

A New Regulatory Paradigm for the Sharing Economy

Remarks from Attorney General Eric T. Schneiderman as prepared for delivery to the “Sharing City, Sharing Economy: Urban Law and New Economy Conference” on April 24, 2015

Good afternoon. Thank you, Dean Martin, for that kind introduction, and Dean Davidson, for organizing this event. I’m grateful to the Fordham Urban Law Center for hosting us here for this important and—I hope—provocative conference, and for inviting me and members of my staff to participate. My Executive Deputy Attorney General for Economic Justice, Karla Sanchez, who is an alum of Fordham law school, will be participating in one of the panels this afternoon.

Ladies and gentlemen, I want to start by telling you a story that I think illuminates the challenge that this conference seeks to address. Right around this time of year, in 1905, President Theodore Roosevelt dispatched his then-Secretary of War, William Howard Taft, to address a room of 300 railroad executives.

The railroad industry had, by that time, become a dominant force in the domestic economy. Railroads were the connectors. They provided unprecedented links / interconnectivity / if you will and that gave them unprecedented power. America’s laws had been written before the transformation of business, culture and daily life that were brought about by the railroads. But—after muckraking journalists shined a spotlight on abusive industry practices, President Roosevelt introduced groundbreaking legislation to impose severe regulatory constraints. Railroad industry executives were getting ready to wage war.

Secretary Taft went with a surprising message to those executives. He was adamantly opposed to calls for government to take over or to impose draconian regulations on the railroad industry.

But something had to give. Let me quote his words:

“What the railway men of this country ought to do,” Taft said, “is assist in the passage of a law that will accomplish the result.”

“It is not an easy law to draw,” he continued, “but if they,” meaning the railroad men, “will stand up and assist they will take away from the extreme feeling which exists against the railroads.”

“What we want,” Taft said, “is a law that will enable the railroads that wish to obey the law to compel the others to do so or else go out of business. You must respond to public demands.”

Close quote.

In other words: Be part of the solution. Work with the government to figure out functional rules that support and protect responsible businesses. And don't defend the bad guys.

I think this is a useful way to think about the challenge you gather here today to discuss how to create—collaboratively or through conflict—a new regulatory paradigm for new / tech-based business models.

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Now, the companies that make up the sharing economy—even the tech sector as a whole—do not yet hold the power of the railroads of Roosevelt's time. But their trajectory is not so different. Uber's \$41 billion valuation is among the largest in history for a privately-held, pre-IPO company—bigger than the market caps of Delta, Charles Schwab and Kraft Foods. Airbnb, has been reported to be raising money at a \$20 billion valuation, which is bigger than Starwood Hotels and Resorts, Hyatt Hotels, and Wyndham Worldwide.

These valuations anticipate a period of exponential growth. PricewaterhouseCoopers estimates that ten years from now, the sharing economy will capture 50 percent of the total revenue generated by the rental sector.

And as the sharing economy rapidly evolves into a mature and important part of America's overall economic life, it is no longer credible for its companies to cling to what I have called a cyberlibertarian vision of a regulation-free environment. As I wrote in a New York Times op-ed

last April, “Just because a company has an app instead of a storefront” doesn’t mean laws don’t—or shouldn’t—apply.

At the same time, it is no longer acceptable for regulators and policymakers to cling to traditional rules just because they are familiar, or / to protect the status quo because they are used to working with existing companies.

Today I believe that we need a contemporary response to the problem addressed by Secretary Taft one hundred and ten years ago. The right way to handle a paradigm shift is for enlightened corporate interests and forward-looking government actors to collaborate on a mission to sound out what rules are needed, and what rules are outmoded as we develop the legal framework for companies using new technological models to deliver goods and services.

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Today, I want to share some of my thoughts about what such a collaboration might look like, and talk about some work my office is doing that I believe is relevant to this conversation.

We must begin by asking: What values and concerns should animate a collaborative approach to re-tooling our state and local regulations as new business models emerge?

Beyond the general objective of striking a balance that ensures effective regulation and an environment in which truly innovative companies thrive, what are our substantive goals and priorities?

Let me give you my answer to those questions in a slightly roundabout way.

