CASE: P-81
DATE: 9/25/12

UBER: 21ST CENTURY TECHNOLOGY CONFRONTS 20TH CENTURY REGULATION

On July 9, 2012, Travis Kalanick, CEO of Uber Technologies, had a decision to make—how to respond to a proposed regulation in Washington D.C. that provided some short-term protection for his company's operation, but also imposed restrictions on its future product offerings.

Uber provided a service that allowed customers to call for a limousine using their mobile device. A car would arrive within minutes, and the fee for their trip (including gratuity) would be charged to their credit card. Uber's service was more expensive than a taxi, but cheaper and more responsive than conventional limousine service. Many customers were willing to pay for the quick availability, comfort, and ability to get service from parts of cities not routinely covered by cabs. Uber had service in 16 cities, mostly in the U.S.

The immediate problem was a proposal expected to be introduced and voted on the next day by the Washington D.C. City Council. Uber began service in D.C. in December 2011, but it had a contentious relationship with regulatory authorities from the beginning. Uber's operation was a hybrid of taxi and limousine service; regulations for taxis and limousines were different, and in some cases mutually exclusive, so the company was in a regulatory gray area. The pending proposal would establish a new regulatory class of limousine that covered Uber's model, with a minimum fare per trip. While the proposed minimum was the same as Uber's current minimum charge, the company was in the process of rolling out a lower-priced service. Kalanick thought that preventing companies from reducing prices was an odd way for the city council to serve the public.

David Hoyt and Professor Steven Callander prepared this case as the basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation.

THE TAXI AND LIMOUSINE REGULATORY ENVIRONMENT

There is a distinction between taxicab service and livery (or "for-hire") vehicle (e.g. limousine) service, each operating under a different set of rules. Both taxicabs and livery vehicles are regulated by the states and/or cities in which they operate. In general, taxicabs are regulated at the municipal level, while livery vehicles are regulated by state agencies in some jurisdictions.[1]

Some cities control the total number of taxicabs through the sale of taxicab "medallions"—New York began its medallion system in 1937, and the number of taxicabs in the city had remained about constant ever since (with two medallions selling on the open market for $1 million in October 2011).[2] Other cities, such as Washington, D.C., allow anyone to operate a taxicab, provided the operator obtains a taxicab license and operates according to its regulations. Livery vehicles must maintain valid licenses from their regulating agency.

The rules that apply to taxicabs and livery vehicles are similar from jurisdiction to jurisdiction, although they differ in the details. Regulations typically address issues in the following categories: how the passenger contacts the service provider, the fare structure, and the labeling and appearance of vehicles.

Contacting the Service Provider

Vehicle operators may be contacted by customers in two basic ways: by hailing on a street, or by prearrangement. In general, only taxicabs can be hailed on the street—for-hire vehicles must be prearranged. In most jurisdictions, taxicabs can also be dispatched immediately after a telephone request from a customer, and in many cases taxicabs can also prearrange pickups.

In most cities, livery vehicles cannot be hailed on the street, nor can they respond immediately to pick-up requests—they typically have a minimum prearrangement time requirement, often as much as one hour, before the passenger may be picked up. The prearrangement requirement protects taxicabs from potential competition from livery vehicles. The requirement typically also applies to third-party referrals. In Seattle, for instance, it is a civil infraction for a driver to "solicit … customers … through a third party for immediate non-prearranged limousine service pick up."[3] The fee must also be established prior to pick up. The restrictions also apply to referral agencies—for example, it is an infraction in Seattle to "accept payment to solicit or assign customers on behalf of a chauffeur for immediate, non-prearranged limousine service pick up."[4]

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[1] For a detailed discussion of regulatory issues for taxicabs and for-hire vehicles, particularly as they apply to smartphone applications, see Matthew Daus, "'Rogue' Smartphone Applications for Taxicabs and Limousines: Innovation or Unfair Competition? A National Regulatory Review of Safety, Accountability and Consumer Protection Legal Issues," Windels Marx Lane & Mittendorf, LLP, June 29, 2012.

[2] Megan McArdle, "Why You Can't Get a Taxi, and How an Upstart Company May Change That," *The Atlantic*, May 2012, online at: http://www.theatlantic.com/magazine/archive/2012/05/why-you-can-8217-t-get-a-taxi/8942/ (accessed July 17, 2012).

[3] Daus, op. cit., p. 9.

[4] Ibid.

In many jurisdictions, livery vehicles are required to carry a passenger manifest, including names of one or more passengers, as well as the pick-up point and destination. This also inhibits drivers from picking up unscheduled passengers.

