



Maarten Botterman, Board Chair
Göran Marby, CEO
Internet Corporation for Assigned Names and Numbers

February 21, 2020

Dear Chair Botterman and Mr. Marby:

The proposed private equity-backed sale of the non-profit .ORG domain registry operator Public Interest Registry (PIR) poses substantial risks to millions of non-profit organizations and other non-commercial groups, their hundreds of millions of supporters and constituencies, and to a functioning civil society necessary to fulfill charitable missions and foster democratic participation. One of the undersigned groups, the Electronic Frontier Foundation, has written to you previously to share the concerns of non-profit organizations and Internet users about this proposed transaction. EFF and Americans for Financial Reform Education Fund write today to raise additional concerns regarding the financial terms of the transaction and the long-term financial viability of PIR to continue to fully serve PIR's unique mission.

PIR's recent announcement of pricing restrictions and a "stewardship council" do not address these concerns. ICANN should withhold consent for the change of control of the .ORG registry unless and until ICANN can fully assess the financial terms of the transaction. If PIR and Ethos Capital, the entity seeking to buy it, cannot address these financial concerns, then ICANN should use its contractual authority to reject the change of control, and begin an open public process for selecting a new .ORG registry operator.

We were pleased and encouraged to see ICANN request additional information from the Internet Society (ISOC), the current parent organization of PIR. Your letter of 13 February to ISOC's Chairman recognized that ISOC's 2002 commitments to the Internet community, including a promise to respond to the non-commercial community in the operation of the .ORG registry, remain vital today. The letter shows that ICANN is working to protect .ORG registrants from exploitation as part of its role to ensure the stable operation of the DNS. In that spirit, we offer the following additional observations.

Ethos Capital and ISOC have provided few details on the transaction to the public. But the financial terms of the takeover—especially factors that are unique to private equity purchases—are of paramount importance in determining whether PIR LLC can continue to be an economically viable entity that can fulfill its current mission to provide registry services for non-commercial registrants solely through its current business model and revenue stream.

Ethos Capital and ISOC have revealed the PIR purchase price (\$1.135 billion) and that it will be partially financed with a \$360 million term loan. Private equity leveraged buyouts typically are

financed with debt, the leverage in leveraged buyouts. The debt from these transactions is imposed on the target firm (here PIR LLC), which must repay the loan from its operating revenues. In addition, many private equity firms extract other fees, requirements, or even additional dividends financed by more debt that add to the costs imposed on the target firm. The target firms often pursue severe cost cutting, including reducing service quality, and price hikes to generate revenues for their private equity owners.

Many companies acquired by private equity have collapsed under the weight of debt and fees from the leveraged buyouts and been liquidated in bankruptcy. These impacts have been especially pronounced for entities that have a public service mission like PIR. For example, Philadelphia's Hahnemann University Hospital was shut down after its private equity owners looted its real estate and overburdened the vital safety net hospital with debt. The private equity industry takeovers of about 800 newspapers led to widespread layoffs, shuttering smaller papers, and curtailing local news coverage that undermined the public mission of fostering informed democratic accountability and government oversight. ICANN must critically examine the specifics of the financial terms of the Ethos Capital transaction to assess the impact the deal may have on PIR's future ability to operate the .ORG registry reliably and securely.

PIR's current business model and operating revenue are insufficient to service even the disclosed debt load alone. Over the most recent five years, PIR had average annual operating income of \$35 million (peaking at \$45 million in 2018). ISOC recently disclosed that the interest payments would be \$24 million the first year and then decline (but by an unspecified amount). Twenty-four million dollars would represent about half of PIR's peak income and two thirds of typical operating income, leaving little to invest in operations or deliver to Ethos Capital (less than 2 percent of the purchase price). More importantly, at the end of the loan term, PIR would still have to repay the \$360 million principal. The total cost of the loan would amount to about \$460 million over 5 years (the typical business loan term), which far exceeds PIR's current net operating revenues over five years (even the peak earnings only generate \$225 million over 5 years).

It seems overwhelmingly likely that the private equity-imposed debt load would prevent PIR LLC from relying solely on PIR's existing business model of charging modest annual fees to non-profit organizations for .ORG domain registrations, especially given PIR's recent announcement that it will limit itself to fee increases of no more than 10 percent, compounded annually. PIR LLC will have to generate substantial additional revenue to service the debt, which could force PIR LLC to take advantage of its monopoly position to raise prices; impose new service charges; reduce technical upkeep that could impair web connectivity or non-profit email traffic; or pursue other business strategies that could undermine the independence of non-profits, including suspending or transferring domain names in a censorship-for-profit strategy that has been used by other domain registries and internet companies. Ethos Capital may have other, as yet undisclosed, strategies to extract new revenues from additional services or conditions on its customers.

The non-profit, non-commercial entities that have .ORG domain registrations are captive customers of PIR's monopoly control of .ORG domain names. The for-profit PIR LLC would have the ability and incentive to impose price increases or new service conditions on its customers who would have

little alternative without losing their branded Internet presence (and face substantial financial and reputational costs to switch to another top-level domain).

