VERISIGN™

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VIA FAX AND EMAIL

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Re: Transfer of Risks Under New gTLD Program and ICANN's Risk Reserve Fund

Dear John,

We write to share with you our concerns about the risks associated with the new gTLD program and the transfer of those risks to the parties participating in the new gTLD program and the general public utilizing Domain Name Services. We are also writing to question the need for the substantial risk reserve fund maintained by ICANN and funded by new gTLD application fees, which appears to be for the purpose of defending against claims that may materialize in implementing the new gTLD program and delegating new gTLDs into the DNS. We respectfully request that ICANN provide to the community more information and detail with respect to the risks associated with the new gTLD program that it has transferred to others and, in particular, the need and uses for the substantial risk reserve fund maintained by ICANN and funded by application fees.

The allocation of risks, and any transfer of risks, through indemnification, limitation of liability, release or other mechanisms, should reflect commercial and operational realities so as to allocate the risks to the party in the best position to identify, manage, and/or mitigate those risks. We do not see this desired allocation and transfer of risks occurring in the new gTLD program as currently structured. Instead, the allocation and transfer of risks in the new gTLD program fall on parties who are not best positioned to identify, manage, and/or mitigate those risks – applicants, registrars, registries, and consumers utilizing the DNS.

ICANN, the organization that has designed, and is administering and implementing, the new gTLD program, surely is the entity in the best, and perhaps the only, position to ensure that the risks of the new gTLD program are identified, managed, and/or mitigated appropriately, including the risks Verisign identified in its "New gTLD Security and Stability Considerations" report, a copy of which we provided to ICANN's Chairman and CEO on March 28, 2013 (the "Verisign Report"). Instead of taking responsibility for the identification, management, and/or mitigation of these risks in the new gTLD program, ICANN has sought and obtained broad indemnities, limitations of liability, and releases from applicants, registrars, and registries.

Moreover, ICANN, has amassed a substantial risk reserve fund in excess of $100 million from new gTLD application fees, and is seemingly convinced that third party claims will materialize. The contractual framework and new gTLD program construct appear to have been designed to ensure ICANN will be protected, even though it, and it alone, is in the best position to identify, manage, and/or mitigate the very same risks from which it seeks to insulate itself.

We believe ICANN should be forthcoming about the risks it is shifting and the need for the substantial risk reserve fund, in particular. This letter is an appeal to ICANN to do so.

The Risk Reserve

We recently reviewed ICANN's "FY2014 Draft Operating Plan and Budget" (the "2014 Operating Plan") and noted that the "Risk Reserve" that ICANN has established has grown to the total amount of $115.8M as of April 2013 (the "Risk Reserve"). During the period of time since ICANN formally began accepting new gTLD applications in January 2012, the Risk Reserve has grown to this substantial figure, and to date ICANN has not publicly disclosed sufficiently detailed and meaningful information explaining the precise nature and degree of the underlying potential risks for which the Risk Reserve was established and is being maintained. We see no basis in the public record that would justify why it was, and is, necessary to establish the Risk Reserve and fund it with $60,000, or nearly one-third, of each $185,000 application fee paid to ICANN for each new gTLD application.

Pursuant to the notes on slide 38 of the 2014 Operating Plan, ICANN discloses that approximately $1.0M of actual costs against the Risk Reserve has been incurred through March 2013. A separate, related note explains that the current net balance of the Risk Reserve is approximately $114.7M (presumably as a result of the debiting of the above-described $1M of actual costs), which will be maintained to cover "future costs" of the new gTLD program that "cannot be estimated." ICANN has previously stated that the Risk Reserve (a/k/a the "Risk Contingency Fund") was created and is being maintained as a "[new gTLD] program risk contingency for uncertain or difficult to predict costs, and any other risks, including *unanticipated costs such as variations between estimates and actual costs incurred.*" *See* "FY13 ICANN GLOBAL Operating Plan and Budget for Fiscal Year Ending 30 June 2013," dated June 24, 2012, p. 62 (emphasis added) (the "2013 Operating Plan"). Similarly, ICANN has noted several additional scenarios that could give rise to such risks/difficult-to-estimate costs:

- What would happen if many more or many fewer applications were received than anticipated?
- How simple or complex will the average application be (dictating how many process steps must be executed for each application)?

- Have expected fees by outside consultants been estimated correctly?
- Are the time estimates for each task accurate?
- What happens if additional tasks are required?
- Have expenses for support functions such as information technology systems, legal support, contract support, and the like been fully identified?
- Will additional external costs be required to shore up defense against unanticipated events?

See "Update to the Cost Considerations of the New gTLD Program," dated October 2, 2009, p.12 (the "Cost Considerations Report").