Fare Structure

Taxicabs charge a regulated fare based on the time and distance of the trip as measured by a taximeter. Some trips to or from established destinations, such as an airport, may have a fixed price. All taxicabs are required to carry standardized, highly regulated, taximeters that are sealed and periodically calibrated to ensure that the proper fare is charged.

Livery vehicles are generally prohibited from charging fares based on time and distance, and do not carry a taximeter. Fees are generally based solely on time, often with a minimum billed time. Most jurisdictions require that the fee be agreed upon in advance.

Labeling and Appearance of Vehicles

One concern of regulatory agencies is that vehicles hailed on the street must be licensed. Therefore, taxicabs generally must have a distinctive appearance, often including a clear indication of whether or not they are in service. Many jurisdictions extend this to the name on the vehicle, restricting companies from using "Cab" in their names unless they are regulated taxicabs.

For-hire vehicles such as limousines are typically black, with no company identification.

Other Regulations

Many other regulations applied to the operation of taxicabs and limousines, some of which potentially were relevant to Uber. As an example, in some jurisdictions, such as Chicago, taxicabs were required to maintain audible two-way communications with a dispatch station, and the dispatch station had to have a "principal place of business in Chicago."[5]

New York regulations prohibited limousine companies from transacting "more than 10 percent of their business in cash or credit card (as opposed to contractual voucher work)."[6]

There were myriad other regulations that could impact Uber, but these examples illustrate the challenging regulatory environment facing the company.

UBER TECHNOLOGIES

The long-established business models for taxicabs and limousines have some serious deficiencies for customers. Many passengers find taxicabs to be unpleasant, poorly maintained, and unsafely driven. They are also difficult to find in many locales—many taxicabs avoid certain areas of cities, where there are few passengers and where they may have difficulty finding return fares. On the other hand, limousines are expensive and unavailable on short notice. With many city

[5] Ibid, p. 17.
[6] Ibid., p. 18.

dwellers choosing to go without cars, and out-of-town visitors needing local transportation, these problems created business opportunities.

The growth of mobile communications technology facilitated a wide range of business concepts to address these opportunities, ranging from ride-sharing and carpooling applications to those which allowed users to connect with established service providers.

Uber Model

Uber addressed this opportunity by letting customers call for a limousine using a mobile application—essentially hailing the car with a smartphone. The car would generally arrive within a few minutes. The fare, including gratuity, was charged directly to the customer's credit card, so that no cash would change hands (eliminating the safety concern for drivers carrying large amounts of cash). An e-mail receipt was sent to the customer when the trip was completed. The fee was based on time and distance, as determined by the Uber application using the GPS capability of the driver's mobile device, and the standard rate was 40-100 percent higher than a comparable trip using a taxicab. In July 2012, the company began offering a lower-priced limousine service in San Francisco and New York using hybrid cars ("UberX"), which would cost about 10-25 percent more than a taxicab.[7]

Uber did not own its own cars, but relied on a network of established, licensed, limousine drivers and companies that applied to be part of its system. In this sense, it served as a referral or dispatch system. Uber used sophisticated data analysis methods to determine the best locations for drivers to wait, so that they could rapidly respond to service requests. During busy periods, Uber's fees increased to balance supply and demand. The fee paid by Uber customers was split between Uber and the driver (or for-hire company), with the driver receiving 80 percent of the total fare.[8] Company CEO Travis Kalanick described Uber as "sort of like an efficient lead-generation system for limo companies … but with math involved."[9]

In addition to benefitting customers, Uber provided advantages to drivers. They did not have to pay kickbacks to dispatchers (as contrasted with their pre-negotiated fee sharing agreement with Uber). They were guaranteed payment—passengers could not leave the car without paying, since Uber already had their credit card information. They could also rate passengers (as passengers could rate drivers), so a misbehaving passenger would likely have his/her Uber account suspended.[10] Most importantly, it was profitable for them. One San Francisco limousine owner observed that when he had previously driven a taxicab in the city, a busy 10-hour shift would earn him about $300. With Uber, he made more than $700 on a good day. He planned to purchase hybrid vehicles to use in Uber's new lower-cost service.[11]

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[7] Brian Chen, "Uber, an App That Summons a Car, Plans a Cheaper Service Using Hybrids," *The New York Times*, July 1, 2012.

[8] Martin Di Caro, "'From the Draconian to the Inane,' Uber CEO Rips Proposed D.C. Regulations," TransportationNation.com, September 25, 2012.

[9] McArdle, loc. cit.

[10] Ibid.

[11] Chen, loc. cit.

