

A decorative graphic consisting of a grid of grey dots of varying sizes, with several dots highlighted in red. The dots are arranged in a pattern that roughly outlines the shape of the state of California.

# The California Challenge

## How (not) to regulate disruptive business models

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- The latest trend from Silicon Valley is known as the »sharing economy,« sometimes referred to as the »gig economy,« »on-demand,« »peer-to-peer« or »collaborative-consumption« economy. Dozens of »disruptive« companies like Uber, Airbnb, Upwork, TaskRabbit, Lyft, Instacart and Postmates have proven to be attractive to consumers and those who would like to »monetize« their personal property (real estate, car) or find flexible, part-time work. In some ways, these new platforms have the potential to provide new opportunities. But they also display a number of troubling aspects.
- Many of the CEOs of these new companies tend to follow an extreme philosophy of »economic libertarianism,« in which they resist regulation and try to evade paying taxes. There is a new business model, in which companies are little more than a website and an app, with a small number of executives and regular employees who utilize technology to oversee a vast army of freelancers, contractors and part-timers.
- Recent attempts by governments to regulate these companies provide examples of why poorly designed legislation that fails to comprehend the different nature of these companies will inevitably result in regulatory failure. In particular, the widely distributed workforce and anonymous nature of the commercial transactions that occur on these platforms make it all the more crucial that governments have access to the data of the commercial transactions that will make effective regulation possible. Rather than providing the data, these companies have plowed significant resources into sophisticated political and legal operations to resist regulatory attempts.
- California and the US are several years ahead of Germany and Europe in these developments. It is becoming clear that changes in the workforce may be more advanced than traditional measurements are revealing.



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## Introduction

The historical convergence of ever more sophisticated smart phones, wireless high speed internet and Big Data (also known as »the cloud«) is changing the social and economic landscape in dramatic ways.

Now from California, specifically from »Silicon Valley« in alliance with Wall Street investment banks and venture capitalists, comes the latest trend, which appears destined to further reshape the ways we work and live. It's called the »sharing economy«, sometimes referred to as the »gig economy« and also the »on-demand«, »peer-to-peer« or »collaborative-consumption« economy. The sharing economy has become a darling of the media, which reports in rapturous tones on its every new development, including high-priced company valuations in the tens of billions of dollars for companies that have yet to make any profit. Its signature companies – such as Uber, Airbnb, Upwork, TaskRabbit, Lyft, Instacart, Postmates and dozens more, which have all incubated in the San Francisco Bay Area – are being hyped as the new avatars of the way things will be (and now German versions have been launched, including companies such as Clickworker and AppJobber).

The term »disruptive« is often used to describe these companies, signifying a type of »disruptive innovation« in which entrenched, dominant companies or products are unseated in the marketplace by smaller, lighter rivals that use technology to offer attractive solutions and at less cost than the old guard. Disruption is celebrated as being more modern and forward-looking, more twenty-first century, compared with the allegedly old, stodgy rules and companies of the dying twentieth century. Indeed, this is the dominant »California ideology« of Silicon Valley.

Now that we have had several years to observe these US companies, it is clear that the new business model of the sharing/gig economy and its technological innovations show potential for both promise and peril. These platforms and their products and services have proven to be attractive to consumers and, to some degree, provide new opportunities for work, especially for those seeking flexible, part-time work and for those who have been »labour-market outsiders« (traditionally minorities, immigrants, young people and, to some degree, women). But these platforms also display a number of troubling

aspects. The CEOs of these companies tend to follow an extreme philosophy of »economic libertarianism«,

in which they resist regulation and try to avoid paying taxes; their billions also give them sophisticated

*There's much to learn from US-attempts to regulate and tax »disruptive« companies*

political and legal clout that has allowed them to fight off many regulatory attempts.

California and the United States are several years ahead of Germany and Europe in how these developments are transforming the social, political and economic landscapes. Although still in the formative stages, there is much to learn from US attempts to regulate and tax these »disruptive« companies, such as Airbnb, Upwork, TaskRabbit, Uber and others.

### 1. Impact of »sharing economy I«: »hollow companies« commanding millions of assets or jobs, funded by venture capital

With this latest wave of Silicon Valley startup companies, the business model of US corporations is in the process of being redesigned. The post-Second World War era was dominated by vertical, industrial powerhouses, such as auto companies, in which end-to-end production, design, research, marketing and sales were all performed under a single company roof. Many of these companies – such as GM, Volkswagen, Ford, IBM, Siemens, BMW and Daimler – created a huge number of jobs, numbering in the hundreds of thousands.

But this model began to yield in the 1980s and 1990s to companies such as Nike and Apple, in which production was outsourced to low-wage countries – such as China and India – in order to dramatically cut labour costs. However, significant in-house employment still focused on design, research and marketing. But these new types of companies no longer created a huge number of domestic jobs. Apple is the most profitable company in the world, but employs only around 70,000 workers in the United States, which is less than a fifth of the jobs created by the auto companies.

