

**Comments on Michael Kende's Assessment of
Preliminary Reports on Competition and Pricing**

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I. INTRODUCTION

A. TASK

1. I have been asked by ICANN to respond to the report submitted on April 17, 2009 by Michael Kende entitled "Assessment of ICANN Preliminary Reports on Competition and Pricing" prepared on behalf of AT&T. The Kende report comments on my March 2009 papers evaluating: (i) the likely impact on consumer welfare of ICANN's proposed framework for authorizing new gTLDs;¹ and (ii) the appropriate role of price caps for services provided by new gTLDs.²

2. In the Consumer Welfare report, I concluded that, while the evaluation of the ICANN proposal requires consideration of both costs and benefits, "... even if new gTLDs do not compete with .com and other major TLDs for existing registrants, it is likely that consumers would nonetheless realize significant benefits from new gTLDs due to increased competition for new registrants and increased innovation that would likely be fostered by entry."³ In the Price Cap report, I concluded that, in the absence of intellectual property concerns, "... price caps or ceilings on prices charged by operators of new gTLDs are unnecessary to insure the potential competitive benefits of the new

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1. Preliminary Report of Dennis Carlton Regarding the Impact of New gTLDs on Consumer Welfare (March 2009), hereafter "Consumer Welfare report."
 2. Preliminary Analysis of Dennis Carlton Regarding Price Caps for New gTLD Internet Registries (March 2009) hereafter "Price Cap report."
 3. Consumer Welfare Report, p. 1

gTLDs” and that “imposing price caps on the registries for new TLDs could inhibit the marketplace acceptance of new gTLDs by limiting the pricing flexibility of entrants...”⁴

3. In responding to my reports, Dr. Kende claims that “there is no evidence of the type of beneficial competition that Professor Carlton argues that the proposed gTLD framework will introduce.”⁵ He further argues that “[t]he economic study that the Board directed the staff to undertake in 2006 [...] pointed the way to an appropriate and informed approach by ICANN, which would provide the answers to the questions that were addressed by Professor Carlton in his two preliminary studies.”⁶

4. Dr. Kende concludes that new gTLDs would impose costs on trademark holders by requiring “defensive registrations” and that my prior reports “... failed to analyze the present status and satisfaction of trademark holders with the current safeguards...”⁷ He further concludes that price caps for new gTLDs would be appropriate due to the “...possibility that registries might [set prices] aimed at customers registering defensively, who may be less price sensitive”⁸ Finally, he claims that the absence of price caps for new gTLDs could result in the elimination of price caps for existing registries.⁹

B. SUMMARY OF CONCLUSIONS

5. My major conclusions, explained in further detail in the following sections of this report, are as follows:

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- 4. Price Cap report, p. 1.
 - 5. Kende, p. 11.
 - 6. Kende, p. 19.
 - 7. Kende, p. 11.
 - 8. Kende, p. 19.
 - 9. Kende, p. 13.

- There is no basis for Dr. Kende’s claim that the study authorized by the ICANN Board in 2006, which proposed to analyze the scope of the market for registration services, is necessary for evaluating whether consumers would benefit from ICANN’s proposed framework for introducing new gTLDs. Even if *.com* (or, for that matter, any other TLD) today exercises market power, new gTLDs could enhance consumer welfare by creating new products and fostering innovation, and promoting future competition with *.com* and other TLDs. That is, entry of a new gTLD can be desirable even if the gTLD does not erode any of the market power that *.com* may possess.
- While concerns about consumer confusion and defensive registrations need to be considered, Dr. Kende provides no basis for concluding that restricting the entry of new gTLDs is the best solution to reducing these costs. Alternative mechanisms exist, and others are actively being studied by ICANN, to protect trademark holders while preserving the procompetitive benefits of entry.
- Dr. Kende exaggerates costs associated with ICANN’s gTLD proposal. He defines “defensive registrations” as those which direct traffic to other sites, but this definition fails to distinguish between productive registrations which attract and maintain traffic as well as those undertaken only to protect trademarks.

