

Dear ICANN Board member,

As the Board continues its resolution of the vertical integration issue, we wanted to raise an additional issue with you. We have already presented exhaustive arguments supporting the RACK+ proposal, and will not take your time to restate them here. One issue, among others, that has been raised which we have not yet addressed was whether vertical Integration proposals that restrict cross ownership between registries and registries might present an increased risk of litigation liability for ICANN. When this issue was recently raised, we asked an outside competition law firm to provide counsel on this question. After conferring with counsel today, we attach a memorandum prepared by Wiltshire Grannis along with an executive summary that I prepared for your consideration. We remain at your disposal for any questions you may have.

Respectfully submitted,
Brian Cute

Executive Summary

The attached legal memo discusses the limited risk of liability for ICANN if it adopts proposals from the Vertical Integration Working Group that restrict cross ownership between registries and registrars as well as backend registry service providers and registrars. The memo states that ICANN would not be exposed to liability under Sections 1 or 2 of the U.S. Sherman antitrust act and makes three general points:

1. ICANN is not liable for conspiring with market participants to restrain trade. Rather than conspiring with other market participants to restrain trade, ICANN would be implementing vertical integration restrictions based on its own independent analysis of the pro-competitive benefits of such restrictions.
2. Courts apply the “Rule of Reason” to determine whether a practice is a restraint of trade and engage in a three-part inquiry. ICANN would not be liable if ICANN adopted the RACK+ proposal since the court would ask the following three questions:

- What is the competitive harm resulting from the alleged practice (15% cross ownership caps)?

In the case of Vertical Integration proposals that restrict cross-ownership, even if the eligibility requirement excludes most registrars, the antitrust laws are designed to protect *competition*, not individual competitors.

- Are there any pro-competitive benefits of the challenged practice (15% cross ownership caps)?

There are pro-competitive benefits to 15% cross ownership caps. Vertical integration of registries and registrars poses a high risk of anti-competitive behavior. For example, vertical integration could incentivize collusion among registries that own registrars to grant favorable treatment to affiliated registrars to promote their own gTLDs. Collusion between affiliated registries and registrars could certainly result in higher prices to consumers. It would also harm competition among registries at the wholesale level, and registrars at the retail level.

- Are there less restrictive means than the challenged practice (15% cross ownership caps) to obtain the same result?

The court only reaches this inquiry if potential plaintiffs can prove that ICANN acted in agreement with others when establishing its eligibility requirements. ICANN is entitled to construct its bidding process to distribute gTLDs in the manner that it believes will maximize consumer welfare without restriction.

3. A rule allowing vertical integration would require extensive additional monitoring for anticompetitive behavior by integrated registries and registrars after the bidding process is complete. ICANN simply does not have the resources to police the activities in the market. Reasonable eligibility requirements that will create a structural solution eliminating the need for costly additional monitoring could not trigger antitrust liability.

Vertical Separation Safeguards for New gTLDs Do Not Create Significant Antitrust Risk

As part of the Internet Corporation for Assigned Names and Numbers (“ICANN”) Generic Names Supporting Organization policy development process (“PDP”) on vertical integration rules for the new gTLD round, several stakeholders have proposed structural limits on the eligibility of parties to operate new gTLD registries. In particular, a proposal in the Vertical Integration PDP Working Group called the “RACK+” proposal supported by a broad number of participants¹ restricts cross ownership of (1) registrars and registries, and (2) registrars and registry backend service providers, with a safe harbor for minority (less than 15%) ownership. These eligibility limitations have substantial advantages for ICANN. Most importantly, these structural safeguards will radically reduce the need for continuous monitoring for anticompetitive behavior by affiliated registries and registrars. Contrary to assertions made by some during the PDP process, ICANN would not face antitrust liability by adopting the proposed safeguards in the RACK+ proposal.

*ICANN will not face antitrust liability under § 1 of the Sherman Act.*² A registrar may bring a claim under Section 1 of the Sherman Act against ICANN for conspiracy to restrain trade by restricting eligible bidders to registries that are not vertically integrated with registrars. Such a claim would fail because there would be no conspiracy between ICANN and a third party and because such a policy would not restrain trade. In addition, ICANN would have no economic motivation to participate in such a conspiracy to restrain trade—a fact that any potential plaintiff would have to overcome.