Today that company model is yielding yet again, to a new one typified by companies such as taxi service Uber, hos-

pitality company Airbnb and labour brokerages Upwork and Task Rabbit. Their precursor was Amazon, which blazed the way for how to market and sell online. These corporations are little more than websites and an app, with a small number of executives and regular employees who utilise technology to oversee an army of freelancers, contractors and part-

timers. Businesses that use such »non-regular« employees reduce labour costs by as much as 30 per

cent, because they do not have to provide health care, retirement, injured worker or unemployment compensation, or paid sick leave or vacations. Also, workers of this kind have few labour protections and can be easily dismissed. In the United States, they do not even have the legal right to join or form a trade union. In the vision of the leaders of Silicon Valley and their hyper-neoliberalism, these are the perfect kind of workers. CEOs want maximum »labour flexibility«, which means a labour supply they can turn off and on, like a garden hose.<sup>1</sup>

The prototype for this new type of digital company is Upwork, which is based in San Francisco. Upwork is kind of an EBay for jobs, directly employing a mere 250 regular employees who are able to use technology to oversee 10 million contractors and freelancers scattered all over the world.<sup>2</sup> The types of worker who contract for Upwork are freelancing professionals and skilled creatives, including engineers, architects, lawyers, tax accountants and management consultants, as well as occupations such as website and app designers, translators, software developers, logo and graphic designers and more. Developed-world workers from Germany, the United States and elsewhere bid for jobs alongside workers from India, Thailand and the Philippines. The workers auction themselves to clients on a »virtual shop floor« and the result is predictable: the lowest bid often wins as cheap Third World labour undercuts developed-world wages in a global race to the bottom.

Upwork is the largest player in the digital temp industry, with a market value expected to grow to as high as USD 46 billion by 2020. Many of the new digital companies use a similar labour model. Uber and Airbnb each employ a mere thousand or so full-time employees, who use the latest app technology to oversee hundreds of thousands of taxi-type drivers and hotel-hosts, who are classified

**250 US-employees use technology to oversee 10 million workers worldwide who compete for work in an online auction, unleashing a global race to the bottom**

by the companies as »independent contractors« and therefore do not qualify for safety net benefits, labour protections or union representation. Uber's estimated market valuation of USD 63 billion is greater than that of BMW, GM and Volkswagen, even though it has manufactured nothing, does not own a single passenger auto, and claims not to employ any drivers because their drivers are legally »independent«. Airbnb is valued at USD 25 billion – over three times the value of the 50-year-old global Hyatt Hotel chain – even though it does not own a single hotel and directly employs only about a thousand people around the world.

## 2. Impact of »sharing economy II«: refusal to follow local laws or pay local taxes

The more recent variety of brash and sassy startup companies in the United States comes with another disturbing quality, namely their refusal to follow local laws or pay their labour taxes. These companies are redesigning notions of corporate responsibility and accountability. Startups such as Uber and Airbnb have broken local laws that oversee the running of hotels and taxi services in city after city. These companies are dramatically claiming a new corporate »right«: set up operations first ... and figure out the laws and tax requirements later.

Airbnb, for example, the largest »home-renting« company, has claimed that, because it is operating in about 34,000 cities around the world, it cannot possibly figure out all the local regulations and tax laws. Airbnb also has claimed that it is a *technology* company that merely connects a guest with a host, not a hotel

**The new corporate principle: set up operations first, figure out laws later**

or hospitality service, and so should not be treated like a hotel (including for fire and safety regulations). So Airbnb has refused to pay hotel/transient occupancy taxes that all other hotels are required to pay and which are an important source of revenue for local governments. Most recently, Airbnb has relented on this a bit, claiming that, while the company believes it is not legally compelled to pay local taxes, it nevertheless has begun *voluntarily* paying taxes in about two hundred locations (though the exact number is in dispute). At this rate it will take

the company a half century to reach over 30,000 cities, which in the meantime is denying local governments billions of euros in tax revenue.<sup>3</sup>

A troubling pattern has emerged: many of these startup companies hope they will not get caught breaking laws, but if they do happen to get nabbed by the authorities they mobilize a battery of lawyers, lobbyists and their large customer base to fight off regulation. Occasionally they pay a small fine, written off as the price of doing business. These kinds of practices have unleashed a cat-and-mouse game between regulators and such rogue companies.

Uber provides another example. The primary service provided by Uber is »ride-renting«, which is pretty similar in form and pricing to any taxi or limousine service. Taxi companies and limousine services in most cities have to pay what are known as »livery taxes« and other related fees to local governments. But Uber has refused to pay most local occupational fees, claiming that taxi laws are not applicable because it is not a taxi company but a technology company – merely a web- and app-based matchmaker between a driver and a passenger (in fact, the full corporate name of the company was changed several years ago to Uber Technologies to reflect this careful legal positioning). Uber does pay federal corporate income tax on the considerable business earnings generated from its cut of each fare (about 25 to 30 per cent of the bill). But just like Apple, Google and other companies, Uber (as well as Airbnb) has constructed a complex web of 30 foreign subsidiaries and tax havens, many of them no more than mailboxes in the Caribbean, as a way to greatly reduce its US tax obligations.<sup>4</sup> »These companies are the future«, says Stephen Shay, a former top international tax lawyer at the US Department of the Treasury, now teaching at Harvard University. »The nature of their business and the structure of the companies can allow them to essentially keep all of their profits out of the US. Unless the tax systems find a way to deal with this, the lost revenue may be enormous.«<sup>5</sup>

So like Airbnb, a major part of the Uber business model of »disruption« is one that everyone wishes they could enjoy: tax avoidance. But Uber's avoidance of laws and regulations does not end with taxes. Because they insist they are not a taxi company and do not own any taxis or directly employ any drivers, they claim that means they are free to operate without the usual taxi licenses. And

they do not generally have to follow other regulations regarding safety, insurance and other requirements. In every location where the company has bumped up against regulations – which is pretty much everywhere – Uber acts like a rogue operation, refusing to comply with local laws and trying to bully local officials.

