



STUDENT ECONOMIC LAW REVIEW



# STUDENTSKA REVIJA ZA PRIVREDNO PRAVO

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## STUDENT ECONOMIC LAW REVIEW

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# **REGULACIJA EKONOMIJE DELJENJA REGULATING SHARING ECONOMY**



## FOREWORD / UVODNA REČ

Dear readers,

Here in front of you, there is a new special issue, fifth in a row, of the Student economic law review which is dedicated to sharing economy. This number is the result of the collaboration of the Student economic law review and students from City University of Hong Kong. In this issue, students have tried to answer some of the main questions and problems that have arisen since the new business concept, better known as the sharing economy, started the ascending path and has shaken the foundation of what was known to be the traditional way of doing business. A great rise caused controversial opinions of the expert and scientific public. It seems, however, that the greatest challenge has been put in front of the regulators. Opinions are mainly polarized and can be divided in two groups – those who believe that the new concept is a major step forward to better exploitation of resources, easier accessibility and reduction of transaction costs, environmental protection and many other advantages. Other, however, believe that sharing economy can be devastating for stability of the legal and economic system that have been built on different foundations for years. Beside that, key issues can be identified in possibility of preserving market discipline, balance and stability. Problems are particularly emphasized in the areas of labor law, insurance law, tax law and legal liability. Without any doubt, the best answer to the challenges that have been put in front is to pay attention to finding solutions that respect and takes into account attitudes of both of the sides. We hope that we succeeded in our intention to answer some of the main questions and issues.

**Prof. dr Tatjana Jovanić**  
*Editor-in-chief*  
**Milena Mitrović**  
*Student editor*

Dragi čitaoci,

Pred Vama je novi specijalni broj, peti po redu, Studentske revije za privredno pravo koji je posvećen regulaciji ekonomije deljenja (*sharing economy*). Ovaj broj je rezultat saradnje Studentske revije i studenata City University of Hong Kong. U radovima koji su pred Vama studenti su pokušali odgovore na neka od pitanja koja su se pojavila od kada je novi koncept poslovanja, poznatiji kao ekonomija deljenja, krenuo uzlaznom putanjom i uzdrmao temelje tradicionalnog načina poslovanja. Veliki uspon je izazvao i oprečna mišljenja stručne i naučne javnosti. Čini se ipak da je najveći izazov stavio pred regulatore. Mišljenja su u velikoj meri polarizovana i mogu se podeliti na one koji smatraju da je novi koncept veliki korak napred ka boljoj eksploataciji resursa, lakšoj dostupnosti i smanjenju transakcionih troškova, očuvanju životne sredine i mnogim drugim prednostima. Drugi, pak, smatraju da ekonomija deljenja može biti pogubna po stabilnost pravnog i ekonomskog sistema koji su godinama izgrađivani na drugačijoj osnovi. Osim toga, ističe se kao velika opasnost po tržišnu disciplinu, stabilnost i ravnotežu. Problemi se posebno ističu u oblasti radnog prava, prava osiguranja, poreskog prava i odgovornosti za štetu. Nesumnjivo je da je najbolji odgovor na postavljene izazove da se što više pažnje posveti pronalaženju rešenja koja uvažavaju stavove i jednih i drugih i da se na taj način postigne ravnoteža. Nadamo se da smo u broju koji je pred Vama uspeli da odgovorimo na neka od ključnih pitanja.

**Prof. dr Tatjana Jovanić**  
*Glavni i odgovorni urednik*  
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# TACKLE CONSUMER PRIVACY FROM ONLINE RATING SYSTEM ON SHARING ECONOMY PLATFORMS

**Leung Yen San**

*Do you feel more uncomfortable when staying in a stranger's house compared to staying in a hotel? Are you more worried when buying products from an unknown individual instead of an established company? To relieve consumers' anxiety, many sharing economy platforms utilize the online rating system to resolve information asymmetry. Yet, how much information do you expect others to provide in order to establish this trust, or rather, how much are you willing to give in to help link the service providers and other consumers? The more information you provide, the more you are exposed to threat. Therefore, there is an ongoing urge for the need to balance trust and privacy to give full effect to the governance of sharing economy. This article examines the privacy concerns relating to the operation of online rating system and decides how legislative framework can be shaped to achieve a balance between consumer privacy and public trust.*

**Keywords:** *sharing economy – online rating – consumer privacy – information asymmetry – Personal Data (Privacy) Ordinance (Cap.486) – Hong Kong*

## 1. Introduction

Following the growth of technology, internet has facilitated enormous business opportunities and altered the economic relationships in businesses. The emergence of sharing economy has a long history.