Uber Rollout and Regulatory Challenges

Uber's business model did not fit cleanly into either the taxicab or limousine regulatory regime. It had aspects of a taxicab, in that fares were determined by the time and distance of a trip, and cars would respond immediately to being called by smartphone (sometimes referred to as "electronic street hailing"). The cars, however, were unmarked black sedans, operated by licensed limousine companies and drivers that were required to accept fares by prearrangement. Even though they determined fares by time and distance, the cars did not have taximeters that could be inspected for accuracy. Unlike either taxicabs or limousines, which had regulated rates, Uber's fares varied depending on demand—rates increased at peak periods, sometimes substantially.[12] Uber also did not meet the requirements that some cities placed on dispatch or referral services. For instance, its principal place of business was not in Chicago, as required for running a taxicab dispatch station in the city, and it solicited and assigned customers to limousine drivers for immediate pickup, contrary to Seattle regulations on referrals.

Uber did not seek preapproval from regulatory agencies when entering a city. It relied on the existing licenses of its participating limousine operators.

Uber introduced its service in 2010 in San Francisco, under the name "UberCab." On October 20, the San Francisco Metro Transit Authority and the Public Utilities Commission of California issued a cease and desist order against the company.[13] The regulators based their order on their contention that UberCab was operating in a similar manner as a taxicab company, but without a taxi license (or the insurance required of taxicabs). Uber's name included "cab," fares were based on time and distance, and they picked up passengers immediately after being called. Not only were Uber's cars not licensed as taxicabs, they did not meet the requirements needed to be licensed—they were not marked appropriately, nor did they have taximeters.

The cease and desist order included a potential $5,000 fine for each violation, plus 90 days in jail for each day the company remained in operation after the order. In response, Uber dropped "Cab" from its name, but made no other changes. They continued operating, and no further punitive actions were taken.

By mid-2012, Uber was operating in 16 cities, 14 in the U.S. and Canada, plus London and Paris (**Exhibit 1**). While the company did not disclose its financial results, revenue had reportedly increased by 20-30 percent per month during the previous year. In San Francisco, Uber's system had 400 drivers, with more being added.[14]

In April 2012, Uber began an experiment using licensed taxis in Chicago, at standard taxi rates.[15] The company promoted this service ("Uber TAXI") by providing rides for free (of up to $20

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[12] Passengers were notified if peak pricing was in effect at the time they called for an Uber car.

[13] Lora Kolodny, "UberCab Ordered to Cease and Desist," TechCrunch, October 24, 2010, online at: http://techcrunch.com/2010/10/24/ubercab-ordered-to-cease-and-desist/ (accessed July 25, 2012).

[14] Chen, loc. cit.

[15] Leena Rao, "Uber Experiments with Lower-Priced Taxis in Chicago Through Newly Launched Labs Group, 'Garage,'" TechCruch, April 18, 2012, http://techcrunch.com/2012/04/18/uber-experiments-with-lower-priced-taxis-in-chicago-through-newly-launched-labs-group-garage/ (accessed August 9, 2012).

value) in June[16] (a potential regulatory issue, since Chicago taxi regulations only allowed holders of taxicab medallions to offer coupons or vouchers for service[17]). The taxi service was still offered on the company website in August 2012, but taxi service had not been extended to any other cities.

The company faced regulatory challenges as it entered new cities. In March 2012, Uber had tried to start operations in Las Vegas, but state law required that all limousine services have a minimum one-hour charge of $40, regardless of the length of the trip. Thus, Uber could not offer an economically viable service using licensed limousine drivers, as even the shortest trip would cost $40. Potential opposition from the politically powerful taxi companies made it unlikely that regulators would change this rule.[18] The company was not operating in Las Vegas as of July 2012.

Uber's Experience in Washington, D.C.

Uber launched its Washington, D.C. service in December 2011. The company's standard fare structure in Washington, D.C. for a black sedan seating up to four people was a base of $7.00 plus mileage. Mileage charges depended on the speed traveled: $3.25 per mile travelled over 11mph, and $0.75 for every minute when travelling under 11mph (e.g. when stuck in traffic or stopped). The minimum fee was $15.00, and there was as $10.00 fee for cancellations.[19]

Many D.C. residents chose not to own a car, taking advantage of the city's compact geography, the Metrorail, public buses, and an unusually high level of taxicabs for the population (facilitated by the lack of a medallion system). Alternative transportation services were beginning to flourish in D.C. These included services that provided bicycles or cars on demand, and convenient ways of connecting passengers with drivers. Despite these many forms of available transportation, Uber grew rapidly. By July 2012, a year after launching in the city, D.C. was the company's third-largest market, behind San Francisco and New York.[20]

