

May 2, 2013

Accountability and Transparency Review Team 2: Questions for the ICANN Community

These comments are submitted in response to the Request for Comments published by the Accountability and Transparency Review Team 2 (“ATRTR2”).¹

EXECUTIVE SUMMARY

ICANN has fallen short of implementing a critical recommendation from the first Accountability and Transparency Review Team (“ATRTR1”). In addition, ATRTR2 should address the issue of gTLD profits and formulate recommendations to assist the ICANN Board of Directors to handle any profits in a manner consistent with ICANN’s status as a non-profit organization.

First, ICANN has not fully implemented ATRTR1’s Recommendation 23. That Recommendation, calling for an expert study of procedures to review decisions by the ICANN Board of Directors, was not carried out for nearly two years. Delayed implementation is not full implementation. Worse yet, the report issued by ASEP avoided the issue of an effective appeal from Board decisions that gave rise to ASEP’s creation and Recommendation 23 in the first place. ASEP’s recommendations, moreover, make it more difficult to challenge and reverse ICANN Board decisions—hardly a refinement of ICANN policy in keeping with Recommendation 23 and the concerns expressed by ATRTR1.

ATRTR2 should address the questions left unresolved by ATRTR1: Should ICANN provide an independent and binding appeal from Board decisions? What body should have that authority?

Second, ICANN stands to recover substantial—perhaps game-changing—profits from the first application round of the new gTLD program. ATRTR2 should investigate the sources of potential profits and formulate recommendations to assist the ICANN Board in handling gTLD profits consistently with ICANN’s legitimate status as a nonprofit organization authorized to manage the global DNS in the public interest.

Ensuring that all gTLD profits—not just the auction proceeds—are “reserved and earmarked”² until the ICANN community has an opportunity to discuss how best to spend them requires proactive measures by the ICANN Board of Directors:

¹ ICANN, Accountability and Transparency Review Team 2, *Questions for the ICANN Community on the Impact of Previous Reviews and Inputs for the ATRTR2* (Apr. 2, 2013) (“ATRTR2 Questions”).

² *Id.* at 4-19 n.1.

- ♦ The Board should issue a formal resolution that revenues from the first round of gTLD application fees and auctions will be spent only for the purposes described in the gTLD Guidebook until the first round is complete.
- ♦ The Board also should issue a formal resolution committing to call for an independent audit of gTLD revenues and costs by internationally reputable accounting firm within 30 days after the last gTLD application of the first round of gTLD applications has been finally administered.
- ♦ And the Board should issue a formal resolution assuring the ICANN community that any profits identified by the audit will be deposited into a designated account and that no expenditures from that account will be authorized by the Board until the community consultation process is complete.

Finally, ATRT2 should consider whether the community would be best served by dividing the process of community consultation regarding gTLD profits into two steps. The Board should first ask how such profits should *not* be used and then, after the first round of new gTLD applications and the accompanying audit are complete, the Board should solicit the community's views about how gTLD profits ought to be disbursed. Serious consideration should be given to refunding portions of the new gTLD application fee charged above the actual cost of administering applications.

RESPONSE TO ATRT2’S REQUEST FOR COMMENTS

ATRT2 should be complimented for soliciting the community’s views at the outset of its work. Such openness, even in setting its work agenda, is deeply appreciated. These comments address only selected questions, to suggest issues where ATRT2’s review might focus for greatest impact.

Before responding to the questions ATRT2 has raised, it is worth pausing a moment to state ATRT2’s authority and central purposes. ATRT2 was constituted pursuant to the *Affirmation of Commitments* (“*Affirmation*”), a legal agreement between ICANN and the United States. The *Affirmation* vests ATRT2 with the authority and responsibility to review ICANN’s operations and decisions and to produce a written report that “shall consider the extent to which the assessments and actions undertaken by ICANN have been successful in ensuring that ICANN is acting transparently, is accountable for its decision-making, and acts in the public interest.”³ ATRT’s mandate, then, is to measure ICANN’s performance against its “key commitments” to “ensure that decisions made related to the global technical coordination of the DNS are made in the public interest and are accountable and transparent.”⁴

1. *ATRT1’s Recommendation 23—Board Review Mechanisms*

ATRT2 asks whether “specific recommendations [of ATRT1] have or have not been effectively, transparently, and fully implemented.”⁵ It also asks for metrics “to measure effectiveness, transparency, and completeness of recommendation implementation.”⁶ In my view, Recommendation 23 of ATRT1, directing ICANN to form an expert committee to study procedures for reviewing decisions of the ICANN Board of Directors, has not been fully implemented.

