of proposals of how to address vertical integration for the new gTLD program. Given that none of the proposals achieved consensual support<sup>3</sup>, it has so far not made any formal recommendation to the ICANN Board as to how to approach the issue of vertical integration in the future.
4. Despite the lack of a clear recommendation in favour of the full removal of vertical separation by the GNSO, the ICANN Board reversed its approach to vertical separation in a resolution of 5 November 2010<sup>4</sup>. In this resolution, it suggested lifting the existing restrictions on cross-ownership between registries and registrars and replacing them by *"requirements and restrictions on any inappropriate or abusive conduct arising out of registry-registrar cross*

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<sup>1</sup> See Board Resolution of 12 March 2010, section 5 on *"New gTLDs Implementation – Vertical Separation"*, available at <http://www.icann.org/en/minutes/resolutions-12mar10-en.htm>.

<sup>2</sup> *Revised Initial Report on Vertical Integration between Registries and Registrars* of 18 August 2010, available at [gns0.icann.org/issues/vertical-integration/revised-vi-initial-report-18aug10-en.pdf](http://gns0.icann.org/issues/vertical-integration/revised-vi-initial-report-18aug10-en.pdf).

<sup>3</sup> See <http://gns0.icann.org/mailling-lists/archives/council/msg09754.html>.

<sup>4</sup> See Board Resolution of 5 November 2010, section 2 on *"New gTLDs – Cross Ownership Issues for Registries and Registrars"*, available at <http://www.icann.org/en/minutes/resolutions-05nov10-en.htm>.

*ownership*". The resolution also mentioned that *"ICANN will have the ability to refer issues to relevant competition authorities"*.

5. It should be noted that ICANN not only envisages applying this revised approach to new gTLDs, but also intends to permit existing registry operators to transition to the new form of registry agreement. The proposed process for handling such amendment requests<sup>5</sup> foresees a competition review by ICANN in the framework of which any such request can be referred to the responsible competition authorities *"[i]n the event ICANN reasonably determines that removal of cross-ownership restrictions might raise significant competition issues"*. Unless withdrawn, the amendment request will remain in pending status until the competition authority concerned has provided a substantive response upon which ICANN will complete its review.
6. The full removal of restrictions on cross-ownership between registries and registrars envisaged by ICANN has caused serious concerns among GAC members. At the beginning of 2011, the GAC therefore submitted a proposal to ICANN, suggesting that ICANN should *"amend the proposed new registry agreement to restrict cross-ownership between registries and registrars, except in those cases where ICANN has determined that the registry does have, or is unlikely to obtain, market power"* and *"consider the absence of a thorough and reasoned explanation of its decision, the rationale thereof and the sources of data and information on which the Board relied with respect to vertical integration to be inconsistent with its commitments under the Affirmation of Commitments"*. In reply to this request, ICANN decided to provide more information about the rationale for its decision (see below), but rejected the proposal to maintain vertical separation in cases of market power in its Board notes of 4 March 2011.

## **II. The rationale provided by ICANN for the envisaged change**

7. On 25 January 2011, the ICANN Board decided to make the rationale for reversing its decision on registry-registrar separation public<sup>6</sup>. According to ICANN, the decision to allow cross-ownership will have a positive Community impact as it will, at a minimum, help foster competition and innovation. The reasons mentioned by ICANN in support of its position are the following:
  - *"Rules permitting cross-ownership foster greater diversity in business models and enhance opportunities offered by new TLDs."*
  - *"Rules prohibiting cross-ownership require more 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."*

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<sup>5</sup> See <http://icann.org/en/announcements/announcement-02may11-en.htm>.

<sup>6</sup> See draft explanations of 21 February 2011: <http://www.icann.org/en/topics/new-gtlds/gac-board-registry-registrar-separation-21feb11-en.pdf>.