Airbnb also has allowed its technology to be used by its hundreds of thousands of »hosts« to evade numerous laws and regulations, including those having to do with insurance and safety requirements, as well as rental laws. Most cities have long-standing laws prohibiting the renting of a domicile for less than 30 days. The reason is to prevent professional real estate operatives from renting out the available housing stock to tourists instead of to local residents. According to a leaked memo from real estate leader Coldwell Banker, property owners can *double* their income by renting out to tourists rather than to local people.<sup>6</sup> But if too much of that activity occurs, it reduces the amount of affordable housing for locals. In popular tourist cities, such as San Francisco, Seattle, Los Angeles, New York and elsewhere, tenants have been evicted from entire buildings, including from rent-controlled apartments, which then have been turned into Airbnb tourist hotels. Some Airbnb »hosts« control dozens of properties; in New York City, some have controlled over 200 properties.<sup>7</sup>

These hosts are not the »regular people« that Airbnb claims to be empowering and whom its public relations spin doctors have thrust forward as the face of the company. Independent analyses of the Airbnb website have found that 40 to 50 per cent of actual Airbnb guest *stays* (as opposed to host *listings*), as well as the company's revenue, come from professional real estate operatives controlling multiple properties.<sup>8</sup> Airbnb has access to all this data and is well aware of these violations of local law, but has done relatively little to rein it in – such as kicking the professionals off the home-renting platform. The reason is clear: a huge chunk of Airbnb's USD 25 billion valuation comes from the professionals. This is a core part of its business model (and, as we will see below, this component may be about to expand rapidly).

*When entire buildings get turned into Airbnb-hotels, affordable housing becomes even more scarce*

### 3. Impact of »sharing economy III«: finding loopholes to avoid paying minimum wages

Labour brokerage platforms such as TaskRabbit and Upwork also present a challenge for regulators, who have been hard-pressed to ensure that workers are earning the minimum wage. As contractors, these workers are not protected by many labour laws, including those guaranteeing a minimum wage. These companies take advantage of the fact that it is hard to track the employment activity of these contingent workers. Vulnerable workers find themselves having to do extra labour for a client and if workers complain they have no labour rights or representation; indeed, they can be given a low rating by the client and even cut off the platform by the company without notice. Lukas Biewald, cofounder and CEO of CrowdFlower, yet another San Francisco-based »labour on demand« company, provided the company framework: »We end up paying people about \$2 to \$3 per hour«, he said in an interview, which is far less than half the federal minimum wage. »It really depends on the level of quality that you need.«<sup>9</sup> So workers hoping to make the minimum wage need not apply.

### 4. Impact of »sharing economy IV«: »liberating« workers to become precarious freelancers

The *quality* of jobs created by many of the Silicon Valley disruptors is also troubling. The business-friendly »happy talk« of Silicon Valley tells us that these new companies are creating new opportunities by allegedly »liberating workers« to become »independent entrepreneurs« and »the CEOs of their own businesses«. In reality, these workers have ever-smaller part-time jobs (called »gigs« and »micro-gigs«), with low wages and no job guarantee or safety net benefits, while the companies profit handsomely.

Freelancers of the sharing economy must string together a series of short-term gigs – some lasting two weeks, two days or even two hours.

They have to juggle multiple gigs, with some workers having multiple employers

in a single day. They must bill all of these clients and ensure that the businesses actually pay them (the Free-

**70 per cent of freelancers don't get paid by at least one client**

lancers Union in the United States has found that 70 per cent of freelancers do not get paid by at least one client, costing them an average of USD 6000 per year).<sup>10</sup> These sorts of workers also have to pay the employer's half of social security, which is a significant deduction from take-home pay. And finally they also must spend a lot of *unpaid* time hustling to find the *next* job.

In short, workers' labour value is reduced to only those exact minutes they are producing a report, designing a logo or cleaning someone's house. It's as if a football star only got paid when kicking a goal or a chef were paid by the meal. In the name of hyper-efficiency, suddenly the »extraneous« parts of a worker's day, such as rest and bathroom breaks, staff meetings, training, even time at the water cooler are being eliminated. Labour brokerages such as TaskRabbit, Upwork, Instacart and other new digital platforms can chop up an array of traditional jobs into discrete tasks and the worker gets paid only for those exact productive moments. The worker's performance is constantly tracked, analysed and subjected to review by the company, as well as the client's customer-satisfaction ratings, all of it logged on the worker's smartphone.

### 5. Impact of »sharing economy V«: replacing government regulation with rating systems and self-regulation

As a replacement for government regulations, many sharing economy advocates have proposed the use of a »rating system« to replace government regulation. Professor Arun Sundararajan, the sharing economy's leading proponent of this increasingly questionable practice, advocates »delegating more regulatory responsibility to the marketplace and platforms«. Their rating systems, he claims, »have sophisticated controls naturally built in«. <sup>11</sup> Airbnb, for example, uses a digital reputation system based on post-transaction reviews and star rankings that provides information to both hosts and renting guests. Uber and others use a similar method. In effect, increasing numbers of workers who supply services on platforms such as Airbnb, Uber, TaskRabbit and Upwork are not required to submit proof of qualifications, or training completed, or any kind of experience at all. What counts instead is the rating given to each service provider by the most recent user, which is being assigned more significance than it warrants.