Recommendation 23 proposed that ICANN “seek input from a committee of independent experts on the restructuring of the three [Board] review mechanisms—the Independent Review Panel (IRP), the Reconsideration Process and the Office of the Ombudsman.”⁷ This expert consultation was intended to be “a broad, comprehensive assessment of the accountability and transparency of the three existing mechanisms and of their inter-relation, if any ... determining whether reducing costs, issuing timelier decisions, and covering a wider spectrum of issues would improve Board accountability.”⁸ ATRT1 specifically asked that the expert

³ *Affirmation*, at ¶ 9.1.

⁴ *Id.* at ¶3.

⁵ *ATRT2 Questions*, at 2.

⁶ *Id.*

⁷ *Final Recommendations of the Accountability and Transparency Review Team 5* (Dec. 31, 2010).

⁸ *Id.*

review consider suggested procedures for compelling the Board to reconsider a decision and for removing the entire Board.⁹

Referring the issue of Board review mechanisms to an expert review was a compromise on the sole point that divided ATRT1. Disagreement centered on whether adequate procedures for reviewing ICANN Board decisions need to be “both binding and independent.”¹⁰ Concern was expressed “over the fact that none of the three accountability mechanisms can review and potentially reverse ICANN Board decisions with binding authority.”¹¹ Yet the full membership of ATRT1 “did not reach consensus on whether binding authority was the standard upon which to judge ICANN’s accountability.”¹²

This disagreement created a unique split between ATRT1 and Working Group 4 (“WG4”), assigned to study procedures for reviewing, reconsidering, and reversing decisions by the ICANN Board. WG4 concluded that all the existing Board review mechanisms were inadequate¹³ and sought guidance from ICANN whether California law might constrain its exploration of alternative Board review mechanisms. ICANN’s legal department responded with a one-page document asserting that under California law “the board cannot empower any entity to overturn decisions or actions of the board.”¹⁴ WG4 viewed the resulting conflict between its mandate and ICANN’s legal position in the most serious terms—as “critical to establishing an appeals mechanism that is both binding and

⁹ See *id.* (“The committee of independent experts should also look at the mechanisms in Recommendation 2.8 and Recommendation 2.9 of the Draft Implementation Plan.”); ICANN, *Draft Implementation Plan for Improving Institutional Confidence* 7 (Feb. 26, 2009), available at <http://www.icann.org/en/jpa/iic/draft-iic-implementation-26feb09-en.pdf> (“Draft Implementation Plan”) (“Recommendation 2.8: Establish an additional mechanism for the community to require the Board to re-examine a Board decision, invoked by a two-thirds majority vote of two-thirds of the Councils of all the Supporting Organizations and two-thirds of members of all the Advisory Committees.”); *id.* (“Recommendation 2.9: Establish an extraordinary mechanism for the community to remove and replace the Board in special circumstances.”).

¹⁰ *Id.*

¹¹ *Final Recommendations* at 53.

¹² *Id.*

¹³ The full ATRT agreed that existing Board review mechanisms are inadequate. Over 2000 complaints have been submitted with the Office of Ombudsman, a “vast majority” of which “were rejected on jurisdiction.” *Id.* at 46. Since 1999, 44 requests for Reconsideration have been submitted, of which 9 (20.4%) were approved and adopted by the Board of Directors. *Id.* at 47. The only IRP case, invoked by ICM Registry to challenge the denial of its application for .xxx, resulted in a decision by the Panel that its decisions were “advisory, and not binding on the ICANN Board.” *Id.*

¹⁴ See Internet Corp. for Assigned Names and Numbers, *Limitations on Third Party Review of Corporate Board Actions under California Law* (Aug. 31, 2010), available at <http://www.icann.org/en/reviews/affirmation/third-party-review-of-board-actions-31aug10-en.pdf> (emphasis added) (“*Limitations*”).

independent, and *essential* to the viability of the ICANN model itself.”¹⁵ And WG4 recommended that ATRT1 should conduct further research of California law and “[c]hallenge ICANN’s interpretation of California corporate governance law as it applies to ICANN policy development.”¹⁶

Conflict gave way to compromise. ATRT1’s internal divisions led it to suggest an expert committee, but unfortunately that compromise turned out to be ineffective.