- *"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 behaviour the Board wants to discourage, including abuses of data and market power. (...)"*
  - *"Case-by-case re-negotiation of existing contracts to reflect the new cross-ownership rules will permit ICANN to address the risk of abuse of market power contractually."*
  - *"In the event ICANN has competition concerns, ICANN will have the ability to refer those concerns to relevant antitrust authorities."*
  - *"ICANN can amend contracts to address harms that may arise as a direct or indirect result of the new cross-ownership rules".*
8. In its Board Notes of 4 March 2011 on the GAC New gTLDs Scorecard<sup>7</sup>, ICANN explained its rejection of the GAC proposal to maintain the existing restrictions on cross-ownership in cases of market power as follows: *"ICANN sought to implement a market place model that would enhance competition, opportunities for innovation and increase choice for consumers while preventing abuses in cases where the registry could wield market power. While lifting restrictions on cross-ownership, ICANN reserves the right to refer issues to the appropriate competition authorities if there are apparent abuses of market power. As previously resolved by the Board, registry agreements will include requirements and restrictions on any inappropriate or abusive conduct arising out of registry-registrar cross ownership, including without limitations provisions protecting against misuse of data or violations of a registry code of conduct"*.
9. In the revised version of its Board Notes of May 2011, ICANN complemented this explanation as follows: *"ICANN considered several options with respect to the vertical separation issue, including a blanket prohibition against cross-ownership by registries with market power. The problem with such an ex ante prohibition is that it is overly restrictive; that is, a prohibition of vertical integration based purely on market power is likely to deprive consumers of the competitive benefits of cross-ownership. From a consumer welfare perspective, a better approach is to allow generally pro-competitive vertical integration while referring any potentially suspect arrangements to expert competition enforcement authorities, who can then take action when their ex post expert evaluation determines it is appropriate. This is particularly important because it is difficult to accurately measure market power. Market definition and the evaluation of market power are contentious issues in most antitrust cases and often require complex economic and econometric analysis. Market share can be used as a proxy, but antitrust authorities around the world recognize that this is an imperfect proxy. Moreover, there are various ways to measure market share. Delegating this expert analysis and post ante determination to competition authorities avoids the problem of mistakenly ex ante deterring competitively beneficial vertical integration while also ensuring that consumers are protected when economic conditions merit competition policy intervention."*

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<sup>7</sup> See <http://www.icann.org/en/topics/new-gtlds/board-notes-gac-scorecard-04mar11-en.pdf>, pages 9-10.

## **B. Assessment from a competition policy perspective and resulting concerns**

10. The services of the European Commission have been asked to provide a preliminary opinion on the proposed policy changes from a competition policy perspective. We fully support ICANN's endeavours to strive for market place models fostering competition and innovation for the benefit of consumers. We are, however, concerned about the envisaged full removal of vertical separation between registries and registrars in the framework of the forthcoming introduction of new gTLDs in view of the possible negative implications for competition that such a decision may entail. The implementation of the principle of vertical separation has, to date, had a key role in ensuring a level playing field for competition at registrar level. A move away from that fundamental principle appears premature given the absence of both expert advice based on well-founded empirical analysis of the relevant market and consensus among stakeholders. In such circumstances, the risks of a negative market outcome for consumers appear real.
11. ***Potential harm to competition resulting from vertical integration:*** It should be noted that all expert reports commissioned by ICANN to evaluate the benefits of vertical integration between registries and registrars recognised not only the potential to yield pro-competitive benefits, but also the risk of anti-competitive effects. CRA International's report of 23 October 2008<sup>8</sup> pointed, inter alia, to the risk that integrated registries could have incentives to discriminate against non-affiliated registrars by, for example, offering lower prices and providing better operational support services to their affiliated registrar or granting it privileged access to competitively sensitive information. In the same vein, the Salop & Wright report of 28 January 2010<sup>9</sup> highlighted that vertical integration could harm competition in terms of higher prices, lower quality levels, too little product variety or less innovation, most likely in cases in which the integrated registry or registrar enjoyed market power.<sup>10</sup>
12. That these concerns do not only reflect a remote possibility is demonstrated by several investigations launched by the European Commission's Directorate-General for Competition under EU competition rules in the past. These investigations were closed once vertical separation between the registry and registrar businesses concerned had been ensured.
13. ***Lack of data supporting the full removal of vertical separation:*** ICANN has as yet provided no substantive economic data that would 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 between registries and registrars, in particular with regard to existing gTLDs. Neither has ICANN satisfactorily demonstrated that the full

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<sup>8</sup> Report by CRA International on "*Revisiting Vertical Separation of Registries and Registrars*" of 23 October 2008 (CRA Report), in particular section 5.

<sup>9</sup> Report by Steven C. Salop and Joshua D. Wright on "*Registry-Registrar-Separation: Vertical Integration Options*" of 28 January 2010.

<sup>10</sup> According to ICANN Board briefing material for the meeting of 24-25 September 2010, these concerns are shared by registries and commercial stakeholders who "*generally want to prohibit registrars from running registries (and vice-versa) based on the theory that allowing registry-registrar cross-ownership would make it easy for registries that are co-owned with registrars to take advantage of registry data to charge high prices for valuable registrations*", available at <http://www.icann.org/en/minutes/board-briefing-materials-1-25sep10-en.pdf>, page 54.

removal of vertical separation between registries and registrars is indeed likely to benefit consumers in the form of lower prices and enhanced services.

