DEMAND MEDIA COMMENTS ON

COMPETITION AND PRICING FOR NEW TLDS

Introduction

The following are our views on the Competition and Pricing Reports prepared by Professor Dennis Carlton as well as our analysis of the overarching issue of Demand and Economic Analysis. Both our comments and Professor Carlton's Reports address the issues discussed by the ICANN Board in their October 18, 2006 meeting[i].

Our analysis is not based on academic or professional expertise in economics, but rather on 12 years of practical experience in the buying and selling of domain names. Currently, we are the number two ICANN registrar by volume, managing 12 million domains.

We provide comments on the follow questions:

1. Is each TLD Its Own Market or do They Compete?
2. Should there be Price Controls on Initial Registrations?
3. Should there be Price Controls on Renews?
4. Have Previous "New" TLDs Added Competition?
5. Will More TLDs Create Competition?
6. Should Collision Be Resolved Through Competition on Price and Service?
7. Is Further Economic Study Required?

In our comments we try to apply the 'common sense' perspective. With most issues above we ask ourselves the following, primary question -- *Is there anything about domains that makes them so different from other products in terms of pricing and competition that there is a need for special regulation?* In most, but not all cases, we find that the answer is no.

1. Is Each TLD Its Own Market or Do They Compete?

Our observation of registrant behavior is that there is competition between TLDs at the time of Initial Registration. Sometimes this competition is strong. Registrants typically compare these factors when selecting a TLD:

- Is the second level name I want available in that TLD?
- What is my perceived brand value for that TLD?
- What is the price?
- What special rules or restrictions (if any) does this TLD have?

The weight put on each factor varies from consumer to consumer. Sometimes consumers will purchase the same string in multiple TLDs, but more often they weigh the four factors above and select a specific TLD. In many cases this TLD is not COM/NET/ORG. This observation of actual registrant behavior is confirmed by registration statistics. There are currently millions of registrations in TLDs other than COM/ NET/ ORG where the owner of the SLD is different from the owner of the same SLD in COM/NET/ ORG (if that name is registered in COM/NET/ORG). The vast majority of these are not trademark names (for a detailed explanation of this, please see our separate study here - http://www.circleid.com/posts/20090202_analysis_domain_names_registered_new_gtlds/.

Currently, in the gTLD environment, consumers place considerably higher brand value on COM versus other products. This, as well as COM's longevity, accounts for its larger market. When ccTLDs are introduced however, COM frequently has lower brand value than many (for example .AU). ccTLDs such as .AU have significantly larger market share than COM in their countries. One of the reasons for this is stronger affinity with consumers. However, even with these ccTLDs consumers still weigh the four bulleted factors above.

2. Should There be Price Controls on Initial Registrations?

Our experience indicates price controls on Initial Registrations in new TLDs are unnecessary, impractical and likely harmful to competition.

We currently sell primary market (Registry supplied) domains in over 50 TLDs. Some TLDs sell at $3 per year others at $150 per year. Customers are well informed about the prices of various these products and they make decisions based on their needs. We find domains are like most product categories in terms of pricing. Like domains, prices in most product categories vary widely (e.g. shirts: some sell at $15 and others at $300). Customers have a choice and they make judgments based on a variety of factors.

The logic of the 'trapped customer' does not apply at time of Initial Registration[ii]. A registry that raises prices for Initial Registrations is not harming anyone. If the registry decides the price of Initial Registrations will go from $5.00 to $10.00 (next week) no-one is harmed unless the buyer has no choice but to select that product. The more choices the consumer has the less likelihood of harm. A future buyer who does not like the new $10.00 price will simply choose not to purchase a name is that TLD, or will go to a more attractive TLD. The more TLDs that exist the more opportunity a customer has to make choices, and the more market forces will incent each registry to be competitive on pricing.

Similarly there is no rationale for a mandated warning period on price increases for initial purchases of domain names. Manufacturers of other products announce price increases or decreases from time to time and typically give their customers some warning of this, but this is not regulated or mandated. Products with volatile pricing tend to be treated warily by customers. Existing TLDs that do not have price controls (e.g. TRAVEL, ASIA, MOBI) have provided their customers with predictability on pricing. The absence of controls on those TLDs does not appear to have harmed consumers.

Leaving aside the need for price controls, how would they work? Would caps be uniform across all TLDs, or individually selected? There are significant problems with both approaches. What methodology could be used to select a cap? A 'benchmark' of existing TLD prices would be biased towards TLDs with millions of names under management. A uniform approach to caps would 'standardize' every TLD in terms of its features and marketing which we think would be harmful to innovation and competition. How would price caps address different functionality? How would ICANN measure and cap the value to a consumer of a new and innovative TLD solution (e.g. MAIL domains with built in spam inhibitors or SAFE domains with built in authentication)?