A. *Delayed Implementation*

Recommendation 23 was not implemented fully because it was implemented late. ATRT1 issued its Final Recommendations in December 2010, and the ICANN Board approved those Recommendations without exception in June 2011.¹⁷ But ICANN did not commission an expert study of Board review mechanisms until September 2012,¹⁸ the Accountability Structures Expert Panel (ASEP) published its report in October 2012,¹⁹ and the Board approved ASEP’s recommendations in December 2012.²⁰

Waiting 22 months to commission ASEP breached ICANN’s responsibility under the *Affirmation* to “take action within six months of receipt of the recommendations.”²¹ Administrative preliminaries such as approving the recommendation, assigning Board and staff leadership responsibilities for it, and allocating a budget do not remotely satisfy ICANN’s obligation to respond to community reviews promptly. A delay of nearly two years before seeking expert input likewise disregarded ATRT1’s expressed urgency. Recommendation 23 was intended to be implemented “[a]s soon as possible, but no later than June 2011.”²² Just in case the words “as soon as possible” and “no later than” were somehow unclear, ATRT1 assigned Recommendation 23 “high priority.”²³

¹⁵ *Draft Findings* at 1 (emphasis added).

¹⁶ *Id.*

¹⁷ Internet Corp. for Assigned Names and Nos., *Adopted Board Resolutions*, no. 2 (June 24, 2011) (consent agenda), available at <http://www.icann.org/en/minutes/resolutions-24jun11-en.htm#2>.

¹⁸ See <http://www.icann.org/en/news/announcements/announcement-11sep12-en.htm>.

¹⁹ *Report by Accountability Structures Expert Panel (ASEP)* (Oct. 2012), available at <http://www.icann.org/en/news/in-focus/accountability/asep/report-26oct12-en>.

²⁰ Internet Corp. for Assigned Names and Nos., *Adopted Board Resolutions*, nos. 17-19 (Dec. 20, 2012) (main agenda), available at <http://www.icann.org/en/minutes/resolutions-24jun11-en.htm#2>.

²¹ *Affirmation* at ¶ 9.1(e).

²² *Id.* (“As soon as possible, but no later than June 2011, the ICANN Board should implement Recommendation 2.7 of the 2009 Draft Implementation Plan for Improving Institutional Confidence which calls on ICANN to seek input from a committee of independent experts on the restructuring of the three review mechanisms”) (emphasis added).

²³ *Id.* at 2.

ICANN's delay in implementing Recommendation 23 undermines the *Affirmation's* model of voluntary self-correction. Prompt implementation of organizational review recommendations is indispensable to the accountability promised by the *Affirmation*.²⁴ That agreement relies on ICANN's good faith efforts to put organizational reviews into action. Failing to follow through on a high priority recommendation of the first review team organized under the *Affirmation* raises the uncomfortable question of whether such reviews can produce needed institutional change.

Prolonging implementation of Recommendation 23 creates an ugly feedback loop. Long delays in executing prior community reviews cause review cycles to bump into each other, making it appear that ICANN is constantly the object of review, while the community is denied genuine progress despite consensus-supported recommendations for change. Together these circumstances tend to exhaust ICANN's institutional appetite for critical self-review and the community's faith that such reviews will produce meaningful reform.

B. ASEP—A Missed Opportunity

Despite appearances, ASEP did not fully implement Recommendation 23.

To be sure, it addressed Board review mechanisms and proposed several changes to ICANN bylaws governing the Request for Reconsideration and the Independent Review Process (“IRP”),²⁵ which the Board already has approved.²⁶ ASEP's recommendations are open to criticism, however. Some make it even harder to reverse objectionable ICANN Board decisions in appropriate circumstances.²⁷

ASEP left important parts of Recommendation 23 unaddressed. It evidently gave little consideration to procedures compelling the Board to reconsider a decision and one removing and replacing the Board.²⁸ ASEP's only mention of these

²⁴ See *Affirmation* ¶ 9.1(e) (“Integral to the foregoing reviews will be assessments of the extent to which the Board and staff have implemented the recommendations arising out of the other commitment reviews enumerated below.”).

²⁵ *Report by Accountability Structures Expert Panel (ASEP)* (Oct. 2012) (“*ASEP Report*”), at <http://www.icann.org/en/news/in-focus/accountability/asep/report-26oct12-en>.

²⁶ Internet Corp. for Assigned Names and Nos., *Adopted Board Resolutions*, nos. 17-19 (Dec. 20, 2012) (main agenda), at <http://www.icann.org/en/minutes/resolutions-24jun11-en.htm#2>.

²⁷ GNSO, *gTLD Registries Stakeholder Group Statement, Issue: Expert Recommended Improvements to ICANN's Accountability Structures 2* (Nov. 16, 2012) (“We believe that this amendment to the Section 4 of the IRP [changing the standard of review] frustrates the overall purpose of the IRP and runs counter to the intent of improving ICANN's accountability mechanisms.”), at <http://forum.icann.org/lists/asep-recommendations/msg00000.html>.