Despite digital technology has altered the economic relationships in businesses,<sup>1</sup> Hong Kong has lagged in protecting consumers' rights, as chastised by the Chairman of the Consumer Council, professor Wong Yuk-shan.<sup>2</sup> A comprehensive jurisdiction should be created not only to protect consumers' privacy, but also to ensure Hong Kong to continue be in line with the global economy market. This article serves to

provide an insight to raise awareness among the public considering the increasing abuse in P2P privacy and B2P privacy.

## 2. Research methodology

My research methodology includes a combination of survey, as a primary source; and secondary sources. I hope to shed light on the following questions through my research: (1) What does online rating system seek to achieve? (2) How well does the system work and what is the problem? (3) How P2P privacy issues contribute to the ineffectiveness of the system and how the legislation can be improved? (4) How businesses make use of the data provided on the online rating system, and how this B2P privacy invasion, because of the big data analytics, reduces the willingness of consumers to utilize the system? What are the possible changes to the static law in the digital age?

### 2.1. primary Source

I conducted a survey (hereinafter known as "the Survey") among 27 law students and 3 law professors from City University of Hong Kong to find out (a) how they weigh the privacy concerns induced by the online rating system against other factors when rating or providing review, and (b) assuming they are aware of the privacy issues, which method they prefer to improve their privacy protection in order to enhance the system.

Care was taken in order to prevent the results from being slanted so as to prevent jeopardizing them and creating interview bias. It is, however, not guaranteed that the responses they give are generalisable for the Hong Kong population.

### 2.2. secondary Sources

My methodology includes gathering information and arguments from scholarly articles and organizational reports. These sources are able to offer extensive background information and numerical figures, increasing the credibility of the article.

1 A. De Franceschi, "Current Issues and New Perspectives", in A. De Franceschi, *European Contract Law and the Digital Single Market*, Intersentia, Cambridge 2016, p. 1–18.

2 N. Sun, *Calls for Hong Kong Government to Bring in Laws Protecting Online Shoppers*, Hong Kong, 2016, available at: <http://www.scmp.com/news/hong-kong/economy/article/2043642/calls-hong-kong-government-bring-laws-protecting-online>, (26.10.2017).

### 3. Definition of sharing economy

In 2013, Economists announced “the rise of sharing economy”.<sup>3</sup> Sharing economy is also termed as “collaborative economy” or “crowd-based capitalism”.<sup>4</sup>

As identified by Botsman and Rogers, sharing economy includes activities such as “bartering, lending, renting, gifting, and swapping”, which encompass mainly 3 business models – ‘product service systems’, ‘redistribution markets’, and ‘collaborative lifestyles’.<sup>5</sup> Although the OECD does not provide a definition,<sup>6</sup> it is speculated that it adopts a similar wide approach, as it refers “sharing economy” to a variety of online platforms specialized in “matching demand and supply in specific markets, enabling P2P sales and rentals”.<sup>7</sup>

Examples in each categories include:

- a) P2P selling (examples: eBay and Etsy);
- b) P2P sharing (examples: Airbnb, Uber, TaskRabbit);
- c) crowdsourcing (examples: Mechanical Turks, Kickstarter, Angel List).