- Finally, I understand that there is no basis for Dr. Kende’s claim that the absence of price caps for new gTLDs will require elimination of price caps for existing TLDs.

II. DR. KENDE INCORRECTLY CONCLUDES THAT THE 2006 STUDY AUTHORIZED BY ICANN IS NECESSARY TO UNDERSTAND THE POTENTIAL BENEFITS OF NEW gTLDs.

6. Dr. Kende asserts that two critical questions for studying the potential benefits of new gTLDs are “whether there is market power in the domain registration market, and whether there is evidence that entry would be sufficient to counteract such market power.”¹⁰ He claims that the results of the study requested by the ICANN Board in 2006 “would determine the extent of competition for existing gTLDs and how to identify where expansion would provide economic benefits in the form of choice for Internet users interested in registering a new core domain name.”¹¹ He further claims that “such a study would necessarily have impacted Professor Carlton’s conclusions.”¹²

7. Dr. Kende’s comments are incorrect and fail to properly recognize the role of entry in promoting consumer welfare in the presence of market power. As I have emphasized previously, new products and services are primary generators of increases in consumer welfare and restrictions on entry will impede innovation.¹³

8. Even if the new gTLDs authorized under the ICANN proposal would not compete with *.com* for *existing* registrants and did not result in the reduction of the fee for

10. Kende, p.3.

11. The 2006 ICANN-authorized report was designed to address questions related to whether the domain registration market is one market or whether each TLD functions as a separate market.

12. Kende, p. 2.

13. See “Preliminary Report of Dennis Carlton Regarding the Impact of New gTLDs on Consumer Welfare” pp. 18-19 for a discussion of the economic literature on the importance of product innovation and technological progress.

.com registration below the price cap level, entry would still be likely to benefit consumers by increasing the likelihood of the successful introduction of new and innovative registration services which generate benefits to consumers. Successful new gTLDs also would be expected to lead existing registries to improve the quality of service they provide and to accelerate the introduction of new services in order to continue attracting new registrants.

9. As this analysis indicates, determining the scope of the market for registry services and the extent of competition between TLDs, as ICANN proposed in 2006, is not critical to the evaluation of the potential benefits from the entry of new gTLDs.

III. ENTRY RESTRICTIONS ARE AN INEFFICIENT MECHANISM FOR PREVENTING THE MISUSE OF TRADEMARKS

10. Dr. Kende claims that an overwhelming number of domain names reflect “defensive registrations” that do nothing more than direct traffic back to a “core registration” site. Dr. Kende claims that “[t]hese are registered to prevent a cybersquatter from registering them instead, or are recovered from cybersquatters who registered them first.”¹⁴ He claims that gTLDs are likely to impose significant costs on consumers by requiring new defensive registrations which serve no productive purpose other than to prevent trademark abuse.

11. This section shows (i) that restrictions on entry of new gTLDs are unlikely to be an efficient mechanism for reducing concerns about “cybersquatting” and defensive registrations; and (ii) that Dr. Kende incorrectly suggests that many domain names that merely redirect traffic to another site are unproductive and serve no other purpose than preventing cybersquatting. As such Dr. Kende appears to overstate inefficiencies

14. Kende, p. 7.

imposed on trademark holders that are likely to result from the introduction of new gTLDs.

A. ENTRY RESTRICTIONS ARE LIKELY TO BE AN INEFFICIENT MECHANISM FOR PROTECTING TRADEMARKS.

12. Dr. Kende claims that my Consumer Welfare report failed to adequately account for costs that new gTLDs would impose on trademark holders through defensive registrations and that restrictions on the entry of new gTLDs benefits consumers by limiting the need for defensive registrations.¹⁵ While trademark holders' concerns about the potential impact of new gTLDs on the need for defensive registrations merit attention, and while protecting trademarks and intellectual property can promote consumer welfare, economic efficiency requires that trademark holders concerns be addressed at the minimum possible cost. Dr. Kende provides no support for his suggestion that restricting entry is the most efficient way of protecting trademark holders. To carry his example to other markets, the fact that car accidents impose costs does not imply that cars should be banned.