²⁸ *Final Recommendations*, at 5 (“The committee of independent experts should also look at the mechanisms in Recommendation 2.8 and Recommendation 2.9 of the Draft Implementation Plan.”).

recommendations was to note that it had reviewed the recommendations and “understood community concern and lack of consensus on [them].”²⁹

But the ASEP Report’s greatest weakness is its failure to address what accountability means for ICANN or how to tackle the problem identified by the ATRT’s WG4—that ICANN has no procedure compelling the Board to reverse a decision or policy that contravenes ICANN’s bylaws or other written commitments. ASEP’s work does not move ICANN any closer to embracing a coherent standard of accountability or adopting measures reasonably designed to achieve it.

Perhaps ASEP can be excused for not engaging these politically controversial and conceptually thorny questions because of the short time available to complete its assignment. Whatever its reasons, ASEP did not address the definition of accountability or the creation of an effective appeal from ICANN Board decisions. ASEP’s omissions mean that ATRT1’s Recommendation 23 has not been fully implemented in substance, any more than in timing.

C. Metrics for Implementing ATRT1

Metrics for gauging whether Recommendation 23 was fully implemented are straightforward.

On timing the question is whether the ICANN Board has implemented the recommendation within six months as provided in the *Affirmation*. If implementation is delayed for reasons beyond the Board’s control, reasonable steps should be taken to implement the recommendation as soon as feasible thereafter. Given the seriousness of ICANN’s commitments under the *Affirmation*, the Board should publicly explain the reasons for the delay, the steps it has taken to carry out the recommendation as promptly as feasible, and the date by which it expects to implement the recommendation. Judged by these metrics, implementation of Recommendation 23 was untimely.

On substance the question is whether the ICANN Board has implemented the recommendation without modification. Is there a gap between a fair reading of the recommendation and how it was carried out? For Recommendation 23 the answer to these questions, unfortunately, is that ASEP’s report fell considerably short of full implementation.

2. An Effective Appeal from Board Decisions as Due Process

ATRT2 asks for “specific information and suggestions for improving Board governance.”³⁰ In my view, ATRT2 would serve a critical need by taking seriously ICANN’s commitment under the *Affirmation* “to ensure that the outcomes of its

²⁹ *ASEP Report*, at 2.

³⁰ *ATRT2 Questions*, at 2.

decisionmaking will reflect the public interest and be accountable to all stakeholders by ... the consideration of *an appeal mechanism for Board decisions*.”³¹

The reasons for creating an effective appeal from ICANN Board decisions are compelling. ICANN’s commitment to establishing an effective appeal appears in the *Affirmation*, the Joint Project Agreement, and the Memorandum of Understanding and its amendments; indeed, an effective appeal was contemplated as an element of the privatization of DNS management in the *DNS White Paper* itself.³² Apart from its pedigree, an effective appeal from Board decisions is a practical necessity to prevent the Board from rendering ICANN’s bylaws and other written commitments literally unenforceable.

The risks of allowing the ICANN Board to exercise its considerable authority without an independent and binding appeal are illustrated by the recent attempt to insert language in both the New gTLD Registry Agreement and the Registrar Accreditation Agreement (“RAA”) allowing the Board to modify these agreements unilaterally.³³ In a rare show of unity, the ICANN community universally condemned the very idea of giving the Board power to modify contracts unilaterally.³⁴

Within the past week, revised versions of the agreements have been published containing some improvements. The clause authorizing the Board to modify contracts unilaterally has been replaced with a complex set of procedures permitting the Board to force through amendments only after certain preconditions are satisfied.³⁵ Disputes over the exercise of that power are now subject to binding arbitration³⁶ or (for the RAA) civil litigation.³⁷

³¹ *Affirmation*, at ¶9.1 (emphasis added).

³² See Rolf H. Weber & R. Shawn Gunnarson, *A Constitutional Solution for Internet Governance*, 14 COLUM. SCI. & TECH. L. REV. 1, 20-21 (2013) (tracing the history of ICANN’s commitments to establish an effective appeal from Board decisions).

³³ ICANN, *Draft New gTLD Registry Agreement* § 7.6(e) (authorizing the ICANN Board of Directors to approve a Rejected Amendment over registry operators’ objections); ICANN, *Proposed Registrar Accreditation Agreement* § 6.3 (Mar. 7, 2013) (authorizing the ICANN Board of Directors to approve a Special Amendment to the RAA over registrars’ objections).

