BUSINESS LAW

Uber Can't Be Fixed — It's Time for Regulators to Shut It Down

by Benjamin Edelman

JUNE 21, 2017

From many passengers' perspective, Uber is a godsend – lower fares than taxis, clean vehicles, courteous drivers, easy electronic payments. Yet the company's mounting scandals reveal something seriously amiss, culminating in last week's stern report from former U.S. Attorney General Eric Holder.

Some people attribute the company's missteps to the personal failings of founder-CEO Travis Kalanick. These have certainly contributed to the company's problems, and his resignation is probably appropriate. Kalanick and other top executives signal by example what is and is not acceptable behavior, and they are clearly responsible for the company's ethically and legally questionable decisions and practices.

But I suggest that the problem at Uber goes beyond a culture created by toxic leadership. The company's cultural dysfunction, it seems to me, stems from the very nature of the company's competitive advantage: Uber's business model is predicated on lawbreaking. And having grown through intentional illegality, Uber can't easily pivot toward following the rules.

Uber's Fundamental Illegality

Uber brought some important improvements to the taxi business, which are at this point well known. But by the company's launch, in 2010, most urban taxi fleets used modern dispatch with GPS, plus custom hardware and software. In those respects, Uber was much like what incumbents had and where they were headed.

Nor was Uber alone in realizing that expensive taxi medallions were unnecessary for prebooked trips — a tactic already used by other entrepreneurs in many cities. Uber was wise to use smartphone apps (not telephone calls) to let passengers request vehicles, and it found major cost savings in equipping drivers with standard phones (not specialized hardware). But others did this, too. Ultimately, most of Uber's technical advances were ideas that competitors would have devised in short order.

Uber's biggest advantage over incumbents was in using ordinary vehicles with no special licensing or other formalities. With regular noncommercial cars, Uber and its drivers avoided commercial insurance, commercial registration, commercial plates, special driver's licenses, background checks, rigorous commercial vehicle inspections, and countless other expenses. With these savings, Uber seized a huge cost advantage over taxis and traditional car services. Uber's lower costs brought lower prices to consumers, with resulting popularity and growth. But this use of noncommercial cars was unlawful from the start. In most jurisdictions, longstanding rules required all the protections described above, and no exception allowed what Uber envisioned. (To be fair, Uber didn't start it — Lyft did. More on that later on.)

What's more, Uber's most distinctive capabilities focused on defending its illegality. Uber built up staff, procedures, and software systems whose purpose was to enable and mobilize passengers and drivers to lobby regulators and legislators — creating political disaster for anyone who questioned Uber's approach. The company's phalanx of attorneys brought arguments perfected from prior disputes, whereas each jurisdiction approached Uber independently and from a blank slate, usually with a modest litigation team. Uber publicists presented the company as the epitome of innovation, styling critics as incumbent puppets stuck in the past.

Through these tactics, Uber muddied the waters. Despite flouting straightforward, widely applicable law in most jurisdictions, Uber usually managed to slow or stop enforcement, in due course changing the law to allow its approach. As the company's vision became the new normal, it was easy to forget that the strategy was, at the outset, plainly illegal.

Rotten to the Core

Uber faced an important challenge in implementing this strategy: It isn't easy to get people to commit crimes. Indeed, employees at every turn faced personal and professional risks in defying the law; two European executives were indicted and arrested for operating without required permits. But Uber succeeded in making lawbreaking normal and routine by celebrating its subversion of the laws relating to taxi services. Look at the company's stated values — "super-pumped," "always be hustlin'," and "bold." Respect for the law barely merits a footnote.

Uber's lawyers were complicit in building a culture of illegality. At normal companies, managers look to their attorneys to advise them on how to keep their business within the law. Not at Uber, whose legal team, led by Chief Legal Officer Salle Yoo, formerly its general counsel, approved its Greyball software (which concealed the company's practices from government investigators) and even reportedly participated in the hiring of a private investigator to interview friends and colleagues of litigation adversaries.