The foregoing examples are largely comprised of administrative cost-overruns that, given the inaugural nature of the new gTLD program, arguably could occur in connection with program development and/or the processing and evaluation of new gTLD applications; however, these potential, administrative cost-overruns, considered individually or in the aggregate, do not appear significant enough to warrant the accumulation and maintenance of $115.8M in the Risk Reserve. This conclusion seems confirmed by page 19 of the 2014 Operating Plan, which forecasts only approximately $755,000 of "New gTLD Risk Costs" for FY2013 and does not budget any amount for "New gTLD Risk Costs" for FY2014. Notably, these forecasted and budgeted figures in the 2014 Operating Plan are dramatically lower than their counterpart figures in the 2013 Operating Plan, in which "Risk Costs" were budgeted at $54.755M for FY2013 and estimated at $56.902M for FY2014. *See* 2013 Operating Plan, p. 61.

Assuming the universe of potential "New gTLD Risk Costs" is limited to administrative cost-overruns akin to the examples described above, and given that ICANN forecasts only approximately $755,000 of "New gTLD Risk Costs" for FY2013 and has not budgeted any amount for "New gTLD Risk Costs" for FY2014, there would be no need for ICANN to maintain such a large risk reserve going forward. ICANN has recognized the possibility that "a surplus of funds may be realized either during the application processing period or upon its completion." *See* 2013 Operating Plan, p. 63. In the event a surplus of new gTLD program funds is realized from any source, ICANN has stated that its "staff will initiate a policy development process to define with the community the purpose and mechanism of administration of such excess." *Id.* Yet, ICANN has not publicly recognized any portion of the Risk Reserve as a surplus or engaged the Internet community in any dialogue regarding the potential administration of any fund excess.

In light of the foregoing, we believe the substantial size of the Risk Reserve suggests that ICANN contemplates potential risks arising from the new gTLD program that are much larger than the risks of potential, administrative cost-overruns in developing and administering the new gTLD program. We believe that ICANN may have established and be maintaining the Risk Reserve in such a high amount in anticipation of significant claims that may be asserted against ICANN by third parties relating to the new gTLD program, including claims relating to one or more risks identified in the Verisign Report. This belief has been confirmed to some extent by the prior statements of record made by one of ICANN's senior staff members, who stated that the $185,000 new gTLD application fee includes a risk contingency "for *any possible litigation*, as well as some historical development recouping of prior expenses incurred." *See* statements of Juan Ojeda, ICANN's Controller, in the "Framework for the FY12 Operating Plan and Budget Consultation," dated March 14, 2011, p. 12 (emphasis added).

ICANN's bylaws (the "Bylaws") authorize ICANN to set "fees and charges for the services and benefits provided by ICANN," with the goal of "establishing reasonable reserves for future expenses and contingencies reasonably related to the legitimate activities of ICANN"; however, the Bylaws mandate that any such fees and charges be "fair and equitable" and, once adopted, "be published on [ICANN's] Website in a sufficiently detailed manner so as to be readily accessible." ICANN Bylaws, art. XVI, § 5. The Bylaws also state that "ICANN and its constituent bodies shall operate to the maximum extent feasible in an open and transparent manner and consistent with procedures designed to ensure fairness." *Id.*, art. III, § 1.

We believe the foregoing provisions of the Bylaws obligate ICANN to provide more detailed and meaningful information to Verisign and the community concerning the risks underlying the establishment and maintenance of the Risk Reserve, including, in particular, the details regarding what "possible litigation" factored into ICANN's decisions regarding the creation of the Risk Reserve, its level of funding, and its continued maintenance. The information provided by ICANN should include, at a minimum, a copy of the report commissioned by ICANN and prepared by Willis, Inc., that studied the uncertain/hard-to-predict cost components of the new gTLD program and quantified the $60,000 risk contingency component of each new gTLD application fee, along with any updates or supplements thereto. *See* Cost Considerations Report, p.12.

ICANN's Additional Liability Protections Relating to New gTLD Program

In addition to its Risk Reserve, ICANN has garnered substantial other protections, including indemnification rights, liability releases and limitations, and other risk-shifting mechanisms in its contracts with many of the new gTLD program's key stakeholders in an effort to further shield itself from, or otherwise mitigate, any potential third party liability it may ultimately face related to the new gTLD program.

For example, the current draft form of Registry Agreement for new gTLD registry operators provides that:

> Registry Operator shall indemnify and defend ICANN and its directors, officers, employees, and agents (collectively, "Indemnitees") from and against any and all third-party claims, damages, liabilities, costs, and expenses, including reasonable legal fees and expenses, arising out of or relating to intellectual property ownership rights with respect to the TLD, the delegation of the TLD to Registry Operator, Registry Operator's operation of the registry for the TLD or Registry Operator's provision of

> Registry Services, provided that Registry Operator shall not be obligated to indemnify or defend any Indemnitee to the extent the claim, damage, liability, cost or expense arose: (i) due to the actions or omissions of ICANN, its subcontractors, panelists or evaluators specifically related to and occurring during the registry TLD application process (other than actions or omissions requested by or for the benefit of Registry Operator), or (ii) due to a breach by ICANN of any obligation contained in this Agreement or any willful misconduct by ICANN.