In our view, TLDs should compete with each other on price, availability, perceived value and features – like the overwhelming majority of other products do. We think this will be more beneficial to consumers than arbitrary and expensive to manage price controls.

3. Price Controls on Renewals

The common concern is that a consumer purchases a domain, builds value in it, and then faces a significantly higher price at renewal time. As domains are unique, there is not the ability to 'move' this domain somewhere else (although it is arguably easier for the registrant to move from abc123.COM to abc123.NEWTLD than it is to move to def456.COM). However, the need for notice periods on Renewals is not clear cut. In his paper, Professor Carlton argues against the need to regulate this problem. He argues that every supplier has *'captive buyers in the short run'* and that domain registries have a vested interest in not exploiting customers due to the detriment this would cause to their business reputation. He argues that registries who engage in this behavior will be punished by the competitive marketplace.

We see the logic in Professor Carlton's analysis, and he is a far more qualified economic commentator than ourselves. Our experience particularly confirms his conclusion that: *"suppliers in growing markets face the strongest incentives to preserve their reputation and thus to avoid opportunistic behavior. This is because, in a growing market, an opportunistic firm risks greater future losses than do similar firms in stable or declining markets. Thus, the rationale for imposing price caps is weakest in rapidly growing Industries"* (*Price Caps* report page 6).

His views are reinforced by the behavior in all existing registries that do not have price controls (such as .TRAVEL, .JOBS, .ASIA, .TEL, and .MOBI). Although these are 'sponsored' TLDs, in practice there is wide ability for the registry to vary prices if they choose, and they have chosen not to do so.
There is a strong argument that information and predictability are more useful than regulation. If a consumer knows a TLD can raise its prices at renewal time this consumer may choose to make Initial Registration in a different TLD; One that has contractually committed to not change its renewal prices.

On the other hand, we acknowledge the widespread concerns expressed about Renewal pricing in the public comments period. We believe these concerns are overstated because the market will dictate that registries give their customers adequate warning about Renewal price increases and some registries will voluntarily lock-in renewal prices to consumers in order to differentiate themselves from competitors. Given the concerns expressed, however, on balance we are prepared to accept a mandated notice period for Renewals because we think this is how the market will work in practice.

4. Have the Existing New TLDs (BIZ, INFO, TRAVEL, MOBI, ASIA etc) Added Competition

We have seen a moderate amount of competition generated by the addition of new gTLDs (since 2001). We think this competition would have been greater had the selection process for those TLDs been closer to the proposed process for 2009. Previous rounds had subjective selection criteria and encouraged applicants to put constraints on their business models (for example, price controls or registrant authentication requirements). Professor Carlton agrees with this concept when he says: *"imposing price caps on the registries for new gTLDs could inhibit the development and marketplace acceptance of new gTLDs by limiting the pricing flexibility of entrants to the provision of new registry services without generating significant benefits to registrants of the new gTLDs"* (*Price Caps* paper pages 2 and 3).

There tends to be a comparison of all new TLDs to COM with a common conclusion that any TLD not approaching COM's size is unsuccessful. We don't think this is a valid basis for measuring success, or competition. Most new TLDs since 2001 represent profitable, well run registries that contribute to consumer choice and quality. We think these registries have also positively contributed to the ICANN policy development process. We see an analogy with cities and towns. Just because White Plains has a smaller population than New York City does not mean White Plains isn't thriving. People choose one over the other for various reasons, for example one is very crowded while the other offers a broader choice of living spaces.

5. Will this 2009 Round of TLDs Truly Introduce Competition?

As previously noted, many ccTLDs out-compete COM in their markets. It seems illogical to us that national identity would be the only affinity strong enough to create this competition with COM. As more TLDs are introduced we think affinity groups (large and small) will place a higher brand value on their new TLD than they do on COM.

Although it is possible a single, new TLD will emerge to threaten or eclipse COM in size, we think it is far more likely that COM will lose market share to the cumulative effect of many smaller to medium-sized TLDs. Previous new gTLDs were less successful competing with COM because there were few of them (and hence they lacked overall market visibility), and their selection process encouraged constrained business models. This round will be more successful because there will be more TLDs and they will not have to constrain their business models. The readers of *Gulliver's Travels* might agree.

Even should COM retain dominant market share, and this is certainly possible in the medium term, we agree with Professor Carlton that *"consumers would nonetheless realize significant benefits from the new gTLDs due to increased competition for new registrants and increased innovation"* (page 4 of *Consumer Welfare* paper). We also agree with his analysis that *"to the extent COM and other TLDs have any market power today, expansion of the number of TLDs would help dissipate it in the future"* (page 10).