Beyond the rating system, Sundararajan claims that self-policing on the part of the platforms in most cases provide sufficient oversight, precluding the need for government regulation. As »proof« he cites Airbnb, which employs »more than 50 investigative agents, headed by a former army intelligence officer, on its trust and safety team«, charged with ensuring the safety of the platform.

To test the »self-regulating« Airbnb safety system, I became a home-renting host on the company's platform. I took a few photos of my house, inside and out, uploaded them to the Airbnb website, and within 15 minutes my place was »live« as an Airbnb rental. No background check, no verifying my ID, no contact with a real human from their trust and safety team. I could have used photos of my neighbor's house, or even photos saved from the website of *Better Homes and Gardens*. Within an hour, I had my first inquiry from a guest. Within a couple of months, I had over a dozen reservation requests that would have netted me at least USD 4,000 in short-term rental income, if I had followed through with renting my house.<sup>12</sup>

The same applies to fire and safety protection. Airbnb's CEO Brian Chesky has claimed that such laws are »20th-century laws, or sometimes even 19th-century laws, in the 21st century«, made obsolete by its ratings-based customer evaluation system. Airbnb advertised that it would provide a free smoke and carbon monoxide detector to its hosts, so as a host I followed the instructions and requested one via the Airbnb website. It turned out that Airbnb's offer had expired, and instead the company offered me a free »Emergency Safety Card« with which I could list emergency numbers, exit routes and other resources for my guests.

This revealed not only a huge credibility gap between what this company says and what it does, but also provided a glimpse into the reality of how »self-administered« and »self-rating« systems actually work, especially when compared with government regulation. The occurrence of tragic episodes at Airbnb host locations, including broken limbs, carbon monoxide poisoning, the finding of a decomposed murder victim, a mauling by a host's vicious dog and even death, reveals the potential for safety hazards in millions of homes that have turned themselves into commercial hotels, with little oversight.<sup>13</sup>

## 6. Regulating the digital economy: the difficult US experience

Efforts have been made by US authorities for several years to regulate these businesses, but without much success. The federal government, for example, has not attempted to regulate these companies at all, so the task of reining in the excesses has fallen to local and state governments. However, the failure of officials nearly everywhere to grasp the disruptive nature of the digital economy, particularly the sharing/gig economy sector, has made these efforts ineffective to date.

### Regulatory failure with Airbnb and home-renting

The Airbnb story in San Francisco, where the company originated, is emblematic of how the different forces at work have resulted in such stunning regulatory failure.

Worried about affordable housing being transformed into high-yield Airbnb-hotels, the local governing council of San Francisco finally passed legislation to legalise and regulate short-term rentals. The law included requirements that hosts had to occupy the dwelling being rented, that units could be rented for only a limited number of nights per year and that hosts were required to register with the city. Critics claimed the legislation was poorly designed in its details, in part because it was undermined by Airbnb's influence in City Hall (for example, one of the mayor's chief financial backers was a billionaire Silicon Valley venture capitalist with a significant financial stake in Airbnb). The legislation proved impossible to enforce, particularly because it had failed to require Airbnb to provide data about its hosts' commercial transactions (who is hosting, for how many nights and how much was charged per night) that would enable enforcement and taxation. Over a year after the law was implemented, only about 15 per cent of hosts had registered. With Airbnb insisting that its hosts have a »right to privacy«, even today the vast majority have not registered and continue to operate in the shadows of anonymity.

After local elections were held and a more pro-regulation majority emerged, a second law was passed, in June 2016, to correct the weaknesses of the first law. This new law required that Airbnb and other sites only publish listings that include an official registration number that

shows the property has been approved by the city as a short-term rental. Companies that do not comply will face fines of up to USD 1,000 a day for each listing in violation. So this regulation would make home-renting companies directly responsible, via fines and other enforcement procedures, for its hosts' failure to register. Airbnb says it does not want to be in the position of having to enforce regulations on their hosts with which it does not agree. The company has therefore sued to stop enforcement, saying that it is a matter of a company's free speech and that it is not responsible for the listings.

***Without access to data, tax collectors can only take the companies' word for it***

It is too soon since the passage of this law to know whether it will be effective. However, as the city still does not require that Airbnb provide host transaction data revealing »who, how long and how much«, many critics remain skeptical that the new law will be enforceable.

This »cat and mouse« game between San Francisco's local government and Airbnb was not only over basic regulations but also over the payment of local hotel and occupancy taxes. Airbnb finally began paying this tax, but only after an anti-Airbnb voter initiative (Proposition F) was placed on the November 2015 ballot by citizens, collecting tens of thousands of signatures. Facing a significant voter backlash, the company finally began paying USD 1 million per month. Nevertheless, without having access to the data for thousands of hosts, San Francisco tax collectors have no idea whether this is the right amount of taxes. They have to take the company's word for it.

Beyond San Francisco, officials in other cities also have tried to regulate house-renting. In New York City, Attorney General Schneiderman not only forced Airbnb to give up data needed for enforcement, but also succeeded in getting Airbnb to kick some of the worst landlord violators – some of whom controlled over 200 properties – off its platform. But ongoing vigilance is necessary, because months later many of those landlords had found their way back onto the platform.<sup>14</sup> And Airbnb once again began refusing to provide data to local regulators. More recently, in June 2016, the New York State Legislature weighed in with a version of San Francisco's second law – it banned any advertisements for illegal short-term

***With Airbnb, local governments are worried most about the loss of affordable housing***

rentals.<sup>15</sup> It is estimated that 50 per cent or more of Airbnb listings in New York City fall into this category.