"Draft New gTLD Registry Agreement," dated April 29, 2013, § 7.1(a).

The form of Registry Agreement also includes a provision limiting ICANN's monetary liability for its breach of the agreement to the total, aggregate amount of Registry-Level Fees (as defined therein) paid by the registry operator to ICANN within the preceding twelve-month period. *See id.* at § 5.3. Similarly, the current draft form of Registrar Accreditation Agreement, which is intended for use in connection with the new gTLD program and beyond, caps ICANN's financial liability in the event of its breach of the agreement to the total, aggregate amount of accreditation fees paid by the registrar to ICANN during the preceding twelve-month period. *See* "Draft Registrar Accreditation Agreement," dated April 22, 2013, § 5.9.

ICANN has even built provisions into the New gTLD Applicant Guidebook in an effort to protect itself from risks vis-à-vis new gTLD applicants, new gTLD registrants, and other third parties. For example:

> Applicant shall indemnify, defend, and hold harmless ICANN (including its affiliates, subsidiaries, directors, officers, employees, consultants, evaluators, and agents, collectively the ICANN Affiliated Parties) from and against any and all third party claims, damages, liabilities, costs, and expenses, including legal fees and expenses, arising out of or relating to: (a) ICANN's or an ICANN Affiliated Party's consideration of the application, and any approval rejection or withdrawal of the application; and/or (b) ICANN's or an ICANN Affiliated Party's reliance on information provided by applicant in the application.

"New gTLD Applicant Guidebook, Module 6 (Top-Level Domain Application - Terms and Conditions)," dated June 4, 2012, ¶ 5.

Moreover, each new gTLD applicant is also required to give ICANN a broad release of liability in connection with the new gTLD process:

> Applicant hereby releases ICANN and the ICANN Affiliated Parties from any and all claims by applicant that arise out of, are based upon, or are in any way related to, any action, or failure to

> act, by ICANN or any ICANN Affiliated Party in connection with ICANN's or an ICANN Affiliated Party's review of this application, investigation or verification, any characterization or description of applicant or the information in this application, any withdrawal of this application or the decision by ICANN to recommend, or not to recommend, the approval of applicant's gTLD application. APPLICANT AGREES NOT TO CHALLENGE, IN COURT OR IN ANY OTHER JUDICIAL FORA, ANY FINAL DECISION MADE BY ICANN WITH RESPECT TO THE APPLICATION, AND IRREVOCABLY WAIVES ANY RIGHT TO SUE OR PROCEED IN COURT OR ANY OTHER JUDICIAL FOR A ON THE BASIS OF ANY OTHER LEGAL CLAIM AGAINST ICANN AND ICANN AFFILIATED PARTIES WITH RESPECT TO THE APPLICATION. APPLICANT ACKNOWLEDGES AND ACCEPTS THAT APPLICANT'S NONENTITLEMENT TO PURSUE ANY RIGHTS, REMEDIES, OR LEGAL CLAIMS AGAINST ICANN OR THE ICANN AFFILIATED PARTIES IN COURT OR ANY OTHER JUDICIAL FORA WITH RESPECT TO THE APPLICATION SHALL MEAN THAT APPLICANT WILL FOREGO ANY RECOVERY OF ANY APPLICATION FEES, MONIES INVESTED IN BUSINESS INFRASTRUCTURE OR OTHER STARTUP COSTS AND ANY AND ALL PROFITS THAT APPLICANT MAY EXPECT TO REALIZE FROM THE OPERATION OF A REGISTRY FOR THE TLD; PROVIDED, THAT APPLICANT MAY UTILIZE ANY ACCOUNTABILITY MECHANISM SET FORTH IN ICANN'S BYLAWS FOR PURPOSES OF CHALLENGING ANY FINAL DECISION MADE BY ICANN WITH RESPECT TO THE APPLICATION. APPLICANT ACKNOWLEDGES THAT ANY ICANN AFFILIATED PARTY IS AN EXPRESS THIRD PARTY BENEFICIARY OF THIS SECTION 6 AND MAY ENFORCE EACH PROVISION OF THIS SECTION 6 AGAINST APPLICANT.

Id. ¶ 6.