Other than the profound international platforms such as Airbnb and Uber, Hong Kong has its own local brands including GogoVan, EasyVan, Rent-A-Suitcase, Carshare.HK, Hong Kong Really Really Free Market, Carwash, Hong Kong Free Stuff, Yeechoo, and Business Barter Hong Kong

Alex Stephany's definition of sharing economy – “The sharing economy is the value in taking underutilized assets and making them accessible online to a community, leading to a reduced need for ownership of those assets”<sup>8</sup> – is relatively narrower as it focuses on “needless for ownership”.

For instance, through Airbnb, one can use and reside in a house for a temporary period without buying the full asset. This is indeed the new sharing economy, as supported by Belk and Frenken.<sup>9</sup>

While the definitions differ in language, provisions and interpretations, they reflect a large degree of consensus on what sharing economy is set to achieve – to maximize the utilization of existing resources and assets.<sup>10</sup> For the purpose of this article, it is not essential to select a specific definition as the article aims to analyze the relationship between data and privacy, an issue which exists in each form of sharing economy market. However, the second category, i.e. P2P sharing, will bear a greater proportion in the following discussion and this is mainly due to three reasons.

Firstly, it is argued that P2P sharing platforms require greater trust between service providers and consumers as parties are more likely to develop long-term relationship, unlike in B2P selling where less interaction is required, and the relationship mostly ends after sales is done.

Secondly, more information is submitted by consumers. This is because service providers must bear higher risk in P2P dealings.<sup>11</sup> For example, they are concerned with the condition of assets or products when they are being returned by consumers. Consequently, information such as contact number, email, personal ID, Facebook or LinkedIn profile of consumers are necessary to verify their identity and credibility.

Thirdly, following the shift to accessing from owning goods, P2P sharing platforms have the most prominent growth in the past few years as shown in the report by PricewaterhouseCoopers LLP.<sup>12</sup> The report estimated that a revenue of \$335 billion would be generated by 2050 from 5 most prominent sharing economy sectors, four of which are P2P sharing platforms including car sharing and accommodation.

3 Economists, *The Rise of The Sharing Economy*, 2013, available at: <https://www.economist.com/news/leaders/21573104-internet-everything-hire-rise-sharing-economy>, (6.6.2017).

4 EU Parliament Directorate General for Internal Policies Policy Department A: Economic And Scientific Policy, *The Collaborative Economy: Socioeconomic, Regulatory and Policy Issues*, Brussels, 2017, available at: [http://www.europarl.europa.eu/RegData/etudes/IDAN/2017/595360/IPOL\\_IDA\(2017\)595360\\_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/IDAN/2017/595360/IPOL_IDA(2017)595360_EN.pdf), (6.6.2017).

5 R. Botsman & R. Rogers, “Beyond Zipcar: Collaborative Consumption”, *Harvard Business Review*, 88 (10) / 2010, 30, p. 30.

6 OECD, *OECD Digital Economy Outlook 2015*, Paris, 2015, available at: <http://ec.europa.eu/eurostat/documents/42577/3222224/Digital+economy+outlook+2015/>, (26.6.2017).

7 EU Parliament Directorate General for Internal Policies Policy Department A: Economic And Scientific Policy, *The Collaborative Economy: Socioeconomic, Regulatory and Policy Issues*, p. 7.

8 A. Stephany, *The Business of Sharing: Making It in the New Sharing Economy*, Palgrave Macmillan, Hampshire 2015, p. 9.

9 J. Gardner, *What Is the New Sharing Economy?*, 2013, available at: <http://www.forbes.com/sites/emc/2013/07/30/what-is-the-new-sharing-economy>, (22.6.2017).

10 S. D. Rowe, “The Rise of the Sharing Economy: Although the Term Itself Might Be Vague, the Fundamental Principles of the Disruptive Business Mode Are Here To Stay”, *CRM Magazine*, 20 (10) / 2016, p. 22.

11 G. Ranzini et al., *Report from the EU H2020 Research Project Ps2Share: Participation, Privacy, and Power in the Sharing Economy: Privacy in the Sharing Economy*, 2017, available at: <https://www.bi.edu/globalassets/forskning/h2020/privacy-working-paper.pdf>, (15.6.2017).