³⁴ Jeff Neuman, *Clearing Up the “Logjam”: ICANN Must Drop Its Request for a Unilateral Right to Amend the Agreements* (Mar. 16, 2013), at http://www.circleid.com/posts/20130316_icann_must_drop_request_for_unilateral_right_to_amend_agreements/; Stéphane Van Gelder, *Mishandling the Registrar Contract Negotiations* (Mar. 8, 2013), at http://www.circleid.com/posts/20130308_mishandling_the_registrar_contract_negotiations/.

³⁵ ICANN, *Proposed Final New gTLD Registry Agreement* § 7.6(e) (Apr. 29, 2013) (detailing the procedures for the ICANN Board to approve a Rejected Amendment); ICANN, *Proposed Final Registrar Accreditation Agreement* § 6.5 (Apr. 22, 2013) (same).

³⁶ *Proposed Final New gTLD Registry Agreement* § 5.2 (disputes over the validity of an approved Rejected Amendment may be decided in binding arbitration); *Proposed Final Registrar Accreditation*

Welcome as these improvements are, they do not resolve the underlying issue. Procedural obstacles may delay or discourage the Board from forcing through amendments to registry and registrar contracts over the contracted parties' objections—but they cannot prevent that result. Only the availability of binding arbitration to resolve disputes makes that power tolerable. At least no contracting party has to depend on the Board's grace to ensure that its power remains within limits prescribed by the written contracts.

But that is exactly the risk that every ICANN stakeholder labors under when there is no independent and binding appeal from Board decisions not governed by formal agreements with contracted parties. Yet the disparity between procedures available to resolve disputes over formal contracts and those available to resolve disputes over the Board's exercise of power outside those contracts cannot be justified. The Board's power extends far beyond contracted parties. Its policymaking authority directly affects stakeholders in countless other ways related to the management of the DNS, and the Board remains free to exercise its power over non-contracted parties—even in defiance of ICANN's bylaws—without an effective appeal. If disputes with contracting parties can be resolved by a procedure capable of binding the Board, there is no principled reason why other disputes—especially disputes over the Board's adherence to its bylaws and other written commitments—cannot be subject to a binding appeal as well.

Regrettably, the ASEP-inspired amendments to the bylaws governing the IRP have removed any realistic prospect of an independent review of adverse decisions not governed by the RAA or registry agreements. As the Registries Stakeholder Group pointed out, “the Board can violate its articles or bylaws while simultaneously acting conscientiously, without conflict of interest, and believing the action in question to be in the best interests of ICANN.”³⁸ Stakeholders should not be left without meaningful recourse if the ICANN Board violates its articles or bylaws to their detriment. And no appeal means no recourse.

The advent of new gTLDs underscores the global reach and financial potency of ICANN's authority over the DNS. That authority must be matched with fair procedures that assure ICANN's stakeholders the rudiments of fair process. A “paradigm” instance of unfair process occurs when an institution acts as a judge in its own cause.³⁹ Yet the absence of an effective appeal allows the ICANN Board to act as the final judge in disputes challenging its decisions. More generally, the

Agreement §§ 6.7, 5.8 (disputes over the validity of an approved Rejected Amendment may be decided in civil litigation or binding arbitration).

³⁷ *Id.*

³⁸ See GNSO, *gTLD Registries Stakeholder Group Statement, Issue*, at 2.

³⁹ JOHN ORTH, *DUE PROCESS OF LAW* 86 (2003).

absence of an effective appeal denies ICANN's stakeholders the rule of law, a political value on which ideological adversaries are in remarkable agreement.⁴⁰

Placing ICANN's accountability on a more solid foundation requires answers to two fundamental questions. What does accountability mean for ICANN? And what structural arrangements or procedural mechanisms would achieve that standard of accountability? ATRT2 ought to tackle both questions head-on. They lie at the heart of why, despite many years and much effort, ICANN is still widely viewed as basically unaccountable.

Common misunderstandings confuse clear thinking about these questions.

Some say that flexibility in adopting and implementing policies is an intrinsic virtue. But flexibility in responding to changing technical developments or unforeseen factual circumstances is quite different from flexibility in adhering to ICANN's bylaws and written commitments. Inconsistent adherence to ICANN's written commitments unfairly leaves its stakeholders not knowing where and when they can rely on ICANN's policies and promises. That uncertainty is a vice, not a virtue, for stakeholders engaged in consequential business decisions on the global Internet. Leading economists have observed a direct relationship between a firm commitment to enforcing known rules and incentives to invest that promote economic growth.⁴¹ If only to continue fostering economic investment in the Internet, ATRT2 should look hard at establishing procedural mechanisms capable of holding ICANN to its written commitments.