Furthermore, the new gTLD Dispute Resolution Procedure provides that ICANN and its board members, employees, and consultants shall not be liable "to any person for any act or omission in connection with any proceeding conducted under [the new gTLD Dispute Resolution Procedure]." "New gTLD Applicant Guidebook, Attachment to Module 3 (New gTLD Dispute Resolution Procedure)," dated June 4, 2012, art. 22. Although a copy of ICANN's agreements with each of IBM and Deloitte for the provision of various services relating to the Trademark Clearinghouse has not been made publicly available, we can only assume that those agreements also contain provisions similar to the above that operate to limit ICANN's financial exposure to third parties in connection with the Trademark Clearinghouse.

All of the foregoing contractual provisions are designed to further insulate ICANN from liability in connection with the new gTLD program, arguably even under circumstances where the liability results from ICANN's recklessness or willful misconduct. In addition to this insulation, ICANN almost certainly enjoys the benefit of additional financial cushions in the form of its insurance coverage, which we understand may include general liability, professional liability, and D&O coverage, as well as the "rainy day" Reserve Fund, which is available for emergency use by ICANN under ICANN's Investment Policy. *See* ICANN's Investment Policy (Definition of "Reserve Fund"). According to ICANN's online financial dashboard, the "rainy day" fund contains approximately $58,908,000 in total assets as of April 30, 2013, above and beyond the $115.8M set aside in ICANN's Risk Reserve.

The Risk Reserve ($115.8M) together with the "rainy day" Reserve Fund ($58.9M) comprises reserve funds held by ICANN in excess of $174M. All stakeholders and users are entitled to an explanation of the needs and uses for such a substantial reserve fund held and maintained by ICANN and funded by applicants. We note that if new gTLD applicants seek to recover their fees and costs paid to ICANN, they may well do so by passing those costs on to consumers through domain registrations fees as this appears to be the only manner in which applicants can recover their fees and costs.

Conclusion

We believe that ICANN, through the establishment and maintenance of the substantial Risk Reserve and the numerous contractual protections described above, has established a regime whereby ICANN will shoulder none of the burden of any financial liabilities and reputational tarnish that may result from any failures of the new gTLD program. This seems an incongruous result given that ICANN wrote the new gTLD Applicant Guidebook, has had exclusive and confidential control of the process for evaluating and approving new gTLD applicants, and will recommend the delegation of new gTLDs into the root. Most notably, ICANN has controlled the entire process concerning the important work of the SSR Review Team, including hiring a third party contractor to assist the team with necessary research and analysis, as well as making unilateral decisions regarding the assessment and disclosure of risks related to the new gTLD program.

And yet, in the event the new gTLD program suffers any failures that give rise to any claims asserted by third parties, ICANN can deflect any resulting financial burden and reputational tarnish to other parties that will be effectuating the new gTLD program on behalf of ICANN, including new gTLD registry operators, registrars, applicants, and registrants. ICANN's shifting of risks in this manner is in opposition to one of the key recommendations of ALAC regarding the new gTLD program. *See* "ALAC Statement to the Board Regarding Security and Stability Implications of New gTLDs," dated May 31, 2013, p. 1 ("ALAC urges the Board to take full consideration of relevant SSAC advice and recommendations to ensure that residual risk is minimized and specifically that residual risk is not transferred to third parties such as current registry operators, new gTLD applicants, registrants, consumers and individual end users.").

During ICANN's January 2012 consultation with members of the Internet community regarding the framework for ICANN's 2013 Operating Budget, Xavier Calvez, ICANN's Chief Financial Officer, stated that the hundreds of millions of dollars that ICANN potentially could collect on account of new gTLD application fees are not "a treasure chest," but rather will be spent to "process the applications and cover the risks." "Framework for the FY13 Operating and Budget Consultation," dated January 27, 2012, p. 24. However, the $115.8M comprising the Risk Reserve seems excessive in the absence of detailed and meaningful information regarding the risks underlying the reserve's creation, level of funding, and continued maintenance. We can only assume that ICANN established and continues to maintain the Risk Reserve at such a high level for good reasons, and we believe that the community has a right to better understand those reasons, which appear are related to potential third party claims that ICANN foresees arising from its implementation of the new gTLD program. We also believe the community has a right to better understand the reasons behind and need for the broad transfer of liability from ICANN to applicants, registrars, registries, and consumers of DNS services when ICANN itself is best positioned of all to identify, manage, and/or mitigate the associated risks for the benefit of all.

Sincerely,

Richard H. Goshorn

Richard H. Goshorn
Senior Vice President, General Counsel,
and Secretary
VeriSign, Inc.

cc: Steve Crocker, Chairman of the Board, ICANN
Cherine Chalaby, ICANN Board New gTLD Program Committee
Fadi Chehadé, President and CEO, ICANN
D. James Bidzos, Executive Chairman and CEO, VeriSign, Inc.