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From: Alexa Raad

Date: Wed, 9 Sep 2009 15:40:48 -0700

To: Peter Dengate Thrush

Cc: Rod Beckstrom , Doug Brent , Kurt Pritz , Diane Schroeder , Hal Lubsen , "Neuman, Jeff"

Subject: Afiliias/Neustar/PIR view on the Registry Registrar Vertical Integration Proposal

Dear Peter

Attached please find a document co-authored by Afiliias, PIR and Neustar on the salient issues facing the board re the proposed Registry/Registrant vertical integration. The paper aims to map out some of the risks associated with the proposal while at the same time proposing a path forward that does not jeopardize any further delay in the new gTLD launch process.

The main issues are summarized on page two. Even though we know the board has a heavy agenda, we appreciate the opportunity for the paper will be circulated and discussed.

Many thanks in advance.

P.S.

(Diane, would you kindly circulate to the board list)

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REGISTRY AND REGISTRAR SEPARATION POLICY

The Registrant Pays the Check

ICANN staff is proposing a change to the longstanding policy of separation between registries and registrars to permit vertical integration in the newTLD round. This proposal represents a fundamental change in ICANN policy and the market structure for domain names.

As of today, the Commercial and Business Users Constituency, the Intellectual Property Constituency, the Non Commercial Users Constituency, the Registry Constituency, the Government Advisory Committee, and the Internet Commerce Association (representing domainers), respectively, have either raised concerns about or opposed the proposed vertical integration of registries and registrars. The NCUC will call for a Policy Development Process (PDP) on the issue of vertical separation which could have the effect of delaying the launch of the newTLD round if vertical integration is adopted.

ICANN first adopted its policy on separation of the registry and registrar functions in 1999, in the course of negotiations with Network Solutions. At the time, this policy was intended primarily to facilitate competition and prevent use by the NSI registry of revenue and/or information from the registrar (and vice versa) to disadvantage competitors. By 2000, **it was clear that the vertical separation policy was serving consumer protection values that included – but went far beyond – competition.** As a result, the prohibition against registries owning controlling interests in registrars or distributing their own TLD was included – without discussion, in the contracts for new gTLDs such as .biz, .info, and .pro. No additional steps were needed to apply the vertical separation requirement to back-end service providers – the established provider, Verisign, was subject to the provision via its agreement with ICANN.

New entrants into the registry services provider market, Afilias and Neustar, also applied for and were awarded registries (.info and .biz, respectively) and the separation requirement was implemented via their contracts for these registries. .Museum secured a modest exception to this rule, given the nature of its operations. .Coop sought, but did not receive, a similar exception. The policy was continued in the subsequent ICANN accredited registry contracts for top level domains (TLDs) in 2005. Today over 99% of domain names in gTLDs have been registered under the vertical separation policy applicable to all registry operators and all back-end registry service providers. The policy has resulted in explosive and vibrant competition for domain name registrations at both the registrar and registry levels that continues today.

Summary of Points

- **Since its inception, it was clear that the vertical separation policy was serving consumer protection values that included – but went far beyond – competition.**
- **Eliminating the vertical separation restraints under the current top down process could result in significant delay in the newTLD round.**
- **Studies to date have not fully addressed how such a change would benefit consumers and registrants, nor have they included an analysis of the potential harm to domain name registrants of permitting registrars to operate as new gTLD registries while selling in their own string.**
- **The vertically integrated registry/registrar will create an environment that is ripe for “insider trading” opportunities using data that is commercially sensitive and available uniquely to the registry operator.**
- **Permitting vertically integrated registry/registrar operations will eliminate certain current penalties that discourage abusive practices.**
- **Registrars divided: “Right now, our industry has conflicts of interest and it is putting personal short-term gain ahead of long term commercial interests,’ says Joe White at the Gandi registrar.**
- **Since registry service providers or “backend” providers offer functionally equivalent services as registry operators, the application of existing policy to registry services providers is appropriate and necessary to effectuate the longstanding pro-competition and end user protection goals of the policy.**
- **ICANN need not delay the new TLD round on the basis of the vertical separation issue. ICANN can proceed by continuing the policy of separation for registry operators and registry service providers in the new round while the community, if necessary, launches a PDP that can appropriately address the fundamental economic and registrant impact issues on a parallel track.**

Process, process, process

At the moment, ICANN staff has been promoting the view that the vertical separation policy should be changed. However, important questions about the *process* for changing such a fundamental policy, particularly one that has a far reaching impact on end users and the industry, have not been addressed. “Review” of the vertical separation policy was initiated by ICANN staff who then commissioned Charles River Associates (CRA) to do a report on the issue. The ultimate version of the CRA Report actually underscored the complexity of the issues that must be analyzed and recommended that ICANN proceed cautiously before making a change in policy. ICANN’s own experts have said that the economic and competition questions to be addressed *before* ICANN can make such a change are complex, require a case-by-base approach and require significant data collection and analysis.