There is also the mistaken view that accountability is synonymous with other institutional values. But public input is no substitute for accountability. Sound policy decisions that attract broad community consensus are no substitute either. And accountability and transparency are independent values. Substituting one for the other will not produce an organization capable of carrying forward the multi-stakeholder model any more than substituting good service for cleanliness will produce fine dining.

⁴⁰ Compare FRIEDRICH A. HAYEK, *THE ROAD TO SERFDOM* 72 (1944) (“[G]overnment in all its actions is bound by rules fixed and announced beforehand—rules which make it possible to foresee with fair certainty how the authority will use its coercive powers in given circumstances and to plan one’s individual affairs on the basis of this knowledge.”) with E.P. THOMPSON, *WHIGS AND HUNTERS: THE ORIGINS OF THE BLACK ACT* 266 (1975) (“But the rule of law itself, the imposing of effective inhibitions upon power and the defence of the citizen from power’s all-intrusive claims, seems to me to be an unqualified human good.”).

⁴¹ See Douglass C. North & Barry R. Weingast, *Constitutions and Commitment: The Evolution of Institutions Governing Public Choice in Seventeenth Century England*, 49 *J. ECON. HIST.* 803, 803 (1989) (“Rules the sovereign can readily revise differ significantly in their implications for performance from exactly the same rules when not subject to revision.... For economic growth to occur the sovereign or government must not merely establish the relevant set of rights, but must make a credible commitment to them.”).

Nor is there substance to ICANN's dogmatic assertion that "the board cannot empower any entity to overturn decisions or actions of the board."⁴² Further research strongly suggests that California law erects no impediment to placing the ICANN Board under a binding form of appellate review.⁴³

In short, the need for an effective appeal from the ICANN Board's decisions deserves a fresh and thorough look. Resolving that longstanding concern is "essential to the viability of the ICANN model itself."⁴⁴

3. ICANN's Legitimacy and gTLD Profits

ATRT2 asks, "Are there other issues that should be addressed or investigated by ATRT2 consistent with its mandate?"⁴⁵ It should address the issue of gTLD profits and recommend measures for the Board to handle those profits in a manner that avoids harming ICANN's institutional legitimacy.

ICANN admits that gTLD auctions to resolve string similarity contentions will produce excess revenues,⁴⁶ though how much revenue auctions will generate is unknown and will remain so for some time. Initial Evaluation must be completed for all gTLD applications, the applicants whose applied-for names are in string contention must have sufficient time to attempt a negotiated solution to their conflicts, and the auctions themselves will have to be conducted to learn how much the winning applicants agree to pay for their desired names.

Despite these uncertainties, ICANN will almost certainly receive substantial revenues from gTLD auctions. There are 230 exact match string contention sets composed of 754 total applications.⁴⁷ Several applications involved in direct contention have been submitted by Amazon, Donuts, Google, and Top Level Domain Holdings Limited—applicants with millions in financial backing to compete and prevail in high stakes auctions over commercially valuable gTLDs. Given the

⁴² *Limitations*.

⁴³ See Weber & Gunnarson, *A Constitutional Solution for Internet Governance*, 14 COLUM. SCI. & TECH. L. REV. at 43 ("California law permits the ICANN Board to limit its own powers. None of these broadly-worded provisions is qualified by the supposed requirement of preserving corporate autonomy. Instead, the law expressly allows ICANN to do what it says California law forbids: authorize some entity to exercise binding review of the Board.").

⁴⁴ *Draft Findings* at 1 (emphasis added).

⁴⁵ *ATRT2 Questions*, at 6.

⁴⁶ ICANN, *gTLD Applicant Guidebook Version 2012-06-04*, at 4-19 n.1 ("*Guidebook*") ("It is planned that costs of the new gTLD program will offset by fees, so any funds coming from a last resort contention resolution mechanism such as auctions would result (after paying for the auction process) in additional funding.").

⁴⁷ See ICANN, *New gTLD Program: String Similarity Contention Sets* (Feb. 26, 2013), at <http://www.icann.org/en/news/announcements/announcement-26feb13-en.htm>.

financial interests involved, auctions among such applicants will almost certainly result in substantial excess revenues for ICANN.⁴⁸

But auctions are not the only source of profits from the new gTLD program. Excess revenues probably will come from already-paid gTLD application fees, for at least three reasons.