As New York’s top law enforcement officer, I have a responsibility to enforce and defend the laws of the state of New York. But when I think about where to focus my office’s resources, I prioritize the laws that protect the basic safety and welfare of our citizens, and those that promote fundamental fairness and require everyone to play by the same set of rules.

Let me cite some of the things I've done in the last few months with those values in mind.

I've investigated deceptive practices—and secured groundbreaking reforms—in the herbal supplement industry to ensure that purchasers are getting the products they are told they are paying for, and that the products they purchase are safe. My office has exposed the fact that supplements often do not actually contain the product on the label—such as ginseng or Echinacea—and sometimes include contaminants not listed on the label. Here, we are preventing fraud, and enforcing basic principles of consumer protection.

I've also sponsored legislation to stop the personal care industry from manufacturing products with tiny plastic particles, known as microbeads. These particles absorb toxins and they have been found in alarmingly high levels in New York's lakes and waterways, threatening fish, wildlife and public health. Here, a product that presents no direct harm to the consumers that use it in eye gloss or shampoo poses a real threat to the public welfare through externalities / in this case the effect of this product on lakes and rivers that all of the rest of us must pay to clean up. I am very optimistic that my bill will become a law within the next few weeks. It actually passed in the New York State Assembly yesterday.

Third, in an area of particular concern for me, I've prosecuted unscrupulous employers who cheat their employees out of hard earned wages, tips and overtime. In fact, we've recovered more than \$20 million for over 17,000 workers over the last three years. That's \$20 million that was stolen from workers by employers who refused to pay minimum wage, or to pay overtime, or stole tips, and employers who routinely refuse to pay their fair share to our funds for disability insurance and workers compensation.

I am deeply committed to the notion that New Yorkers working full-time should earn a living wage—one that is enough to meet their basic needs—and, of course, that they be paid what they're owed. I reject, as I hope you all do, the idea that we—as taxpayers—should have to subsidize companies that refuse to pay a living wage, and instead pay so little that their employees qualify for food stamps, Medicaid, or other programs for those who live in poverty.

Finally, my anti-trust bureau is working on a wide variety of matters related to unfair competition. Free markets are not free. They require diligent watchdogs to ensure that there is a level playing field for all who would compete based on the merits of their goods and services.

The four fundamental principles at the heart of these examples of our work are the same principles that I believe we must focus on as we consider rules of the road for the sharing economy:

- We must protect consumers, and guard against business practices that deceive or defraud.
- We must be concerned about externalities—costs imposed on individuals outside of a sharing economy transaction, or on society as a whole. These can be in the form of harm to the environment, or public safety, or financial risks that are borne by taxpayers rather than the parties to a transaction.
- We must also think about the impact on workers—on the American people—as old industries give way to new systems of labor, and ensure that we do not step backwards in the fight for an honest day’s pay for an honest day’s work. This is a different sort of externality than the environment or public safety because in the United States we have a societal compact—an understanding that we are all in this together—and that the smart, and moral, and American way to build the sort of country we want our grandchildren and great grandchildren to live in is to ensure that everyone gets a fair shot.
- And we must ensure active competition and vibrant marketplaces, so that we do not give birth to a new generation of *monopolies* or crony capitalists with the power to stifle competition and to squeeze consumers.

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I would suggest that these four substantive principles provide the framework for evaluating our laws, regulations and the structure of the regulatory agencies that have evolved over the last century to address legitimate public concerns in the context of traditional business. The values are and must remain the same if the public interest in a truly fair, level platform for competition is to be served.

Obviously many existing laws and regulations are not tailored to serve these four principles! Some do. Some are well-intentioned, but cumbersome, and some are just plain protectionist.

For example, it is no secret that I believe that there is good sense in a New York law that says apartments used by tourists should be subject to a specific set of safety standards and building codes, and that residents in apartment buildings have some right to expect that the apartment five feet across the hall from their children won't be turned into a hotel room.

I was in the Legislature when this law was passed—at the urging of Mayor Michael Bloomberg's Buildings Department in 2010. This wasn't protectionism, it was common sense—and it's a law the City should continue to enforce, even if it means some limitations on the activity of companies like AirBnb.

At the same time, one can't help but wonder about the value of laws in states across the nation that make it difficult, or even impossible for Tesla to sell its cars directly to consumers. It is fair to ask whose interests such laws serve.