As an initial matter, a potential plaintiff registrar must prove that there was a conspiracy: *i.e.*, that ICANN reached an agreement with others when making its decision to impose these eligibility restrictions on the competitive bidding process, as opposed to imposing those restrictions as the result of its own independent action.³ Unilateral conduct, regardless of its competitive effect, is not governed by Section 1.⁴

Here, implementation of a proposal limiting vertical integration would fall far short of the standard necessary to establish a conspiracy in restraint of trade. Rather than conspiring with other market participants to restrain trade, ICANN would be implementing vertical integration restrictions based on its own independent analysis of the pro-competitive benefits of such

¹ The RACK+ proposal is supported by Afilias, PIR, GoDaddy, Ron Andruff of RNA Partners Inc., Sébastien Bachollet in his individual capacity, Olga Cavalli in her individual capacity, Anthony Harris of the Latin American and Caribbean Federation for Internet and Electronic Commerce (eCOM-LAC), Alan Greenberg in his individual capacity, Cheryl Langdon-Orr in her individual capacity, and Jothan Frakes in his individual capacity.

² 15 U.S.C. § 1.

³ *Matsushita Elec. Indus. Co., Ltd. v. Zenith Radio Corp.*, 475 U.S. 574, 588 (1985) (citing *Monsanto Co. v. Spray-Rite Service Corp.*, 465 U.S. 752, 764 (1984)) (antitrust plaintiffs “must present evidence ‘that tends to exclude the possibility’ that the alleged conspirators acted independently”).

⁴ *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752, 769 (1984) (concerted action under Section 1 can only occur when “two or more entities that previously pursued their own interests separately . . . combin[e] to act as one for their common benefit” in the restraint of trade).

restrictions and developed through its PDP. ICANN's decision will be the result of thorough examination of the results of the PDP, including independent economic analysis and reports.

The fact that ICANN's participation in a putative conspiracy would also be economically irrational heightens the hurdle a plaintiff would have to overcome to prove a conspiracy, which means that the existence of a conspiracy cannot be simply inferred. "[I]f the factual context renders [plaintiffs'] claim implausible—if the claim is one that simply makes no economic sense—respondents must come forward with more persuasive evidence to support their claim than would otherwise be necessary."⁵ In the absence of "any rational motive" to join an alleged conspiracy, "refusal to deal could not by itself support a finding of antitrust liability."⁶

Here, participation in any alleged conspiracy would clearly be economically irrational: ICANN would likely *lose* revenue as a result of eligibility requirements limiting vertical integration. A restriction on eligible bidders would reduce any revenue ICANN would receive from entries to the competitive bidding process. ICANN also stands to lose additional revenue that it would receive from the fixed per-name registration fees to the extent that the eligibility requirement restricts potentially successful operators from bidding for new gTLDs. Because ICANN's eligibility restrictions are contrary to its economic interest, potential plaintiffs will indeed be required to present "more persuasive evidence" of conspiracy. But they will be unable to meet this higher standard, especially given both the extensive evidence of ICANN's independent analysis and the fact that there simply is no such conspiracy. In the absence of a conspiracy, there can be no Section 1 violation.

Even if a potential plaintiff can demonstrate a conspiracy amongst registries seeking to exclude certain classes of registrars or backend providers from the competitive bidding process, ICANN will face no liability.⁷

Recent changes in the law will make it even easier to have a Section 1 claim dismissed. Courts now impose a heightened pleading standard on plaintiffs, meaning that plaintiffs must allege more specific facts to support their claims if they hope to survive a motion to dismiss.⁸ For a Section 1 claim, a potential plaintiff must present "enough fact to raise a reasonable expectation that discovery will reveal evidence of illegal agreement."⁹ The Supreme Court has specifically held that "conclusory allegation of agreement at some unidentified point does not supply facts adequate to show illegality."¹⁰ In other words, a potential plaintiff will have to provide enough facts about a conspiracy to jump this new, higher hurdle to survive a motion to

⁵ *Matsushita*, 475 U.S. at 587.

⁶ *Id.*

⁷ *See, e.g., VeriSign, Inc. v. Internet Corp. for Assigned Names and Numbers*, No. CV 04-1292, 2004 U.S. Dist. LEXIS 29965 (C.D. Ca. May 18, 2004) (ICANN dismissed as defendant in conspiracy to restrain trade where plaintiff claimed that VeriSign pressured ICANN to make contract).

⁸ *See Bell Atl. Corp. v. Twombly*, 550 U.S. 544 (2007).

⁹ *Id.* at 556.

¹⁰ *Id.* at 557.

dismiss—enough to show that a conspiracy is not merely conceivable, but actually plausible.¹¹ And as noted above, the fact that such a conspiracy would be economically irrational from ICANN’s perspective will mean that a potential plaintiff will have to allege even more facts to make any inference of a conspiracy plausible.