The fine for anyone who advertises such a unit is up to USD 7,500 per violation. But like in San Francisco, the New York law did not require Airbnb to provide host data for enforcement purposes. It remains to be seen whether this law will be enforceable.

Recently, Santa Monica officials, fed up with the rampant hotelization of their gorgeous southern California beach town, passed a law explicitly outlawing rentals of less than 30 days, though permitting the renting of a spare room as long as hosts followed certain registration requirements and paid the city's 14 per cent hotel tax.<sup>16</sup> New Orleans legislated a virtual ban.<sup>17</sup> Officials in both cities also found their respective laws very hard to enforce without company data. In Portland, Oregon, the city council worked with Airbnb to pass a law legalising much of its activity, but requiring hosts to register for a license to operate and submit to fire and safety inspections. But like in San Francisco, over a year later only 11 per cent of Portland's 2,500 hosts had registered.<sup>18</sup> In addition, an investigative report found that half of the Airbnb units were entire homes or apartments, which were available for more than the legally-allowed 95 days per year (the hosts must reside in their homes for at least nine months per year).<sup>19</sup> This provision has been impossible to enforce unless the government is willing to hire a lot more officials to go door to door, which would be an expensive, time-consuming enforcement strategy.

Other regulations of home-renting that are being tried include Airbnb offering USD 1 million in liability insurance (but the insurance comes with many conditions and vague disclaimers, so that it's not actually clear what it covers); and some cities are also requiring Airbnb hosts to comply with »good neighbor regulations« having to do with noise, parking, trash and related potential nuisances.<sup>20</sup>

Berlin implemented an Airbnb law in May 2016 that is nearly as restrictive as the one in Santa Monica, but as in the US cities the law failed to include an insistence on access to host data and it remains to be seen whether it is enforceable.<sup>21</sup> Certainly Airbnb shows no signs of slowing down in Berlin. The clear lesson here is that without access to the data that documents specific details of each commercial



transaction, public officials will have a very hard time tracking, regulating, as well as taxing this company or its business activity.

At the level of the federal government in the United States, there has been little interest in regulating home-renting or anything else about the sharing economy. The first formal step by any federal lawmaker to launch a serious inquiry into the issue was taken only this year. In July 2016, US Senator Elizabeth Warren, along with two other senators, penned a letter to the Federal Trade Commission urging the government body to investigate whether Airbnb and its competitors are »exacerbating housing shortages and driving up the cost of housing in our communities«. The letter also highlighted a recent study that found commercial users pocketing a disproportionate amount of income from short-term rentals and called on the Federal Trade Commission to see whether the disparity is widespread.

Looking to the future, the evolution of the home-renting industry may soon see Airbnb's disruption of local real estate markets take a quantum leap. A recent report from RealtyShares, titled »The Rise of the Airbnb Investor«, indicates that there are rumblings that some giant corporate real estate companies, which own tens and even hundreds of thousands of units, are eyeing the Airbnb platform as a potential lucrative strategy.<sup>22</sup> Indeed, Airbnb CEO Brian Chesky has held meetings with executives from these big players.<sup>23</sup> If they begin renting out huge numbers of apartments on sites like Airbnb, it would drastically reduce the housing stock that is available for local residents. This »Airbnb on steroids« would make the company's previous disruption look small-time by comparison.

### Regulatory mismanagement of Uber and ride-renting

Uber and other ride-renting companies have stubbornly refused to follow virtually any local taxi laws, claiming that it is not a taxi company but a technology company. According to Uber, the driver is a »private contractor«, not an employee. Hiding behind this kind of rationale, aided by their aggressive lawyers, Uber and Lyft have gotten away with using grossly underinsured drivers and faulty

background checks. Even when regulations are passed, Uber has a pattern of not following all the provisions of the very law it originally agreed to. In some places, cars have been impounded and drivers have been fined.<sup>24</sup> But Uber has offered to pay drivers' fines; after all, a company valued at USD 63 billion has enough money to write it off as a minor business expense.

One advantage that Uber has in the United States, in contrast to the situation in Germany or elsewhere, is that the taxi business in most US cities is not very popular. Service is very slow and of inconsistent quality. So for a few years, while Uber and its ride-renting competitors were still relatively small, regulators ignored the disruptive newcomers who were breaking taxi laws. The service continued to expand and finally in 2013 California became the first US state to pass a law legalising ride-renting. The state public utilities commission created a new class of »transportation network companies« (TNCs) which established some rules, including for auto insurance, vehicle inspections, criminal background checks and more.<sup>25</sup> In addition, the new law smartly required Uber to share some of its data with public officials, including information on the number of trips by zip code, how much riders are paid, information about accidents and how many wheelchair-accessible vehicles had been requested. But the latter requirement did little good because Uber promptly ignored it. A couple of years later, regulators finally caught up with Uber's truant ways and in 2016 Uber was forced to pay a USD 7.6 million fine for violating the part of the state law requiring company data.<sup>26</sup>

That was not the first time that Uber had been fined for violating laws, including over how it handles data – in particular passenger data. In January 2016 Uber paid a fine to settle an investigation by New York's Attorney General over how it handles sensitive user data. And the district attorneys of San Francisco and Los Angeles sued Uber for misleading consumers over the thoroughness of their background checks. The district attorney of San Francisco claimed that the company's criminal checks are »completely worthless«.<sup>27</sup>

***A \$63 billion-company thinks it can afford to simply ignore rules it doesn't accept***

The lack of adequate background checks has had tragic consequences. An Uber driver hit and killed six-year-old Sofia Liu and badly injured her mother and brother, on New Year's Eve 2013 in San Francisco. It turned out that driver had a reckless driving

record in Florida, including being arrested for driving 100 mph into oncoming traffic while trying to pass another car, which Uber's faulty background check failed to uncover.<sup>28</sup> However, Uber claimed that the company had no responsibility or liability because the driver was not an Uber employee but an »independent contractor«.