The .ORG registry serves a unique role for non-profit groups, civil society, foundations, and charitable institutions that benefit from a vibrant internet for non-commercial activity. PIR and the .ORG registry have long provided a largely transparent and accountable forum for these non-profit registrants. The financial terms of the proposed transaction are extremely relevant to the future economic viability of the proposed PIR LLC after its conversion to a for-profit entity. In addition to the disclosures it has already requested, ICANN should insist that Ethos Capital, ISOC, and PIR publicly disclose the following information to evaluate the terms of the financial deal:

- 1) Describe in detail the investors and firms behind the Ethos Capital-proposed purchase of PIR. Ethos Capital is a very new private equity firm, and its investors have been reported only in the media. These almost unknown entities will be the owners of the .ORG domain registry for 10 million non-profit groups worldwide. Which firms or entities are participating in the deal as equity partners? How much cash equity are Ethos Capital and every other investor or co-investor each contributing to the proposed deal?
- 2) Will PIR LLC be able to service even the reported term loan (let alone other costs) under its current business revenue stream? When private equity firms purchase a target company through leveraged buyouts, the target company (in this case, PIR LLC) is responsible for repaying the loan that financed the transaction. ISOC reported that the interest-only cost of servicing the loan would be \$24 million the first year and then decline (an unusual structure for interest-only payments). The total \$460 million cost of repaying the loan includes repaying the \$360 million in principal as well as the interest payments, far above PIR's most recent five-year net operating revenue of about \$175 million. PIR had \$35 million average net operating income over the past five years, peaking at \$45 million in 2018. The interest-only payments would take two-thirds of typical net earnings and even half of peak net earnings, leaving little or no capacity for PIR to generate other revenues for Ethos Capital or to invest in operations. Ultimately, PIR also would have to repay the \$360 million in principal after the fifth year (the typical business loan term), creating a \$380 million obligation in 2024. What is the interest rate/basis points, duration/term, any origination or other fees, payment schedule, and any other relevant terms or conditions on the \$360 million term loan and the annual cost for PIR LLC to service this debt?
- 3) Are there any other currently undisclosed costs or obligations that Ethos Capital's purchase of PIR would impose upon the future operations of PIR LLC?
 - a. *What costs may be associated with any other credit or financing obligations?* PIR has reported that Ethos and its investment partners are providing *all* the balance of the \$1.135 billion purchase price in cash equity, or \$775 million in cash. Most private equity purchases have higher levels of leverage (about 60 percent), and it is possible that the PIR purchase involves additional debt or credit instruments beyond the reported term loan. Ethos and PIR should be required to describe in detail the terms and conditions of

any other credit instruments related to the purchase of PIR, including any non-cash equity credit, borrowing, equity issuance or any other financing.

- b. *What costs might be imposed by any other fees, services, or other ongoing costs included in the transaction?* Some private equity purchases include requirements to use particular business advisors or consultants, incurring additional costs on the target firm, or other consulting or management fees. Ethos and PIR should be required to detail any and all fees, services, or other ongoing projected costs related to the transaction.
- 4) What is Ethos Capital's projected revenue model for PIR LLC? PIR currently has 10 million subscribers with .ORG domain names that pay about \$10 annually. This has generated just over \$90 million in annual revenue, but with about \$45 million in operating income in 2018 (and far less in earlier years) according to its annual report. The overwhelming majority of its current revenues come from .ORG registrations, but the total number of those registrations has been declining slightly in recent years—especially for new .ORG registrations, which fell 7 percent annually since 2015. Ethos has promised not to raise prices more than 10 percent annually. If the transaction costs from debt and other imposed costs exceed operating revenues, how will PIR remain solvent given its promise?
- 5) Did PIR make provisions in the proposed takeover to limit future transaction-related expenses? Many private equity firms require target portfolio companies to pay “dividend recapitalizations” to the private equity firm that are funded through additional borrowing. Some private equity firms require that portfolio companies purchase goods or services from other affiliates or subsidiaries. These can impose significant additional costs on target firms like PIR LLC. Did PIR management secure legally binding commitments that Ethos Capital will not take out a dividend recapitalization? And did it establish binding conflicts of interest policies to prevent PIR LLC from being forced to enter contractual business arrangements with Ethos Capital affiliates? In particular, a number of people closely involved in the management of both Ethos and PIR also have substantial connections to the registry operator Donuts. Will Ethos require PIR to contract with Donuts for any registry services?
- 6) Did PIR include provisions for the business operation, non-profit mission, or other operational concerns for any future sale of PIR LLC? Most private equity firms aim to own a portfolio firm for a limited amount of time, typically 5 to 7 years, before creating an independent company (either a private or public company) or selling it to another investor or corporation. While Ethos, PIR, and ISOC have contended that PIR LLC will continue to fulfill PIR's non-profit mission with a commitment to minimal price hikes and a stewardship council, did PIR or ISOC include any operational pre-conditions for any future sale of PIR LLC to investors, companies, or other private or public offerings?
- 7) Did Ethos Capital provide any financial inducements or remuneration to the PIR or Internet Society board, executives, or management? Many private equity buyouts occur in partnership with management—including, it appears, the PIR purchase. In many cases, the existing management team receives financial consideration for completing the transaction. Ethos, PIR,

and ISOC should be required to detail any financial provisions for the PIR and/or ISOC management, board members, or consultants, including any equity stakes, one-time bonuses, employment or board tenure commitments, retirement or other financial benefits, or any other related perquisites.

These financial details are needed for ICANN, .ORG domain registrants, civil society, and the public to fully understand the scope and practical impact of the proposed Ethos Capital takeover of the Public Interest Registry. As Chair Botterman recently wrote to ISOC, it is imperative to discern the terms of the proposed deal to assess whether PIR can “continue to ensure and serve the unique purposes of the .ORG.” Unless the parties can clearly demonstrate that the transaction will not imperil the future operation of .ORG, ICANN should exercise its power to withhold support for the change of control, terminate its registry agreement with PIR, and begin a public process to find a new capable and trustworthy steward for the .ORG domain.

Sincerely,

Cindy Cohn, Executive Director
Mitch Stoltz, Senior Staff Attorney
Cara Gagliano, Staff Attorney
Electronic Frontier Foundation

Lisa Donner, Executive Director
Ricardo Valadez, Private Equity Campaign Manager
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