First, the gTLD application fee may reflect amounts in excess of actual costs. Charging \$185,000 per application relied on a “detailed costing process” that has not been publicly disclosed and the historical baseline used to confirm that cost estimates were reasonable consisted of asking ICANN staff to estimate the cost of administering 10 previous TLD applications.⁴⁹ Adding to doubts about the methodology for setting the fee, vocal criticism by several groups has been directed at the \$60,000 risk management component of the fee. Why ICANN decided to self-insure against risk rather than obtaining a commercially reasonable insurance policy has never been explained. Nor has it been explained why the risks exclusively associated with the new gTLD program justify ICANN’s collection of over \$114 million (calculated by multiplying \$60,000 per application by 1,900 applications).

Second, the unexpected volume of new gTLD applications may have reduced the cost of administering each application. Before the application period began, ICANN estimated that the demand for new gTLDs during the initial round of applications would be “in the 400-500 range.”⁵⁰ More than 1,900 applications were submitted, 400% more than anticipated. Greater than expected volume ordinarily produces economies of scale that should reduce ICANN’s costs. Additional cost savings probably arise because similarities among gTLD applications in particular categories, such as gTLDs sought by recognized brand holders for their exclusive use, simplify evaluation.

Third, the volume of new gTLD applications gave ICANN a massive infusion of capital from which it will derive interest and investment revenue while applications are being evaluated. Earning a return on the \$355 million ICANN has received in application fees is exactly why the Board has invested it.⁵¹ Even a

⁴⁸ Private auctions will reduce the amount of auction revenues going to ICANN. But there is no evidence that private auctions will seriously compete with, much less supplant, the ICANN-managed auctions prescribed by the *Guidebook* as the conflict resolution mode of last resort.

⁴⁹ ICANN, *New gTLD Program Explanatory Memorandum: Cost Considerations of the New gTLD Program 2*, 2-3 (Oct. 24, 2008), at <http://archive.icann.org/en/topics/new-gtlds/cost-considerations-23oct08-en.pdf>.

⁵⁰ ICANN, *Draft: Delegation Rate Scenarios for New gTLDs*, at 9 (March 5, 2010) (corrected version).

⁵¹ ICANN, Board of Directors, *Rationale for Resolution 2012.12.20.21*, at <http://www.icann.org/en/groups/board/documents/resolutions-20dec12-en.htm#2.e> (acknowledging that “ICANN has collected approximately US\$355 million of application fees from applicants for generic top-level domains (gTLDs) in the New gTLD Program” and explaining that “the funds will be earning some return on investment during the period of time that the funds are invested”).

modest return of 5% on the original investment for a single year would yield approximately \$17.8 million.

Until the first round of gTLD applications has been evaluated and approved names have been delegated to the root zone, we cannot know how much revenue ICANN will recover from the new gTLD program. Nor can we know ICANN's actual costs. Litigation and other risks also may arise only after some time has elapsed. Despite these uncertainties, it is highly probable that ICANN will recover profits from the new gTLD program.

Those profits could dwarf any excess revenues ICANN has known before. Investment revenues, the source of gTLD profits about which we know the most, could generate \$17.8 million in a single year. By comparison, ICANN reported a \$10.7 million net gain from all its operations for the fiscal year ending June 2011.⁵² Auction revenues and net revenues from charging greater fees than actual costs could far surpass investment revenues. Recall that the risk component of gTLD fees amounts to \$114 million, and it remains unclear exactly how much of that fund will be necessary for the narrow purpose of mitigating risks (litigation and otherwise) from the first round of new gTLD applications.

Substantial profits from the gTLD program raise potential challenges for ICANN's legitimacy. The legitimacy of ICANN's authority over the DNS rests on its commitments to "remain a not for profit corporation" and to continue "operat[ing] as a multi-stakeholder, private sector led organization with input from the public, for whose benefit ICANN shall in all events act."⁵³ These commitments form ICANN's institutional DNA, the core reasons justifying ICANN's unique authority over the global DNS. Handling excess revenues from the new gTLD program in the same way a profit-making enterprise would handle a windfall—as property to be used for whatever purposes the corporation decides—would raise immediate and urgent questions about the legitimacy of ICANN's authority.

Yet the ICANN Board has not formally announced what it intends to do with gTLD revenues. The *Guidebook* assured gTLD applicants that "[a]ny proceeds from auctions will be reserved and earmarked until the uses of funds are determined. Funds must be used in a manner that supports directly ICANN's Mission and Core Values and also allows ICANN to maintain its not for profit status."⁵⁴ The *Guidebook* adds that "a process can be pre-established to enable community consultation in the event that such funds are collected," a process that will include "publication of data on any funds collected, and public comment on any proposed models [for distributing the funds]."⁵⁵ But the Board has said nothing about other

⁵² ICANN, *2010 IRS Form 990*, at <http://www.icann.org/en/about/financials/fiscal-30jun11-en.htm>.