13. As discussed in my prior report, mechanisms currently exist for protecting the use of trademarks in domain names. For example, ICANN maintains the Uniform Domain Name Dispute Resolution Policy (UDRP) for, among other things, resolving claims that a registrant owns a domain name that infringes an existing trademark. While a large number of disputes are routinely resolved under these procedures, Dr. Kende cites dissatisfaction with these rules by trademark holders.¹⁶

15. Kende, p.8.

16. Kende, p.10.

14. Entry restrictions are an extreme approach to addressing trademark concerns when alternative approaches, such as modifying existing dispute resolution mechanism, may also help achieve these goals while preserving the benefits to consumers of entry. As mentioned in my Consumer Welfare report, for example, implementation of a “user pays” rules in domain name disputes or other changes in dispute resolution mechanisms would help deter trademark infringements and baseless challenges of trademark violations.¹⁷

15. In addition, ICANN has instituted a process to address concerns of trademark holders and to improve mechanisms for protecting trademark holders’ property and preventing the unauthorized use of trademarks in domain names. In March 2009, ICANN formed the Implementation Recommendation Team (“IRT”) whose purpose is to consider and recommend proposals that will help protect the legal rights of trademark owners focusing on, but not limited to, issues arising with respect to the introduction of new gTLDs.¹⁸

16. The IRT recently has issued a report which proposes new mechanisms for protecting trademark holders. These include: creating a centralized intellectual property clearinghouse to support new gTLD registries; instituting a mechanism for blocking registration of domain names with certain globally protected trademarks (those included in the Globally Protected Marks List) in both the top and second level domain space; and creating a venue for expedited proceedings for blatant trademark infringement and abuse. The status of these recommendations is under review. Before resorting to the draconian

17. Consumer Welfare Report, p. 21. A more extreme form of the “loser pays” rule would involve the loser paying a penalty.

18. IRT Report (<http://www.icann.org/en/announcements/announcement-4-29may09-en.htm>)

remedy of restricting entry, the existing and proposed alternative mechanisms for dealing with gTLD-related trademark concerns should be pursued.

B. DR. KENDE INCORRECTLY SUGGESTS THAT ALL “DEFENSIVE” REGISTRATIONS SERVE NO PRODUCTIVE PURPOSE.

17. As noted above, Dr. Kende defines “defensive registrations” as those which “redirect traffic back to a core registration.” He claims that defensive registrations serve no purpose other than to “prevent a cybersquatter from registering them.”¹⁹

Dr. Kende, however, fails to recognize that many domains that “redirect traffic back to a core registration” are undertaken for reasons wholly unrelated to cybersquatting concerns and reflect attempts by registrants to attract traffic and efficiently structure the hosting of Internet content.

18. According to Dr. Kende, more than 97 percent the registrations by the five representative firms he reviewed meet his definition of “defensive” registrations.

Dr. Kende, however, has not produced the questionnaire or data that provide the basis of his analysis. As a result, I cannot determine whether survey respondents to the MarkMonitor survey consider all registrations that merely redirect traffic to other domains as unproductive expenditures designed to prevent cybersquatting or whether this is Dr. Kende’s interpretation.

19. In fact, many registrations that direct traffic to other sites are complementary to “core” registrations and help attract traffic to a “core” website and are

19. Kende, p. 7. More fully, Dr. Kende defines defensive registrations as follows: “*Defensive Registration*: These registrations are not unique, in that they do not resolve, or they redirect traffic back to a core registration, or do not contain unique content – for instance registrations that contain typos of a trademarked name. These are registered to prevent a cybersquatter from registering them instead, or are recovered from cybersquatters who registered them first.”

not merely undertaken to prevent cybersquatting. For example, the following types of registrations that direct traffic to other sites would help attract traffic and would not be maintained simply to prevent cybersquatting:

- Registrations involving trademark names that direct traffic to the website of a corporate parent;
- Registrations involving trademark names no longer in active use;
- Registrations involving trademark names not currently used that may be used in the future;
- Registrations involving common misspellings that redirect traffic to the core site.