The still relatively new California law tried to deal with the issue of insurance liability, but instead it became an example of what happens when regulators pass poorly designed laws. The new law mandated a minimum USD 1 million of coverage per incident, which Uber complied with. However, its ambiguity made it unclear who is legally responsible if the driver is logged in to the Uber app but has no passenger or is not on the way to pick up a passenger, which has become known derisively as the »insurance gap«. Uber's lawyers have exploited that loophole whenever necessary, including to evade responsibility for the killing of young Sofia Liu. But the distinction defies industry standards. Taxi drivers are covered by the company's commercial insurance for as long as they are in the car, as are pizza delivery drivers and virtually any kind of professional driver.

Finally, yielding to public opinion – and no doubt to pressure from its venture capital investors, concerned about the company's reputation – Uber announced that in the future it would cover the »insurance gap«.<sup>29</sup> But the company's »responsiveness« to public opinion was mostly cosmetic, because the fine print revealed that the coverage was minimal, far less than the USD 1 million required by law for the more clear-cut situations when there is a passenger in the car. This kind of »nickel and dime« behavior, whether towards various kinds of liabilities or its drivers, has become typical of Uber.

### Regulatory attempts will be faced with counter-campaigns

In Austin, Texas ride-renting had been extremely popular and lucrative for Uber and Lyft, but in late 2015 the city council passed an ordinance requiring the companies to be regulated like taxis, especially in terms of ensuring that its drivers would be fingerprinted as part of its background check. In response, Uber and Lyft spent USD 8 million on a ballot measure campaign that asked voters to overturn the city council decision and threatened to pull out of Austin entirely if the vote went the wrong

way. After they lost, the companies did in fact withdraw from Austin, but also announced they would go to the more conservative state legislature to get the local law overturned.

The lesson from all of these different episodes is clear: Uber, Airbnb and many other startup companies are going to fight virtually any and all regulation. No matter whether the law is passed by a local city council or by voter initiative; no matter whether the companies themselves help design the law that is eventually passed; no matter whether the law requires them to turn over data, these companies are willing to push the limits. Thus any government at the local or state level in the United States – or in any other country – that tries to regulate the digital economy, especially the sharing/gig economy companies, is going to have to be prepared to use all the tools of government regulation and enforcement, including criminal charges for lawbreaking if necessary, and lawsuits on behalf of the public good, to reign in these disruptive companies.

### Regulatory challenges based on the poor data provided on the number of affected workers

A consistent theme has been the fact that new kinds of labour, such as gig workers, are hard to track using traditional measurement tools. In the United States, the Bureau of Labor Statistics claims that, based on available data, there has been little increase in these types of workers. However, in April 2015 the US Government Accountability Office issued a report saying that »estimates of the size of the contingent workforce range from 5 percent of the total workforce...to almost 30 percent« depending on widely-varying definitions of contingent work.<sup>30</sup> That is a pretty broad discrepancy, based on different methodologies. And the US Department of Commerce concluded in a report that statistical agencies are hampered in measuring the sharing economy's financial size and employment scope by their lack of access to federal tax records used to measure income from sources such as payments made to a person who is not an employee.<sup>31</sup>

Harvard University economist Larry Katz has found that the share of workers receiving income through »alternative work arrangements« – independent contractors, freelancers and the like – increased by 50 per cent between 2005 and 2015, concluding that »all net employ-

ment growth in the US economy since 2005 appears to have occurred in alternative work arrangements<sup>32</sup>. Other independent measurements are arriving at similar conclusions. And yet none of this is showing up in official data.

The digital economy will be very hard to regulate properly if policymakers do not have the right data to monitor the activity of these technology platforms. Fortunately, the US Department of Labor and the US Census Bureau are gearing up to gather more information about part-time and »contingent« workers, starting in 2017.

### Regulation depends on adequate law enforcement

A federal study concluded that US employers have illegally »disguised« 3.4 million regular workers as contractors, while the US Department of Labor estimates that up to 30 per cent of companies illegally misclassify employees as contractors.<sup>33</sup> The Department of Labor under the Obama administration has been considered the most pro-labour in years, yet it has been either incapable or unwilling to mount strong enforcement efforts. Consequently, class-action lawsuits by plaintiffs represented by private attorneys has begun to fill the regulatory gap, starting in the more traditional economy. In June 2015, FedEx was slammed with a USD 288 million settlement after a federal appeals court ruled that the company had short-changed 2,300 California delivery drivers on pay and benefits by improperly labelling them »independent contractors«.<sup>34</sup> Microsoft had to pay USD 97 million to settle a lawsuit for improperly denying benefits to more than 8,000 temp workers. Trucking firms in Los Angeles and Long Beach lost two major court battles with drivers who claimed that they had been robbed of wages by being misclassified as independent contractors. Nevertheless, most jobs in the traditional economy are still regularly employed workers, either full-time or part-time.