This growth was driven in part by deficiencies in the city's taxicab service. The taxi fleet included many cars that were dirty and in poor repair, creating an unpleasant experience for passengers. Few accepted credit cards. Large numbers of taxicabs congregated in busy areas, leaving much of the city poorly served. These issues resulted in widespread dissatisfaction among residents—a survey of taxicab passengers by a member of the D.C. city council "found that 69 percent of respondents feel that taxi service in the District is worse than in other American cities."[21] One D.C. resident, living 1½ miles from the Capitol, wrote that it often took a long time to find a taxicab, if she could get one at all. Although legally required to accept all

16 Marcus Riley, "Uber Offers Free Taxi Rides This Week," NBCChicago.com., June 25, 2012, http://www.nbcchicago.com/blogs/inc-well/160257835.html (accessed August 9, 2012).

17 Daus, op. cit., p. 17.

18 Joe Schoenmann, "Cab-like Service Runs in Obstacle; Regulations May Keep It Out of Vegas," *Las Vegas Sun*, March 29, 2012.

19 Uber Website, Washington, D.C. page, https://www.uber.com/cities/washington-dc#cities (accessed July 26, 2012).

20 Sommer Mathis, "The End of Taxis," *The Atlantic Cities*, July 5, 2012, online at: http://www.theatlanticcities.com/commute/2012/07/end-taxis/2353/ (accessed July 26, 2012).

21 Ibid.

fares, drivers frequently refused to take her to her home, as it would be difficult to get a return fare. As a result, she and her neighbors rarely even tried to use taxicabs. Once they discovered Uber, however, they embraced the service.[22] Another concern in many large cities was denial of service by taxi drivers for racial or other reasons. When a driver saw a fare that he did not want to pick up, he would switch off the cab's "in service" light. Drivers dispatched by Uber could not do this, as their agreement with the company required that they pick up the fare. Uber already had the customer's credit card and identification information, as well as the name of the driver dispatched, and would know if the trip was not completed. A driver who refused to pick up passengers could be dropped from the Uber network.

Despite the demand for its service, Uber had a contentious relationship with the D.C. regulators from the time it began offering service. On January 6, 2012, the D.C. Taxicab Commission conducted the first of several sting operations, resulting in an impounded Uber car and ticketed driver. The head of the commission participated in the sting, calling the Uber car on his smartphone and directing it to a location where taxi inspectors were waiting. The car was licensed as a limousine, but the commission claimed that it was operating as a taxicab, thus violating several regulations.[23]

There were more than 150 taxi companies in D.C.[24] These companies and their drivers formed a politically powerful lobby. One blogger characterized the situation as follows:

> D.C. had a hard-fought mayor's election in 2010 in which the city's taxi drivers mobilized heavily in support of the challenger, Vince Gray. Gray won, Gray's administration owes favors to the taxi drivers, and the Gray administration has been moving on behalf of cabbies' interests by approving a substantial fare increase. Uber's game is to hack the regulatory system and introduce more competition with the taxis. A city government determined to increase the incomes of its cab drivers naturally isn't going to like that and will counter-mobilize with regulatory decisions. It's not really any one interpretation of any one rule so much as it is the underlying correlation of political forces. Does the DC government want more competition in the industry or does it want higher incomes for incumbent cab drivers?[25]

Despite the hostility of the Taxicab Commission, Uber continued to operate in a legal gray area, not owning its own vehicles, and with the licensed limousines in its network incorporating aspects of both taxicab and limousine operation.

The members of the commission served three-year terms, and were appointed by the mayor, with the advice and consent of the D.C. City Council.[26] Washington D.C. was divided into 8 wards,

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[22] McArdle, loc. cit.
[23] Mike Debonis, "Uber Car Service Driver Ticketed in D.C. Sting," *The Washington Post*, January 13, 2012.
[24] "Washington DC Taxis," About.com Washington, DC, http://dc.about.com/od/transportation/a/Washington-Dc-Taxis.htm (accessed September 25, 2012).
[25] Matthew Yglesias, "DC Commission Acting to Shut Uber Down," *Slate*, January 13, 2012.
[26] Commission website, "About DCTC," http://dctaxi.dc.gov/dctaxi/cwp/view,a,3,q,487847,dctaxiNav,|30623|.asp (accessed August 22, 2012).

each of which elected one member of the 13-person city council. Four members were elected at-large to represent the entire District. The council was not led by the mayor, as is the case in many cities, but by a chair who was elected at-large by the entire District.[27] Like the legislative branch of the federal government, the Council's primary function was to make laws for the District. The council was the primary policy-making body for the District. The mayor led the executive branch of city government, which included more than 40 departments and offices (with such wide-ranging responsibilities as an Office of Cable Television, the Metropolitan Police Department, the Child and Family Services Agency, the Office of Disability Rights, the Department of Public Works, and the DC Taxicab Commission.) An Office of City Administrator provided support to deputy mayors that helped oversee these agencies.[28]