Before moving forward with vertical integration in the newTLD round, ICANN must explain to the community why it did not use the PDP set forth in its bylaws to introduce changes of this magnitude in longstanding ICANN policy. The NCUC’s pending call on ICANN to launch a PDP seeks to preserve the “bottom up” ICANN policy making process. ICANN staff’s management of this issue to date has been entirely top down. **Attempting to eliminate the vertical separation restraints under the current top down process could result in significant delay in the newTLD round.** The complexity of the issues and the distinct interest in the policy by a number of constituencies who want to ensure that comprehensive analysis is undertaken will certainly push the PDP beyond the envisioned launch date for the newTLD round. Additional considerations, such as the need for a transition period if vertical integration is allowed, will push the envisioned launch date out further. Such unnecessary delay would disappoint many constituents and potential new TLD applicants who have been anticipating a timely launch.

What about the registrant?

To date, much of the discussion of the vertical integration issue has centered on the impact to registrars and registries. One important element of the analysis that must be undertaken before eliminating vertical restraints is a study of both the potential benefits and the potential harms to registrants resulting from such a change. The Government Advisory Committee (GAC) in a recent communiqué to the ICANN Board stated, “[f]urther concerns have arisen regarding the apparent desire to alter existing policy that requires a structural separation between registrars and registries. Change to this policy should be guided primarily by whether and how such a change would benefit consumers and registrants. **Studies to date have not fully addressed this aspect of the marketplace, nor have they included an analysis of the potential harm to domain name registrants of permitting registrars to operate as**

new gTLD registries.”¹ In particular, ICANN must analyze how registrants will be affected by: 1) a registrar’s access to registry data and how that could be leveraged in the market; and 2) the impact of the consolidated financial position of the integrated registry/registrar on existing behaviors.

Clearly, registrants may be harmed by an integrated registry/registrar operation’s ability to identify high value domains, hold those domains off the market (either directly or through affiliates) and to then monetize them at a premium price. These practices render the domain name unavailable to the “first-come” registrant or force that registrant to pay a higher price than the standard retail offer. These practices, in their various forms, are the equivalent of domain name scalping where a registrant is forced to pay a price that is a multiple higher than the “face value” or standard retail price. ICANN established a “first-come-first-serve” system to ensure that all prospective domain name registrants have a non-discriminatory opportunity to register the domain name(s) they seek. Such a system is necessary to ensure registrant confidence in both the fairness of the registration system and in ICANN as the entity that sets the rules of the road.

The short history of the domain name market has witnessed creative approaches to gaming the first-come-first-serve system through domain name tasting, front running, kiting etc. While these practices may have occurred outside a vertically integrated registry/registrar, sufficient analysis has not been done to examine how these types of practices could be enhanced through a vertically integrated structure. In our opinion, **the vertically integrated registry/registrar will create an environment that is ripe for “insider trading” opportunities using data that is commercially sensitive and available uniquely to the registry operator and is rife with conflicts of interest for both the registry and the registrar in question.**

Insider Trading

Webster’s dictionary defines insider trading as “[t]rading by people who have access to material, non-public information that allows them to make a substantial profit by either buying or selling the company’s securities (usually stock).” Replace the word “securities” with “domain names” and add a vertically integrated registry/registrar and you have an environment where access to non-public registry data creates incentives for profiting from a form of insider trading. Another concern is that by **permitting vertically integrated registry/registrar operations ICANN will eliminate certain penalties that discourage abusive practices.** For example, it does not appear that ICANN has considered how the consolidated financial position of an integrated registry/registrar would impact existing financial disincentives to engage in domain tasting. Our understanding is that the financially consolidated

¹ GAC comments on version 2 of the newTLD Draft Applicant Guidebook, August 19, 2009.

registry/registrar operator eliminates as much as 94% of the current penalties.² Moreover, a vertically integrated registry would be in a position to provide 100% refunds to its affiliated registrar by granting an exemption request in the event of “extraordinary circumstances” – the definition of which is left exclusively in the discretion of the registry. While there are reporting requirements that are designed to capture these types of requests, a creative registry/registrar can navigate around them.

One can also imagine the creative approaches that could be employed by an integrated entity, especially one that controls over 100 registrars, who can quickly run up the number of refunded or exempted registrations to make the excess deletes practice more interesting. Any remaining costs for the vertically integrated entity would be nominal and would be more than offset by revenue generated from the use of registry data to engage in more targeted, “smarter tasting.” These new forms of tasting would be more targeted and hence attractive to ensure ROI that exceeded any minimal remaining costs. Without separation, enforcement and compliance efforts can be severely hobbled.