Companies that are part of the sharing/gig economy rely almost exclusively on workers who are regarded in legal terms as contractors and not regular employees. Federal labour law affords these workers very few protections. Puzzlingly,

***Companies of the sharing economy rely almost exclusively on what they call »contractors«, not regular employees***

the Department of Labor has yet to file a single misclassification grievance against a gig economy company.

Workers who have contracted with TaskRabbit, Upwork and others have complained that sometimes they do not even earn the legal minimum wage, particularly once you subtract the considerable expenses incurred in the effort to constantly find the next job, travel from gig to gig, drive their own vehicles for delivery, pay for their own health care, pay the employer's half of Social Security and Medicare and other costs that are incurred when you work as an »independent« contract worker.

The insistence by the digital companies that these workers are contractors – »the CEOs of their own business«, as already mentioned – is controversial to say the least. The legal standard determining who is an employee of a company and who is a contractor is based on the amount of control that the business exerts over the worker. The primary tool for redress has been class-action lawsuits by

private attorneys on behalf of thousands of workers. Uber eventually settled one such lawsuit rather than risking that it might

lose in court and see its entire business model collapse. A *Fortune* magazine study into the costs of classifying all drivers as employees painted a dire picture: if it lost, Uber most likely could not afford to stay in business.<sup>35</sup>

Other companies – such as delivery services Postmates, Try Caviar and Instacart, laundry service Washio, shipping company Shyp and house cleaning company Homejoy – have also been sued by their workers, who argued that they should be classified as employees and not independent contractors.<sup>36</sup> These lawsuits typically take many years to reach a verdict and so far none of them have reached that final stage.

### Regulatory vacuum has allowed high tech surveillance of workers

Lacking labour protections, the contractor-workers in the gig economy are being confronted with »employee surveillance« technology that appears hard to regulate. Upwork provides its business clients with a suite of tools for online

management and supervision to crack down on »cyber slacking«, the notion that poorly paid freelancers should stay focused, hard at work and away from the virtual water cooler. The company has developed software – cheerfully called the »Private Workplace« – that provides minute-by-minute logs of contractors’ computer keystrokes, tracks mouse movements and (in the latest innovation in labour surveillance) secretly snaps periodic screenshots, allowing employers essentially to »look over the worker’s shoulder«.37 Stephane Kasriel, the CEO of Upwork, waxes enthusiastically about the surveillance technology: »I can see from random screenshots that she seems to be working on the stuff I asked her to.«38

To date, the US track record of attempts to regulate the digital economy – especially of companies in the sharing/gig economy – has been spotty, inconsistent and ultimately inadequate. Most of the regulatory interventions are fairly recent, dating from 2014 through 2016, but few have been successful and often have been rife with poor design and ineffective approaches. At the federal level, regulatory relief has been non-existent; at the state and local level it has been inadequate. Perhaps the best that can be said is that in certain cities and states, government officials and regulators realise they have made mistakes and are doing the best they can to correct those mistakes. But in other locations, officials and regulators seem to be uninformed about the impacts of these new technologies and companies, or, even worse, are ideologically sympathetic to the neo-libertarian, anti-government philosophy of these sharing-economy leaders.

## 7. Lessons to be learned, actions to be taken

The transatlantic economies are in a state of rapid evolution and the new digital technologies are a primary driver. Predictions about the »rise of the robots« replacing humans, the advent of self-driving vehicles, the merging of humans and machines via biotechnology (a phenomenon known as the »technological singularity«) and other fantastic horizons sound like the stuff of science fiction – yet experts tell us, with great certainty, that this will be the future.

Consequently, any lessons learned at the current time will likely be temporary as we adjust to a quickly changing landscape. Nevertheless, at this point we can draw several conclusions.

### Lesson One: data, data, data

Whether tracking how people are working today, or tracking the commercial activities of digital companies and their vast army of anonymous contractors, or reining in the abuses of company surveillance of employees and misuse of employee data, or cracking down on corporate misuse of our personal data as we use the internet, new policies for the use of data in the digital age are badly needed. Without good data, the public, as well as regulators are like an airplane flying in the night sky without radar. »We the public« must regain control over the data that increasingly are being used as the currency of the digital age.

### Tracking the commercial activities of digital companies just like any other enterprise

Commercial data, withheld by companies such as Airbnb, Uber and others, are crucially needed to regulate these companies and make their services safe for consumers, workers and communities. Drawing from the US experience, it is clear that these companies will fight against these attempts as if their business models and very corporate existence depend on it. Government officials should not be swayed by frequently-used arguments from Airbnb, Uber and other digital companies that their hosts, drivers and other forms of contractors have a »right to privacy«, and so the companies »cannot« provide the data. That amounts to another rewriting of commercial law for hotels, taxis and other industries, and an attack on a city’s power to regulate the commercial sector by requiring a business license and registration for enterprises within its jurisdiction. Once you turn your home or automobile into a commercial enterprise, certain other legal requirements should be applied.

Government officials must thus be prepared to use all the legal, political and legislative tools at their disposal. Only if authorities have access to the relevant data will we will be able to monitor, track and regulate these digital

platforms so that the positives of these technologies can be enjoyed without so many negative consequences.

#### Stop rampant workplace surveillance

Workers and freelancers must maintain control over their own employee data, which are being generated at workplaces and being used to spy on them. Workers should retain some degree of »workplace privacy« that overrides an employer's desire to track and monitor employee performance using high-tech surveillance. Workers subjected to a ratings system should »own« their rating and be able to port their high rating to another platform, if they choose. In the digital era, new types of businesses and employment could easily end up infringing on civil and »personality rights«, so policies must be adopted that will protect against that.