The City Council enacted legislation with a simple majority vote. The mayor could veto the legislation, and the Council could override the mayor's veto with a two-thirds vote. Because of the special status of the District of Columbia, once a bill was approved, it had to be sent to the U.S. House of Representatives and U.S. Senate for 30 days before becoming a law. During this period, Congress could pass a joint resolution disapproving the legislation, and if the president signed the resolution, the Council's Act did not become law. If Congress did not take action within 30 days, the Act became law.[29]

Another important part of local government was the 37 Advisory Neighborhood Commissions (ANCs). Each ANC commissioner represented about 2,000 residents (a "district"), and was elected by citizens of the district for a two-year, unpaid, term. ANC commissioners were required to live in the district they represented. The ANCs considered a wide range of issues affecting their neighborhoods, and represented their neighborhoods before the relevant governmental agencies, such as the city council or various city commissions.[30]

Uber tried working with Mary Cheh, the city councilwoman representing the wealthiest D.C. ward. Cheh planned to introduce a bill that would institute comprehensive taxicab reform, addressing many of the problems that customers had encountered with D.C. cabs. Cheh's reform bill, introduced in early July 2012, included an amendment legalizing Uber's service model. It also specified that the "minimum fare for sedan-class vehicles shall be five times the drop rate for taxicabs."[31] With the D.C. drop rate at $3.00, this meant that Uber would be able to maintain its $15 minimum fee for black sedan service, but would not be able to lower the fee in the future. Nor would it be able to introduce UberX, its hybrid car service, with reduced rates. And, if the taxi drop rate increased, it would have to increase its minimum fare by five times the increase. The council was scheduled to vote on the bill July 10.

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[27] Council website, "D.C. Councilmembers," http://www.dccouncil.washington.dc.us/council (accessed August 22, 2012).

[28] Executive Office of the Mayor Website, http://mayor.dc.gov/page/executive-branch (accessed August 29, 2012).

[29] Council of the District of Columbia website, "How a Bill Becomes a Law," http://www.dccouncil.washington.dc.us/pages/how-a-bill-becomes-a-law (accessed August 29, 2012).

[30] Council website, "Learn About Wards and ANCs," http://www.dccouncil.washington.dc.us/pages/learn-about-wards-and-ancs (accessed August 22, 2012).

[31] David Weigel, "How D.C.'s Corrupt Taxicab Cartel Lived to See Another Day," *Slate*, July 10, 2012.

July 10 was also an important day for Mayor Vincent Gray, who had been embroiled in a scandal dating back to his 2010 campaign. According to the U.S. attorney, the "mayoral campaign was compromised by backroom deals, secret payments and a flood of unreported cash."[32] A local Medicaid contractor had reportedly provided $650,000 to a secret account used by the Gray campaign. On July 10, a hearing was scheduled in which the woman who handled the illegal contributions was expected to plead guilty to charges of campaign corruption. While Gray had not been charged with a crime, he was still being investigated by the U.S. attorney.[33]

WHAT TO DO?

Kalanick was faced with a dilemma. Should he accept the new regulation, legalizing Uber's business with its existing minimum fare, but restricting the company from reducing prices? Should he oppose the bill, remaining in a legally ambiguous status? Or, could he get the council to modify the bill to provide Uber the flexibility to offer lower-cost service to customers in the future?

STUDY QUESTIONS

1. What alternatives did Uber have to address regulatory issues when beginning service in new cities? What are the benefits and difficulties with each?
2. How do you expect the incumbent taxi operators to respond to the Uber's entry into D.C.?
3. What should Uber do in the face of the proposed D.C. legislation?

[32] Alan Suderman, "Only the Shadow Knows," *Washington City Paper*, July 10, 2012, http://www.washingtoncitypaper.com/blogs/looselips/2012/07/10/only-the-shadow-knows/ (accessed August 22, 2012).
[33] Ibid.

Exhibit 1
Uber Service Areas in Mid-2012

As of August 2012, Uber's service was available in the following areas:

Atlanta
Boston
Chicago
Charlotte
Denver
Hamptons
London
Los Angeles
New York City
Paris
Philadelphia
San Diego
San Francisco
Seattle
Toronto
Vancouver
Washington, D.C.

Source: Uber website, "Cities," https://www.uber.com/cities/san-francisco# (accessed August 9, 2012).