On a related front, ICANN recently released reports that touted both the “end” of domain tasting and the non-existence of front running. But the third party used to conduct the survey on front running, though reputable, reached its conclusion by reviewing zone file data notwithstanding Network Solutions’ previous disclosure that its practice was to withhold registration data from the zone file after registering the names in question. Simply put, they looked in the wrong place to see if front running had occurred.

Given the fact that the new round could introduce hundreds of new registries, ICANN’s ability to create and enforce effective safeguards against such practices is of paramount concern, particularly where registries may be operated by registrars known to have employed these practices in the past. The policies and procedures in place today that permit ICANN to declare “mission accomplished” on domain tasting were developed, implemented and promoted by registries. A vertically integrated registry would be the beneficiary of its affiliated registrar’s sharp practices, and would not have the incentives that exist today to be part of the solution. This shift, combined with ICANN’s enforcement track record, is unlikely to create market conditions that engender confidence and protect registrants.

² Currently, a registrar is not refunded for excess deletes in a given month beyond the initial 50 or 10% of its “net new” registrations, whichever is greater. Thus a registrar is penalized by not receiving a refund for the remaining 90% of net new registrations in the given month period. Additionally, the registrar is still liable to ICANN for the registrar fee associated with net new registrations (currently .18 cents per registration). The registry is also liable for the registry fee to ICANN but that fee is typically included in the registration price paid by the registrar to the registry. In a vertically integrated registry/registrar, the withheld refund monies for net new registrations in excess of the initial 50 or 10% remain with the affiliated registry. From a consolidated financial perspective, the withheld refund is a wash transaction. Calculations based on these facts show that at least 94% of the current penalty is eliminated in the vertically integrated structure.

Registrar Flip Flopping

“All in all, I think this is something we may want to look into more. When a Registry simply starts bypassing Registrars, I have great concerns.”

Rob Hall of Momentus on GNR registry owning a registrar selling the .name TLD. Registrar Constituency Listserv, January 28, 2003.

The proposed vertical separation policy change is being driven by a small number of registrars who are, ironically, the very same registrars that complained bitterly about the potential for abuses in former vertically integrated registries and registrars. Complaints focused on registrar access to registry data, on unique cross-subsidization opportunities and on the “anti-competitive” effects of services such as Wait List Service. These same registrars also complained vehemently against the combined .name registry/registrar on the grounds that control of the registrar was anti-competitive.³ It is ironic to compare their statements concerning registry/registrar integration when somebody else was doing it compared to their statements when the prospect of vertical integration would be available to them to exploit.

Paul Stahura of Demand Media, in a lawsuit brought against ICANN by eNom and other registrars, complained that VeriSign’s controlled registrar, Network Solutions, was the first registrar to offer preregistrations of WLS and would uniquely benefit from WLS due to a reduction of net loss of domains when they were deleted and reregistered under the proposed service.⁴ Ironically, this registrar and many others offer “wait list” or “drop name” type services that were the focus of their earlier objections.

³ The .name TLD registry launched its own registrar but under intense pressure from the Registrar community about the potential abuses by the integrated registrar, sold off its registrar business. The .museum and .pro TLDs were also exceptions to the integrated registry/registrar policy. .museum is vertically integrated but is subject to a cap of 5,000 registrations beyond which it must use ICANN accredited registrars for distribution. .pro was launched as a vertically integrated registry that was not allowed to distribute its own TLD above a cap of 5,000 names.

⁴ Case No. CV03-5045 JFW (MANx), October 6, 2003.

Bhavin Turakhia from DirectI on GNR's controlled registrar selling .name TLD stated a common complaint of registrars: "past experience has led me to believe that on several occasions [sic] registrars who also run a registry have taken advantage of that position, either by having access to information, or the ability to control transfer pricing etc." "I would wish to see ICANN implement stronger controls and measures of audit, for those Registries who are also Registrars (or viceversa) to ensure that issues such as Transfer pricing are taken care of. It is my experience however that transfer pricing or other arrangements between a Registry and Registrar who have close ties are extremely difficult to detect or control." Registrar Constituency Listserv, January 23, 2003.

Some of these same registrars have made an art form of gaming the "first-come-first serve" system designed to provide registrants non-discriminatory access to domain names. Indeed some of these practices have provoked strong responses from the community to minimize or eliminate them.

The reality is that outside the registrar community there is broad concern about vertical integration and even within the registrar community opinion is far from united in favor of vertical integration. Registrars of all sizes have voiced concerns about the impact on competition of proposed vertical integration and a number of registrars have noted their support for the continuation of the separation policy (see www.registryregistrar-separation.org). Larger registrars, such as Register.com have voiced strong opposition to proposed integration. Gandi, a French registrar, commissioned a survey about the newTLD round that calls on registrars to "clean up" their approach to domain name monetization. The Gandi Report states:

"Right now, our industry has conflicts of interest and it is putting personal short-term gain ahead of long term commercial interests," says Joe White at Gandi. For example, some registrars take available domains out of circulation, so customers can't get them, then advertise on them for profit. Or they place ads on dormant sites to generate revenue when they're not used, thereby filling the web with more junk domain space. 'As an industry, we have to grow up and accept lower sales volume for the sake of maintaining a useable and available name space that is in the interest of all internet users,' says White. 'If we just go all-out for profit, much like the current man-made global pollution problem, we'll just trash our own domain name space.'