Or, more specific to the sharing economy, the entire statutory and regulatory framework governing for-hire transportation is rapidly becoming obsolete. Many taxi laws and regulations in cities and states across America serve none of the four principles I have discussed

The requirement that for-hire drivers have commercial insurance falls clearly into the category of preventing externalities. And it is important to ensure that companies compete based on efficiency and price rather than their ability to avoid taxes and regulations that affect the competition.

But this is a sector in which many regulations all around the country have become irretrievably convoluted. It is hard not to conclude that a top-to-bottom review and overhaul is what's necessary.

These distinctions aren't always easy, and people of good will may disagree, but we all benefit from an honest and thoughtful dialogue that acknowledges the complexity of the issues and identifies areas where reform is necessary and possible.

And let me add that policy-makers and regulators should be the most vocal critics of outmoded regulation and industry capture. Their credibility depends on it. Those of us who enforce the law can and must also be part of a dialogue about changing laws that do not advance one of the four principles I have listed.

At the same time, leaders in the tech community must reject the absurd notion that laws and regulations should simply be scrapped if they impose limitations on new business models.

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Once we agree on basic principles, we can begin our real work: actually crafting laws, regulations, and enforcement strategies to protect consumers, guard against negative externalities, ensure workers are treated fairly, and promote and protect competition.

I pride myself on having built a very forward-thinking law enforcement agency. Catching people breaking the law is our mandate, and I must enforce all of the laws on the books. But I make it clear to all of our lawyers that preventing problems, changing systems so that there are no law breakers to catch is always the best result.

For example, two or three years ago it became apparent to us that the fastest growing property crime in the country was smartphone theft. In 2013, an estimated 3.1 million mobile devices

were stolen in the United States, nearly double the number of devices stolen in 2012. These thefts often involved assaults, and even murder.

The problem—from the point of view of law enforcement—was that smartphones were very easy to steal, very easy to “jail break” and wipe clean of existing data, and very easy to resell as new products. There was an extraordinary global fencing network for smartphones.

Interpol has estimated that transnational criminal networks in Latin America traffic in stolen mobile devices worth over a half million U.S. dollars *every day*.

While most law enforcement agencies were busy developing strategies to bust more thieves and shut down more fences, my office took a different tack.

We discovered that the technology existed for smart phone manufacturers to install “kill switches” that could cancel a smart phone like a credit card. One of the things that alerted us was in incident in which an Apple developer lost a prototype iPhone and the company remotely shut the phone down, reducing it to a useless brick of plastic and metal.

We quickly figured out that companies like Apple, Samsung, and Microsoft could *all* install kill switches that would make smartphones worthless to would-be thieves.

But the companies were not installing them. In the summer of 2013, when we began this work, no wireless carrier or manufacturer offered an automatic kill switch. Perhaps it was because they were making about \$30 billion each year replacing lost or stolen phones.

So my office organized a coalition of more than 100 district attorneys, police chiefs, and other leaders from cities and states all over America and even in Europe. We called it the Secure Our Smartphones Initiative—or SOS.

We convened a meeting with the leading mobile device manufacturers and confronted them with the facts of the ugly crime wave sustained by their refusal to act. I brought in experts from the

New York City Police Department, who had documented the spike in smartphone crime, as well as the family of a young woman who was killed in a violent smartphone theft. The stakes could not have been clearer.

To their credit, several months after our first meeting, Apple came out with the first commercially-available kill switch in the United States, which they have expanded to all iPhones under iOS 8, their new operating system introduced last year.

This change has had a demonstrable effect on smartphone crime. A few months after Apple introduced its kill switch, the theft of Apple devices fell in New York City—while thefts of other phones continued to rise.

A year later, Samsung, Microsoft, and Google have all developed kill switches for their devices. Across the world, smartphone thefts are dropping.

Another example of an effort to apply our four principles to new problems created by new technology is the recent work of my office to draft a new data security law.

A report that I issued last July found that the number of data breaches in New York had tripled between 2006 and 2013.

New York's existing data security law, which has been on the books since 2005, is limited to requiring companies to notify state agencies and consumers if and when their database is breached.

The law does not set forth minimum data security requirements. It does not provide incentives for good corporate citizens. It simply empowers me to fine companies that are slow to report data breaches. In short, it does very little to actually protect consumer data.

My team dug in on this and wrote a new law, working hand in hand with private sector experts in data security.