Having built a corporate culture that celebrates breaking the law, it is surely no accident that Uber then faced scandal after scandal. How is an Uber manager to know which laws should be followed and which ignored?

A Race to the Bottom

The 16th-century financier Sir Thomas Gresham famously observed that bad money drives out good. The same, I'd suggest, is true about illegal business models. If we allow an illegal business model to flourish in one sector, soon businesses in that sector and others will see that the shrewd strategy is to ignore the law, seek forgiveness rather than permission, and hope for the best.

It was Lyft that first invited drivers to provide transportation through their personal vehicles. Indeed, Uber initially provided service only through licensed black cars properly permitted for that purpose. But as Lyft began offering cheaper service with regular cars, Uber had to respond. In a remarkable April 2013 posting, Kalanick all but admitted that casual drivers were unlawful, calling Lyft's approach "quite aggressive" and "nonlicensed." (After I first flagged his posting, in 2015, Uber removed the document from its site. But Archive.org kept a copy. I also preserved a screenshot of the first screen of the document, a PDF of the full document, and a print-friendly PDF of the full document.) And in oral remarks at the Fortune Brainstorm Tech conference in June 2013, Kalanick said every Lyft trip with a casual driver was "a criminal misdemeanor," citing the lack of commercial licenses and commercial insurance.

Given Kalanick's statements, you might imagine that Uber would have filed a lawsuit or regulatory complaint, seeking to stop unfair competition from a firm whose advantage came from breaking the law. Instead, Uber adopted and extended Lyft's approach. Others learned and followed: Knowing that Uber would use unlicensed vehicles, competitors did so too, lest they be left behind. In normalizing violations, therefore, Uber has shifted the entire urban transport business and set an example for other sectors.

Fixing the Problem

It's certainly true that, in many cases, companies that have developed a dysfunctional management culture have changed by bringing in new leaders. One might think, for example, of the bribery scandals at Siemens, where by all indications new leaders restored the company to genuine innovation and competition on the merits.

But because Uber's problem is rooted in its business model, changing the leadership will not fix it. Unless the model itself is targeted and punished, law breaking will continue. The best way to do this is to punish Uber (and others using similar methods) for transgressions committed, strictly enforcing prevailing laws, and doing so with little forgiveness. Since its founding, Uber has offered literally billions of rides in thousands of jurisdictions, and fines and penalties could easily reach hundreds of dollars for each of these rides.

In most jurisdictions, the statute of limitations has not run out, so nothing prevents bringing claims on those prior violations. As a result, the company's total exposure far exceeds its cash on hand and even its book value. If a few cities pursued these claims with moderate success, the resulting judgments could bankrupt Uber and show a generation of entrepreneurs that their innovations must follow the law.

Uber fans might argue that shutting down the company would be throwing the baby out with the bathwater – with passengers and drivers losing out alongside Uber's shareholders. But there's strong evidence to the contrary.

Take the case of Napster. Napster was highly innovative, bringing every song to a listener's fingertips, eliminating stock-outs and trips to a physical record store. Yet Napster's overall approach was grounded in illegality, and the company's valuable innovations couldn't undo the fundamental intellectual property theft. Under pressure from artists and recording companies, Napster was eventually forced to close.

But Napster's demise did not doom musicians and listeners to return to life before its existence. Instead, we got iTunes, Pandora, and Spotify – businesses that retained what was great and lawful about Napster while operating within the confines of copyright law.

Like Napster, Uber gets credit for seeing fundamental inefficiencies that could be improved through smart deployment of modern IT. But that is not enough. Participation in the global community requires respect for and compliance with the law. It is tempting to discard those requirements when a company brings radically improved services, as many feel Uber did. But in declining to enforce clear-cut rules like commercial vehicle licensing, we reward lawbreaking and all its unsavory consequences. Uber's well-publicized shortcomings show all too clearly why we ought not do so.

Benjamin Edelman is an associate professor at Harvard Business School and an adviser to various companies that compete against major platforms.

This article is about BUSINESS LAW