6. Should String Collision Be Resolved Through Competition on Price and Service?

This suggestion was raised by the US Department of Commerce and endorsed by some other commentators. It suggests that if two (or more) applicants want the same string they should compete on promised price and service to customers. Although there is merit to this approach with some forms of procurement (e.g. building a ship to a specification) we think it would be a very poor way to allocate new TLDs. It would have the following, negative consequences if applied to TLDs:

a. **Subjective Judgments.** It will force ICANN to make subjective or artificial service level comparisons. For example, what weight should be given to faster SRS processing speeds when registrar and ISP responsiveness has a greater impact on consumers?
b. **Invalid Comparisons.** How will ICANN compare applicants that offer different features within the TLD? How will they judge one application for MAIL that has an innovative but unproven method of spam control, versus another, lower priced application MAIL that has no such features?
c. **Limited Benefit to Consumers and Abusive Practices.** Low priced domains from the registry do not necessarily mean low priced domains to consumers. If applicants compete to drive down the registry price, say for .WEB, a large number of WEB names will be initially purchased by industry insiders who will then sell them at real market rates. Low-capped prices will result in what we see in COM. One of the wide misconceptions is that COM names are cheap. They're only cheap in the primary (from the registry) market where names are approximately $7.00. Someone who wants a memorable and relevant name can rarely find it in the primary market. They have to go to the secondary market where names often cost hundreds, thousands or millions of dollars. The people who can get cheap names in the primary market are typosquatters and spammers who either don't care about their name or are looking for a name a regular buyers would shun (e.g. a derivative of famous brand)). With COM the lack of full competition and the presence of price-caps have produced the worst of both worlds -- high prices for average buyers and low prices for abusers or those who want very unusual names.
d. **Favors Incumbents**. Competition on price and quality will strongly favor incumbent registry operators who have amortized infrastructure and the cost advantage of existing TLDs.

e. **Commoditization**. It will commoditize the branding of every TLD. For example, one applicant wants to offer EXCLUSIVE domains at a high price to a limited number of users and another applicant wants to offer EXCLUSIVE domains to everyone cheaply, the second applicant will win– even though very cheap EXCLUSVE domains are unlikely to gain much brand value.

f. **Unrealistic Commitments**. It will encourage applicants to make service level promises they cannot (or will not) keep. For example, I may win a TLD by promising over a three year period to sample authenticate and update the WhoIs details of my registrants. What will be the remedy three years from now if I fail to achieve that goal? What will happen if the other applicant for my TLD no longer exists at that time?

7. Is Further Economic Study Required?

There have been suggestions that a detailed economic analysis be performed, specifically including the demand for and benefits of new TLDs. Such an approach is impractical because of the unknown nature of innovation. We agree with Professor Carlton when he says: *"Requiring entrants to justify entry on cost/benefit basis, however, is likely to result in significant consumer harm because the competitive benefit of new business methods or technologies facilitated by entry can be very hard to predict a priori. Economic literature shows that innovations are a principal source of the growth in GNP and consumer welfare over time. Most notably, Robert Solow, who was awarded the 1987 Nobel Prize in Economics for his work on the sources of economic growth, noted in his Nobel Prize lecture that "the rate of growth...depends entirely on the rate of technological process." (page 18).*

We were of similar opinion to this when we made these comments on the first version of the DAG, in 2008: *"Some have asked why we need new TLDs at all, suggesting that consumers are not clamoring for them. We think such arguments display a misunderstanding of the nature of innovation. The most productive and beneficial developments in science and business have rarely been the result of broad public demand for a specific development. Rather, the very concept of innovation means that most people did not think of the idea until after its introduction. We are reminded of the introduction of FM radio when some questioned the need for change on the grounds 'we already have radio', since AM already existed. We believe just as FM and its following technologies resulted in higher quality service and choice for consumers, new TLDs will also begin a second phase of innovation and service improvement for DNS users".*

In our view further studies will be unable to measure the benefits of TLDs due to the unpredictability of innovation as well as the simple fact that innovative applicants will remain silent until the application window opens, in order to preserve their competitive advantage. In our view further studies will shed no more light on what is self evident. 'Studies' have rarely if ever accurately predicted the actual outcomes of innovation. New TLDs will bring competition and innovation for the benefit of consumers.

[i] Our research of the transcript and the minutes of the board meeting in question show that although the Board discussed that particular resolution, it was not voted on.

[ii] Some brand owners assert they are compelled to purchase their name in multiple TLDs. Of course this is a business decision for them to make, and the evidence with existing new TLDs indicates that by and large they do not do this. Regardless, we agree that brand owners should not be charged a premium (see http://www.circleid.com/posts/20090202_analysis_domain_names_registered_new_gtlds/).