14. According to figures from February 2008<sup>11</sup>, the original three gTLDs and the “.com” domain in particular continue to dominate the number of total domain name registrations. Of a total of 99.8 million domain names registered in gTLDs until that point in time, 74% were registered in the “.com” domain, 11% in “.net” and 7% in “.org”. This confirms that even almost a decade after its launch, the “.com” domain continues to be by far the economically most important domain. The data also shows that 85% of the domain name registration market depends on one single company, VeriSign, which is currently still operating both the “.com” and the “.net” registry.
15. According to the same figures<sup>12</sup>, the gTLD registrar industry, in contrast, seems rather unconcentrated with hundreds of registrars active in several of the existing gTLDs. It should, however, be noted that ICANN has so far not published any data on cross-ownership at registrar level.
16. ***Lack of consensus within the GNSO and among stakeholders:*** It is noteworthy that none of the proposals contemplated by ICANN during the last months has achieved consensus support within the GNSO or by stakeholders. What is more, the public comments received by stakeholders on the GNSO’s initial report on vertical integration between registrars and registries<sup>13</sup> revealed that most stakeholders believe that the existing model of vertical separation is, as a default, the best approach for the benefit of end consumers. A majority of stakeholders thus favour maintaining the existing cross-ownership restrictions, albeit subject to limited exceptions to accommodate initially small start-up registries and registries in specific situations (e.g. Single Registry, Single User TLDs and community TLDs).
17. There is thus no agreement among those familiar with or even operating in the domain name market about whether or not vertical separation between registries and registrars should be maintained. This supports the conclusion that abolition of the principle of vertical separation, that has so far served its purpose well of ensuring competition at registrar level, would be premature..
18. ***Procedural concerns:*** The envisaged removal of vertical separation is centred on ICANN’s ability to refer an application to the relevant antitrust authorities for “*expert analysis and post ante determination*” in case of competition concerns. This approach fundamentally disregards the fact that competition authorities’ powers are typically limited to an ex post enforcement of competition rules on the basis of a case by case market analysis. It also raises a number of procedural concerns. First, it is not clear on what basis and according to the laws of which jurisdiction ICANN would determine the existence of competition concerns. Second, absent an express obligation, the referral to the relevant competition authorities remains entirely at

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<sup>11</sup> CRA Report, page 22.

<sup>12</sup> CRA report, pages 19-20. According to these figures, the ten largest registrars accounted for 66% of the existing gTLD domain names in 2008, while the remaining share was split among 862 accredited registrars.

<sup>13</sup> Summary of public comment on initial report on vertical integration between registrars and registries published on 18 August 2010, available at <http://forum.icann.org/lists/vi-pdp-initial-report/pdfXUfFrw6qO.pdf>, as well as ICANN Board briefing material for the meeting of 28 October 2010, available at <http://www.icann.org/en/minutes/board-briefing-materials-2-28oct10-en.pdf>, Annex B, pages 73-77.

ICANN's discretion. Third, it is also not clear if and to what extent ICANN would be obliged to take the relevant competition authorities' evaluation into account when ultimately deciding on whether or not to grant an application.

19. It should be noted that ICANN's current board governance rules allow contracted parties such as registrars to have seats as directors and that this has indeed been the case in the past. Besides, ICANN appears to depend to a substantial extent on the funding by registries and registrars and thus by parties that have a direct financial interest in its decisions. Both issues may cast doubts on the impartiality of its decision-making.
20. A second pillar of the envisaged removal of vertical separation appears to be the new Code of Conduct which ICANN considers to include adequate protections against the abuse of market power. Monitoring compliance with and sanctioning breaches of these rules is likely to place a considerable permanent burden on ICANN. Given the large numbers of gTLDs that are expected to be introduced in the future, it is doubtful whether ICANN will be able to devote sufficient resources to deal with these tasks in an appropriate and efficient manner.

### **C. Conclusion**

21. In the light of the above, we urge ICANN to reconsider its intention to fully remove vertical separation between registries and registrars in the context of the forthcoming introduction of new gTLDs. In view of the concerns outlined above, we consider it preferable to dissociate such a fundamental decision from the new gTLD launch process and maintain for the time being and, subject to the gathering of further data, the existing rules on vertical separation between registries and registrars for both new and existing gTLDs subject to limited exceptions for clearly pro-competitive cases.
22. As regards the question of whether the existing rules on vertical separation between registries and registrars should be partially or entirely lifted, we believe that any such decision should be sufficiently backed up by economic and legal analysis and supported by a majority of stakeholders. We therefore urge ICANN:
  - to seek further independent economic and legal expert advice to evaluate the current state of the domain name market and the impact of the currently existing restrictions on vertical integration as well as a partial or entire lifting thereof on innovation and consumers,
  - to provide fresh market data on the level of competition and cross-ownership currently existing at registry and registrar level,
  - to provide documents and data supporting the different arguments put forward in support of the envisaged full removal of vertical separation (see paragraph 7 above), and
  - to provide comments on how ICANN envisages addressing the procedural concerns raised above.

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