12 PricewaterhouseCoopers, *Consumer Intelligence Series: The Sharing Economy*, 2015, available at: <http://www.pwc.com/us/en/industry/entertainment-media/publications/consumer-intelligence-series/assets/pwc-cis-sharing-economy.pdf>, (25.5.2017), p. 14.

#### 4. Online rating system

It is noticeable that most successful sharing economy platforms build their online reputational mechanisms in two forms: (I) centralized or third-party mechanisms, and (II) peer to peer mechanisms.<sup>13</sup> Aiming to depict the complicated relationship between privacy and trust, this article dissects the latter mechanism, which targets to directly induce trust between the two transactional parties, i.e. the service/products provider and the consumer.<sup>14</sup>

The most usual form of P2P reputational mechanism adopted by platforms is the online rating system which comprises of ratings and reviews.<sup>15</sup> For instance, Uber allows drivers and consumers to rate each other with an aggregated 5-stars rating system at the end of each ride; Airbnb makes use of a combination of star rating and written review to illustrate a clearer picture of the experience.

##### 4.1. The importance of symmetric information

The rating and review system achieves its role of establishing trust between transactional parties by providing information to the public, such as the quality of service and attitude of parties. This function is particularly important in solving information asymmetry in the modern market.

George A. Akerlof raised the lemon theory in 1970, proposing that when sellers have more information about the products or services than buyers, the lower quality products or services (colloquially termed as “lemons”) would crowd out those of higher quality ones (colloquially termed as “plums”).<sup>16</sup> This is because there is a lack of information to help buyers ascertain the average value of products, causing them to be less willing to pay. Eventually, market failure might occur due to adverse market selection.<sup>17</sup>

In reality, however, a perfect market of symmetric information does not exist. The fact that there are disparities of bargaining power,<sup>18</sup> information and resources between the trader and the consumer in the marketplace means that the consumers are always at a weak and disadvantaged position.<sup>19</sup> Plus, companies tend to exploit and manipulate information and create imbalances in their favour,<sup>20</sup> because the less information consumers have, the higher the degree of monopoly power traders possess.<sup>21</sup> Although the “exploitation theory”<sup>22</sup> has become less persuasive due to restraints through other rival companies,<sup>23</sup> information asymmetry is the intrinsic nature of the online setting where sharing economy platforms operate.<sup>24</sup>

On top of that, sharing economy platforms are multi-sided, in that they serve to connect groups of heterogeneous buyers and heterogeneous sellers.<sup>25</sup> In other words, traditional online markets can attract a significant number of buyers to purchase from a single seller, but sharing economy platforms often match multiple buyers to multiple sellers. While information asymmetry issues become symmetrical because the service providers and the consumers have to worry about each other, downside of things going wrong is much more severe from the perspective of a consumer.<sup>26</sup> As a result, we need trust to be built much more than in the context of traditional online markets.

13 J. Duffy, H. Xie, YJ Lee, “Social Norms, Information, and Trust Among Strangers: Theory and Evidence”, *Economic Theory*, 52 (2) / 2013, 669–708, p. 703; C. Dellarocas, “The Digitization of Word-of-Mouth: Promise and Challenges of Online Feedback Mechanisms”, *Management Science*, 49 (10) / 2003, 1407–1424, p. 1421.

14 A. Jøsang, R. Ismail, C. Boyd, “A Survey of Trust and Reputation Systems for Online Service Provision”, *Journal of Decision Support Systems*, 43 (2) / 2007, 618–644, p. 641.

15 *ibid.*; C. Koopman et al., “How the Internet, the Sharing Economy, and Reputational Feedback Mechanisms Solve the “Lemons Problem””, *University of Miami Law Review*, 70 (3) / 2016, 830–878, p. 864.

16 G. A. Akerlof, “The Market for “Lemons”: Quality and the Market Mechanism”, *Quarterly Journal of Economics*, 84 (3) / 1970, 488–500.

17 *ibid.*

18 G. K. Hadfield, R. Howse, M. Trebilcock, “Information-Based Principles for Rethinking Consumer Protection Policy”, *Journal of Consumer Policy*, 21 (2) / 1998, 131–169, p. 133–34.