⁵³ *Affirmation*, at ¶8.

⁵⁴ *Guidebook*, at 4-19 n.1.

⁵⁵ *Id.* at 4-20 n.1.

sources of gTLD profits, nor has it passed a resolution binding itself to the reassurances expressed in the *Guidebook*.

ATRT2 should look into the issue of gTLD revenues and, based on its analysis, include specific recommendations for the ICANN Board in its written report.

At the threshold of ATRT2's investigation is the reality that community consultation cannot be meaningful if gTLD profits are spent beforehand. Ensuring that all gTLD profits—not just the auction proceeds—are “reserved and earmarked”⁵⁶ until the ICANN community has an opportunity to discuss how best to spend them requires proactive measures by the ICANN Board of Directors:

- ◆ The Board should issue a formal resolution that revenues from the first round of gTLD application fees and auctions will be spent only for the purposes described in the gTLD Guidebook until the first round is complete.
- ◆ The Board also should issue a formal resolution committing to call for an independent audit of gTLD revenues and costs by internationally reputable accounting firm within 30 days after the last gTLD application of the first round of gTLD applications has been finally administered.
- ◆ And the Board should issue a formal resolution assuring the ICANN community that any profits identified by the audit will be deposited into a designated account and that no expenditures from that account will be authorized by the Board until the community consultation process is complete.

With the excess gTLD revenues effectively “reserved and earmarked,”⁵⁷ the Board will have to decide how the gTLD profits should be spent. In making that decision the Board should be guided by the views of the community. Treating gTLD profits as a stewardship rather than as corporate property would enhance the legitimacy and credibility of ICANN as an institution charged with “act[ing] in the public interest.”⁵⁸

The *Guidebook* suggests that “a process can be pre-established to enable community consultation,”⁵⁹ but the Board has not yet explained what process it intends to follow. There may be value in bifurcating the process of community consultation. The community should be separately asked for what purposes gTLD profits should *not* be used and for what purposes they should be devoted. Without knowing how much wealth the new gTLD program will generate it is impossible to

⁵⁶ *Id.* at 4-19 n.1.

⁵⁷ *Id.*

⁵⁸ *Affirmation*, at ¶ 9.1.

⁵⁹ *Guidebook* at 4-20 n.1.

say how that wealth should be used. But it is not too soon for the Board to seek the community's views on how gTLD profits should *not* be used.

For my part, gTLD profits represent wealth for which ICANN has a stewardship, not corporate profits it is free to exploit. Expanding the Internet for new gTLDs is supposed to be about competition, innovation, and consumer satisfaction—not empire-building. Any profits should be refunded or invested for the benefit of the entire community and not for the buildup of ICANN as an institution, its infrastructure, staff, or contingency fund. It would be reassuring for the Board to commit now that gTLD profits will not be used in these ways.

As for potential uses of gTLD profits, any part of the new gTLD application fee charged above ICANN's actual costs should be refunded to the applicants. Excess revenues from that source should not be redistributed to community projects, however worthy, because ICANN's only legitimate mandate in charging fees was to recover its actual costs. Determining what counts as excess revenue will require a more careful accounting of the present and future uses of the risk management portion of the application fee. ICANN should disclose how much capital that portion now represents and explain in detail why the amount set aside for risk management cannot be reduced through insurance or other commercially reasonable means.

Auction proceeds may require different treatment to avoid skewed results: participants would be expected to bid differently if they believe that even the winning bid will be refunded, minus the costs of conducting the auction. Such proceeds should go to purposes and projects for which there is the broadest community consensus.

ATRT2 should therefore consider recommending that the ICANN Board establish a bifurcated process for consulting the community about the use of gTLD profits. The first step would be a call for public comments to address how gTLD profits should not be used; that call should be issued now, while the gTLD application process is pending. The second step would be a call for public comments, following the results of the audit described earlier, to ask how members of the community would prefer gTLD profits to be disposed.

CONCLUSION

ATRT2 has made an exemplary start to its important review of ICANN's accountability and transparency by requesting the community for its views on what questions ATRT should address.

Because ATRT1's Recommendation 23 was not fully addressed, ATRT2 ought to take a fresh look at the issue of ICANN Board review mechanisms. Especially important is the issue of creating an independent and binding review of Board decisions.

ATRT2 should also address the issue of new gTLD profits. How the Board manages those profits will have a significant impact—for good or ill—on ICANN's fundamental legitimacy.