20. To take just one small example, my own firm – Compass Lexecon – currently maintains several dozen registrations in addition to *compasslexecon.com*. These include *compass.com* and *lexecon.com*, which were the registrations maintained by the two companies that merged to form Compass Lexecon.²⁰ These domains do not currently host content but instead route traffic to *compasslexecon.com*. Maintaining these registrations prevents the potential loss of traffic generated by individuals who may not be aware of the firm’s name change. However, these would be considered unproductive “defensive registrations” under the standard adopted by Dr. Kende.

21. There are a myriad of reasons that firms maintain registrations that redirect traffic to another site that have little to do with trademark protections. While there is no doubt that some registrations are made to prevent trademark abuse, Dr. Kende’s failure to distinguish “defensive registrations” designed to prevent

20. In addition, Compass Lexecon maintains a variety of .cc registrations and related registrations that direct traffic to the *compasslexecon.com* site.

cybersquatting alone from those that help attract and maintain Internet traffic (while redirecting it to another site) in summarizing the MarkMonitor data likely exaggerates the costs associated with ICANN's gTLD proposal.

IV. THERE IS NO BASIS FOR DR. KENDE'S CONCERNS THAT ICANN'S PROPOSAL WILL LEAD TO THE REPEAL OF EXISTING PRICE CAPS.

22. As noted above, Dr. Kende suggests that the absence of price caps for new TLDs could result in the elimination of price caps for *.com*, *.net*, *.org*, *.info*, *.biz* and *others* as a result of the "equitable treatment" clause in ICANN agreements.²¹ We understand from ICANN that there is no basis for this concern. The language in this clause does not require identical treatment among all registries and recognizes that differences across ICANN contracts with different registries can be "justified by substantial and reasonable cause." ICANN's contracts with existing TLDs recognize that different practices may be appropriate for different registries and allow ICANN latitude to implement different procedures. I am aware of no statement either by ICANN or the Commerce Department favoring the elimination of price caps specified in existing registry contracts.

23. Dr. Kende further claims that price caps for new gTLDs are necessary because "defensive registrations are much less price sensitive than basic new registrations."²² However, the evidence from the introduction of new TLDs does not support this argument. More specifically, the relatively small number of registrations in newer TLDs such as *.info* and *.biz*, despite lower registry fees than those for *.com*, is

²¹ For example, the VeriSign agreement with ICANN states in Section 3.2(a) that "ICANN shall not apply standards, policies, procedures or practices arbitrarily, unjustifiably, or inequitably and shall not single out Registry Operator for disparate treatment unless justified by substantial and reasonable cause."

22. Kende, p.12.

inconsistent with Kende's assertion that the demand for defensive registrations by trademark owners is inelastic and thus likely to generate a high price.

V. CONCLUSION

24. While evaluation of ICANN's proposal requires the evaluation of both costs and benefits, new gTLDs would yield benefits to consumers even if they did not compete directly with *.com* and did not result in the reduction of *.com* fees below the price cap level. This implies that ICANN's proposed 2006 study, which would have analyzed whether *.com* or other existing TLDs are separate markets and could exercise market power in the absence of price caps, is superfluous to an assessment of whether consumers would benefit from new gTLDs.

25. While Dr. Kende argues that the increase in costs for trademark owners from new TLDs should prohibit their introduction, he provides no evidence that restricting entry is the most efficient method for reducing these costs. ICANN, through the IRT, is currently studying possibilities for more efficient procedures to resolve trademark-related disputes involving registrations. Such improvements to existing procedures can help protect trademark holders while preserving the procompetitive effects of entry. In addition, the data reported by Dr. Kende appear to exaggerate the significance of "defensive" registrations designed to prevent cybersquatting and thus exaggerate the implied need for restricting entry in order to deter trademark abuse.