If a plaintiff can prove a conspiracy, the court will consider whether the challenged practice is a restraint of trade. To consider whether a practice is a restraint of trade under Section 1, courts apply the Rule of Reason.¹² The court engages in a three-part inquiry: (1) what is the competitive harm resulting from the alleged practice? (2) Are there any pro-competitive benefits of the challenged practice? (3) Are there less restrictive means than the challenged practice to obtain the same result?¹³ In this instance, the challenged practice would be the eligibility requirements to participate in competitive bidding to become a registry operator for a new gTLD.

Competitive Harm. A potential plaintiff registrar will be unable to show a competitive harm. First, even if the eligibility requirement excludes most registrars, the antitrust laws are designed to protect *competition*, not individual competitors.¹⁴ Therefore, a registrar that ICANN finds ineligible to bid would not be able to state an antitrust harm based on its own exclusion from the competitive bidding process, where such bidding is otherwise pro-competitive.

A potential plaintiff might argue that restrictions on vertical integration will cause higher prices, although ICANN’s previous experience with the Network Solutions, Inc. (“NSI”) monopoly tends to show that vertical integration itself—as opposed to restrictions on vertical integration—will cause higher prices for consumers. Indeed, Professors Salop and Wright, who generally favor vertical integration, have conceded that vertical integration potentially could result in “higher prices, lower quality levels, too little product variety, or less innovation.”¹⁵ A potential plaintiff registrar, however, might argue that eliminating the registry would create additional efficiencies and therefore lower prices. But higher prices alone are not enough to prove anticompetitive conduct, without further evidence of such conduct.¹⁶ As the Supreme Court discussed in *Leegin Creative Leather*, many legitimate business decisions might result in higher prices, including decisions to improve quality or promote awareness.¹⁷ Even if higher prices were to result from restrictions on vertical integration—which is contrary to the expected results and ICANN’s own previous experience—such prices would be completely justifiable as a

¹¹ *Id.* at 570.

¹² *Texaco Inc. v. Dagher*, 547 U.S. 1, 5 (2006).

¹³ P. Areeda, *The “Rule of Reason” in Antitrust Analysis: General Issues*, 2 (Federal Judicial Center) (1981).

¹⁴ *Brown Shoe Co. v. United States*, 370 U.S. 294, 344 (1962) (“It is competition, not competitors, which the [Sherman] Act protects”).

¹⁵ Steven C. Salop & Joshua D. Wright, *ICANN, Registry-Registrar Separation: Vertical Integration Options*, 1 (2010), <http://www.icann.org/en/topics/new-gtlds/registry-registrar-separation-vertical-integration-options-salop-wright-28jan10-en.pdf>.

¹⁶ *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 551 U.S. 877, 896-97 (2007).

¹⁷ *Id.* at 896.

result of reasonable efforts to facilitate competition, spur innovation, or reduce the risk of anticompetitive action or collusion by affiliated registries and registrars.

A potential plaintiff might also argue that, without vertical integration, new gTLDs will be at a competitive disadvantage to established gTLDs like .com and .net because of a lack of name recognition. This type of disadvantage is inherent to new entry into a market, however, and is not a “harm” that the antitrust laws are designed to address. In short, a potential plaintiff will not be able to argue any competitive harm that passes the “sniff test”—there is no competitive harm in vertical separation requirements designed to *promote* competition in the gTLD market.

Pro-Competitive Benefits. In applying the Rule of Reason, courts must also consider pro-competitive benefits of the challenged practice.¹⁸ Here, ICANN is clearly trying to avoid the competitive harms resulting from vertical integration in this market amply demonstrated by the NSI monopoly.¹⁹ Vertical integration of registries and registrars poses a high risk of anti-competitive behavior. For example, vertical integration could incentivize collusion among registries that own registrars to grant favorable treatment to affiliated registrars to promote their own gTLDs. Collusion between affiliated registries and registrars would certainly result in higher prices to consumers. It would also harm competition among registries at the wholesale level, and registrars at the retail level. As the CRA International Report noted, discrimination against unaffiliated registrars and registries could take “the form of price breaks [for affiliated registrars], better operational support, and access to registry information that the registry may uniquely have as a result of operating the registry.”²⁰ Reasonable restrictions on vertical integration, as proposed in RACK+, would promote competition at both the wholesale and retail levels.

Less Restrictive Means. In applying the Rule of Reason, courts either require a plaintiff to show that a challenged restraint is a reasonable restraint of trade or that the same pro-competitive effect could be achieved through less restrictive means. This inquiry is only reached, however, if potential plaintiffs can prove that ICANN acted in agreement with others when establishing its eligibility requirements.²¹ As noted above, unilateral conduct, regardless of its competitive effect, is not governed by Section 1.²² In their analysis, courts generally do not require a company to devise the least restrictive means possible to achieve the desired pro-

¹⁸ *Id.* at 886 (the Rule of Reason “distinguishes between restraints with anticompetitive effect that are harmful to the consumer and restraints stimulating competition that are in the consumer’s best interest.”)