#### Lesson Two: Freelance Nation: recognise that changes in the workforce may be more advanced than traditional measurements are revealing

Government agencies need to become better at collecting the data needed to help us understand how millions of people are working today in the digital economy. According to my interviews, on both sides of the Atlantic researchers – both government and private – do not seem to know whether workers are self-reporting inaccurately, or how many workers are contractors or freelancers, or are employed by online, foreign-based labour brokerages such as Upwork, or even how many are not covered by the social security system. Whether in the United States, Germany or many other places, the standard methodologies for gathering and analysing data still reflect the »good old days« of standard employment. The increasing unreliability of this data feeds various myths about the virtues of these digital platforms and prevents us from understanding the urgency of the developing situation.

*»Industrial-age« statistics hide the urgency of the developing situation*

#### Lesson Three: *taxation of businesses in the digital age*

Whether at the national, state or local level, tax policies often lose out to the digital economy, as disruptive companies do everything they can to avoid taxation, as well as regulation. Governments must adjust their tax policies to this digital economy, otherwise the cat-and-mouse game between the regulators and the unregulated will undermine financing for the welfare state. Companies must be required by law to provide the data necessary to determine proper levels of taxation. Particularly if more workers come to be employed by online, foreign-based digital companies such as Upwork, tax officials at the national level have to figure out how to track these workers at the international level in a way that allows them to collect social security contributions from both workers and those who are hiring them.

#### Lesson Four: political influence of the digital companies

It is important to recognise that regulatory efforts have been greatly hindered by the growing political sophistication of Airbnb, Uber and other digital economy companies. Part of these companies' business model involves mobilising their substantial customer base into a potent political force. They have slickly combined this »citizen activism« with company lobbyists, lawyers and public relations gurus (some of them hired from the upper echelons of the Obama administration and the Democratic Party) who use all the tricks of their trade. These companies have proven to be very skilled at mounting political pressure capable of influencing politicians and resisting regulation and taxation.

#### Lesson Five: re-empowering workers

Workers must be allowed to advocate for themselves and to improve their situation collectively. The city of Seattle has shown leadership by passing a law in December 2015 that establishes a framework that allows Uber drivers to organise and to bargain for collective agreements on issues such as pay and working conditions. The law cleverly gets around federal law, which forbids independent contractors such as Uber and Lyft drivers from legally organising or joining a labour union, by allow-

ing non-profit organisations to organise these workers, rather than trade unions. It is a legally bold strategy that, naturally enough, Uber and its allies are challenging. The law has not yet gone into effect, so it is not possible to evaluate its effectiveness, and so far, no other city has copied this strategy.

Germany's »social market capitalism« to figure out how to erect a new infrastructure that is well-suited for the emerging Digital Age.

### Lesson Six: Making labour protections, including a portable safety-net, for the digital age

With more workers employed individually as contractors, freelancers, temps, part-time or solo self-employed, workers must be able to benefit from job retraining, labour and safety protections, affordable access to high-speed internet and other supports. New forms of work, such as »crowd work«, require new regulations. Minimum standards for wages, health and safety, working hours and social security must be established to prevent this form of work from becoming exploitative and the jobs precarious.

In addition, all workers must be included in a new kind of portable and universal safety net, including solo self-employed persons and crowd workers, ensuring co-financing of their social security contributions by the businesses that hire them. In my book *Raw Deal: How the ›Uber Economy‹ and Runaway Capitalism Are Screwing American Workers*, I propose a universal and portable safety net that would operate something like a system of »Künstlersozialkasse for all«, building upon the existing support in Germany for artists, musicians and journalists to foster a system that encompasses other occupations that currently fall through the cracks of the welfare system. Efforts in the United States to enact such a safety net support infrastructure have begun, particularly at the local level, but it will take many years to enact nationally.<sup>39</sup>

While efforts to adapt the laws, regulations and labour protections for the digital economy are still in their infancy in the United States, there is a growing recognition that business, government and trade unions must adjust to these new realities by working together to forge a new social contract for all types of workers, occupations and industries. Germany and Europe will benefit from understanding the extent of regulatory efforts in the United States, especially the shortcomings and omissions. Those insights will be helpful in leveraging the advantages of





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## About this study

The analysis presented in this paper is based on publicly available reports (some of them produced by the companies themselves), legal briefs, as well as on personal interviews, publicly available news articles and reports and other sources. Where specific company names are used, that information is based on many available public sources. The practices of these companies being described are shared by other companies within the same industry. And because the landscape of the digital economy is changing so quickly, these companies are also changing and adapting their practices and habits. This text is describing a general pattern, yet there may be examples of places where the companies are trying out alternatives to their general business model.



### About the author

**Steven Hill** is a journalist, author and lecturer, and was the Spring 2016 Holtzbrinck fellow at the American Academy in Berlin. He is also a former senior fellow with the New America Foundation in Washington DC. His latest books include *Raw Deal: How the »Uber Economy« and Runaway Capitalism Are Screwing American Workers* ([www.RawDealBook.com](http://www.RawDealBook.com)), which was selected by *The Globalist* as one of the Top Ten Books of 2015. His previous books include *Europe's Promise: Why the European Way is the Best Hope in an Insecure Age*. For more info visit [www.Steven-Hill.com](http://www.Steven-Hill.com) and [@StevenHill1776](https://twitter.com/StevenHill1776).

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