Gandi.net: The Liberalisation of the Internet, June 9, 2009, pp. 32.

The Gandi Report goes on to cite conflicts-of-interest and a number of questionable registrar practices that must be addressed in the context of the newTLD round:

“List of shady domain name practices edited from Gandi Bar:

1. Sneaky pricing: Different pricing for register (buy now, £0.99 per year!) and renewal (oops, it costs more next year): Different pricing for transfers out (oh, you want to leave, that’ll be £xx): The cost of a .co.uk at the registry is £2.50 per year (\$4, €2.9 at current exchange rates). Companies selling below this have an ulterior motive!
2. Service restrictions - Can’t get full DNS control - pay more for additional services.
3. Front running/’sniffing’ - Using your domain search data to buy domains before you do, or selling your domain search data. More references.
4. Account lock-ins - Locking your account for a period following changes, prevents transfer-outs.
5. Domain ownership - Not the owner of your domain? Some companies buy it on your behalf and then rent it to you.
6. Privacy - Selling your whois data/customer data.”

Gandi.net: The Liberalisation of the Internet, June 9, 2009, pp. 33.

All of the above practices will be magnified in a vertically integrated registry/registrar where they market their own TLD string.

One certainty in a sea of change

The new round of TLDs may dramatically alter the DNS landscape by introducing hundreds of new TLDs and new opportunities for registrants to establish their home on the Internet. While consumer benefits could be significant, the road so far has not been particularly smooth. The scope of the round alone has created unique challenges for ICANN and ICANN has not yet developed the enforcement muscle it needs to address harmful practices that are in the market today.

Continuing the policy of vertical separation is important to ensuring a quality and fair experience for the domain name registrant. It is critical to note that the potential abuses can be perpetrated through both the registry operator and the registry services “backend” provider. **Since registry service providers offer functionally equivalent services as registry operators, the application of existing policy to registry services providers is appropriate and necessary to effectuate the longstanding pro-competition and end user protection goals of the policy.** Regulatory agencies

routinely apply existing policy to new forms of service providers and new technologies as they emerge in the marketplace.⁵ Pro-competitive and pro-consumer policies would be meaningless if new forms of functionally equivalent service providers or technologies could be used to circumvent the policies and to perpetrate harms that are the focus of the policies in the first place.

While the PDP on vertical separation could examine issues such as benefits and harms to registrants and the possible incentives created by vertical integration, it is important to continue the separation policy for registry operators and registry services providers alike in the new round to protect registrants. Preventing abuse either through the registry operator or the registry service provider is critical to protecting the registrant and building ICANN's credibility as a responsible steward of the DNS – particularly in a post JPA world.

Straight Path to the Finish Line

ICANN need not delay the new TLD round on the basis of the vertical separation issue. ICANN can proceed by continuing the policy of separation with full effect for registry operators and registry service providers in the new round while the community launches the PDP that could address the fundamental registrant impact issues on a parallel track. Contrary to the outcries of certain registrars, this approach leaves the door open for many new applicants and the entry of new competitors in the TLD registry market. No doubt, most if not all new entrants will apply regardless of a decision to continue the policy. Registries have not advocated against the entry of registrars and other entities in the registry market. Rather, registries have simply argued for the continuation of the existing policy that constrains registries from distributing or selling their respective TLDs. This policy has provided both benefits and protections for domain name registrants and should only be changed only after appropriate process and careful, comprehensive study.

As for Public Interest Registry, Neustar and Afilias, continuation of the vertical separation policy for registry operators and registry services providers ensures important protections for registrants in a market that will soon include hundreds of new TLD choices. We welcome new competition in the TLD registry market by registrars as long as they are restrained from selling their own TLD and we support the RyC supermajority position on the CRA Report⁶. We maintain that the current restraint against a registry distributing its own TLD should be maintained to avoid creating incentives to abuse registry data and to protect the registrants and other registrars from unfair gaming of the registration system.

⁵ Examples include the U.S. Federal Communication Commission treatment of 911 obligations for VoIP providers; U.S. Federal Trade Commission efforts to combat fraud and protect consumers as practices migrated from “brick-and-mortar” to online fraudulent activities; and the E.U. Commission’s efforts to apply competition policy to emerging online services.

⁶ <http://forum.icann.org/lists/2gtld-guide/msg00083.html>