¹⁹ In fact, when retail market was opened to a variety of registrars, vigorous competition flourished in the retail market for gTLDs.

²⁰ Margie Milam, GNSO Council, GNSO Issues Report on Vertical Integration between Registries and Registrars, 14 (2009), <http://gns0.icann.org/issues/vertical-integration/report-04dec09-en.pdf>.

²¹ *Matsushita*, 475 U.S. at 588 (citing *Monsanto*, 465 U.S. at 764) (antitrust plaintiffs “must present evidence ‘that tends to exclude the possibility’ that the alleged conspirators acted independently”).

²² *Copperweld*, 467 U.S. at 769 (concerted action under Section 1 can only occur when “two or more entities that previously pursued their own interests separately . . . combin[e] to act as one for their common benefit” in the restraint of trade).

competitive effect.²³ There is substantial leeway in this inquiry; antitrust law protects a firm’s right to take a unilateral action to decide with whom it will or will not do business. Both recent and longstanding case law supports ICANN’s right to make independent decisions about with whom it chooses to do business—or in this case, how it determines eligibility for a competitive bid.²⁴ As a private entity, ICANN is entitled to construct its bidding process to distribute gTLDs in the manner that it believes will maximize consumer welfare without restriction. Furthermore, a proposal restricting cross ownership—both by a registry operator in a registrar and by a registrar in a registry operator—with a safe harbor for minority ownership and exceptions to allow greater cross-ownership in certain circumstances that present no threat of anticompetitive conduct would be narrowly designed to promote competition while minimizing anticompetitive effects.

ICANN will not face antitrust liability under § 2 of the Sherman Act.²⁵ There are no legitimate claims for antitrust liability under Section 2. It is possible that a potential plaintiff might make a Section 2 claim under the “essential facilities” doctrine. Under the essential facilities doctrine, a plaintiff must prove (1) control of the essential facility by a monopolist; (2) inability to practically or reasonably duplicate the essential facility; (3) the denial of the use of the facility to a competitor; and (4) the feasibility of providing the facility to competitors.²⁶ Although a potential plaintiff may be able to allege facts to support each of these factors, such a claim would be exceedingly difficult. First, the Supreme Court recently refused to accept the essential facilities doctrine in *Verizon Communications, Inc. v. Law Offices of Curtis V. Trinko*, substantially limiting the impact of the doctrine.²⁷ Second, even if a plaintiff can make out each element, courts will not find antitrust liability when an entity makes reasonable decisions based on limited resources.²⁸ In this case, ICANN is imposing reasonable eligibility requirements to participate in competitive bidding—ICANN is under no obligation to let any and every firm participate in the process. A rule allowing vertical integration would require extensive additional monitoring for anticompetitive behavior by integrated registries and registrars after the bidding process is complete. ICANN simply does not have the resources to police the activities in the

²³ See *Bd. of Trade of City of Chi. v. United States*, 246 U.S. 231, 238 (1918); *Graphic Prods. Distribs., Inc. v. Itek Corp.*, 717 F.2d 1560, 1573, 1577 (11th Cir. 1983); *Clorox Co. v. Sterling Winthrop*, 117 F.3d 50, 56 (2d Cir. 1997); *Wilk v. Am. Med. Ass’n*, 895 F.2d 352, 363 (7th Cir. 1990). But see *Kreuzer v. Am. Acad. of Periodontology*, 735 F.2d 1479, 1495 (D.C. Cir. 1984).

²⁴ See *United States v. Colgate & Co.*, 250 U.S. 300, 307-08 (1919) (holding that a manufacturer can suggest resale prices and refuse to deal with distributors who do not follow them); *Monsanto.*, 465 U.S. at 761 (a business “generally has a right to deal, or refuse to deal, with whomever it likes, as long as it does so independently”); *Leegin Creative Leather*, 551 U.S. at 902-03.

²⁵ 15 U.S.C. § 2.

²⁶ *Gregory v. Fort Bridger Rendezvous Ass’n*, 448 F.3d 1195, 1204 (10th Cir. 2006). See also *Otter Tail Power Co. v. United States*, 410 U.S. 366, 377-79 (1973); *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585 (1985).

²⁷ *Verizon Commc’ns., Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398, 411 (U.S. 2004) (“We have never recognized such a doctrine . . . and we find no need either to recognize it or to repudiate it here”).

²⁸ *Gregory*, 448 F.3d at 1204-05 (finding no antitrust liability where a trade organization denied retail space to a trader at a convention).

market. Reasonable eligibility requirements that will create a structural solution radically reducing the need for costly additional monitoring could not trigger antitrust liability.