The final product is legislation that sets minimum standards for data protection and penalties for failure to meet those standards.

But it also creates a safe harbor, and protects companies from civil liability in the event of a breach if those companies take responsible steps to secure consumer data.

And the bill is drafted so that its security standards are not tethered to today's technology but are, instead, flexible and designed to adapt over time. We tied our standards for best practices to the federal NIST standards, which are constantly updated to keep up with new innovations.

This approach—rooted in broad and honest dialogue between government and the private sector, balanced in both promoting responsible behavior penalizing bad actors, and characterized by forward-looking flexibility—is a good example of how we must develop new regulatory paradigms.

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Let me give you one other example of a less ambitious, but no less relevant collaboration between my office and a company in the sharing economy.

After several severe storms, we received reports of unconscionably high charges by Uber due to its surge pricing algorithm, my office investigated whether the company had violated New York's law against price gouging in emergencies.

Of course, that law was passed in 1979—long before anyone could have conceived of a smartphone, let alone “dynamic pricing” within an app to hail a taxi!

But the law's underlying principle—that there should be reasonable parameters on pricing for goods and services during true emergencies—is as valid today as it was thirty-five years ago.

Uber cooperated with my office, providing the facts and data we needed to thoughtfully apply a long-established law to new technology. Our goals were to protect consumers without diminishing a service they were using, and to provide clarity from government about how the law would be enforced.

Ultimately, our agreement with Uber limited fares during emergencies to normal pricing during the preceding sixty days. It was consistent with the price gouging law, but also recognized that for a company with dynamic pricing, “normal” is not a fixed number but rather a range that changes over time.

As I said at the time, the agreement was a “model for the kind of effective collaboration that should exist between government and technology companies.” This was validated, I felt, when Uber voluntarily implemented the policy nationwide.

As with transformation of the smartphone industry / or our proposed data privacy legislation, pieces of evolving regulatory paradigms can and should be formed from discussion and negotiation, all in a spirit of good faith of public-private collaboration.

It can occur in the context of writing new laws. It can occur in the context of law enforcement. But it can only occur if we agree on basic principles / and abandon any attachment to laws or regulations that no longer serve those basic principles.

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We must call out protectionism for what it is, while at the same time embracing—the role of government / law and regulation in protecting the public, and in keeping our markets both fair and free. We should not tolerate incumbent industry capture, but neither can we condone a digital Wild West.

And I have shared with you several modest but meaningful examples of how this kind of collaboration can produce results.

We must commit ourselves to seeing that such collaboration takes place quickly, in every seat of government and in every startup's bullpen. It must be a priority for government officials like me, and for the companies that want to do business in an environment of smart / regulation.

With that in mind, I am pleased to announce today that, together with New York City Corporation Counsel Zach Carter, I have joined with local law schools to make New York's laws and regulations less opaque to startups.

Working with the Brooklyn Law Incubator & Policy Clinic and Cardozo Law Schools Tech Startup Clinic and with our hosts—through Fordham's Center on Law and Information Policy we will have a regular venue for interaction between New York City and State's top legal authorities and technology startups.

This collaboration will not only help new companies navigate our regulatory system, but it will also help provide insight to the State and the City about outdated or overly cumbersome rules, as well as about trends and needs in this rapidly growing sector of New York's economy.

With this announcement, New York has become the only state and city with start-up friendly clinics, backed up with authoritative legal expertise. Startups will be able to more accurately map out the laws and regulations they must respect when they seek to do business in New York.

My office is also now the first governmental member of Civic Hall, which brings together entrepreneurs, engineers, data scientists and community organizers to improve the ways technology connects people to civic life. We expect that Civic Hall will be an important forum to develop innovative ways to connect the work of my office to citizens and communities across the state.

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Ladies and gentlemen, I am in public service because I deeply believe in the critical and important role that government has to play in people's lives—in protecting us all, in helping those in need and in protecting honest competition.

If we get the regulation right—by prioritizing our work and engaging in an open and honest collaboration—the sharing economy holds enormous potential to be a dramatic agent of positive change for our society.

Government is not ancillary to that potential—it is a critical piece of the equation.

I look forward to working together with you to steer our city and state in the right direction, to ensure innovation, progress, and the improvement of public good in the years ahead.