19 J. Ziegel, “The Future of Canadian Consumerism”, *Canadian Bar Review*, 51 (2) / 1973, 191–206, p. 193.

20 J. K. Galbraith, *The New Industrial State*, Princeton University Press, New Jersey 1971, p. 213–20.

21 UK Office of Fair Trading, “Measuring Consumer Detriment under Conditions of Imperfect Information”, *Economic Research Paper 11*, 1997, 1–130, available at: [http://webarchive.nationalarchives.gov.uk/20140402182945/http://www.oft.gov.uk/shared\\_oftr/reports/consumer\\_protection/oft194.pdf](http://webarchive.nationalarchives.gov.uk/20140402182945/http://www.oft.gov.uk/shared_oftr/reports/consumer_protection/oft194.pdf).

22 G. L. Priest, “A Theory of the Consumer Product Warranty”, *Yale Law Journal*, 90 (6) / 1981, 1297–1352, p. 1299–1302.

23 S. Haupt, “An Economic Analysis of Consumer Protection in Contract Law”, *German Law Journal*, 4 (11) / 2003, 1137–1164, p. 1137–38.

24 A. Jøsang, *Op. cit.*, p. 641.

25 US Federal Trade Commission, *The “Sharing” Economy – Issues Facing Platforms, Participants & Regulators*, 2016, available at: [https://www.ftc.gov/system/files/documents/reports/sharing-economy-issues-facing-platforms-participants-regulators-federal-trade-commission-staff/p151200\\_ftc\\_staff\\_report\\_on\\_the\\_sharing\\_economy.pdf](https://www.ftc.gov/system/files/documents/reports/sharing-economy-issues-facing-platforms-participants-regulators-federal-trade-commission-staff/p151200_ftc_staff_report_on_the_sharing_economy.pdf), (9.6.2017), p. 40.

26 *ibid.*



#### 4.2. The relationship between online rating system and information asymmetry

Recognizing the importance of symmetric information to maintain market balance by placing consumer in an equal position with traders,<sup>27</sup> many jurisdictions, including Hong Kong, have built consumer protection based on the lemon theory.

Licensing requirements have always been treated as a solution to safeguard minimum quality of services/products.<sup>28</sup> They help consumer to verify the qualifications of service/goods providers, their reputation and trustworthiness. For example, s.52(3) of the Road Traffic Ordinance provides that "no person shall drive or use a private car;...for the carriage of passengers for hire or reward unless a hire car permit is in force in respect of the vehicle." The Hotel and Guesthouse Accommodation Ordinance also stipulates that a license shall be obtained if a person wants to operate in Hong Kong premises for short-term leases to provide sleeping accommodation with a tenancy term of less than 28 days.

As society evolves, the existing legislations are not sufficient to accommodate the innovative technology created market. Widely known, the current market aims to connect providers and users to fully utilize underused resources such that consumers can receive services from peers at a more convenient way with cheaper price. Imposing licensing requirements would likely increase burden on the functioning of sharing economy platforms and disrupt the system.<sup>29</sup> Moreover, P2P transactions are to be distinguished from B2P dealings in which the traders have stronger leveraging power in the market due to their scale, expertise and experience,<sup>30</sup> which justifies the stricter requirement imposed on traders in B2P dealings.

As a result, entry barrier to the sharing economy market is often lenient. For instance, according to Uber Hong Kong's website, a hire car permit is required when registering as a driver. Up until this point, the number of permits is limited

to 1500.<sup>31</sup> Meanwhile, there are more than 30,000 Uber drivers, 21 of which have been recently convicted of driving without the said license.<sup>32</sup> The fact that most Uber drivers or Airbnb hosts do not possess the necessary license shows that the rule of hire car permit stated in the website is barely strictly enforced, and the risk of conviction lies in the hand of service providers themselves.

Due to the lack of verification during the admission stage, information asymmetry remains problematic. Although there is no concrete evidence that information asymmetry in sharing economy is much more severe than that in traditional economy, it is acknowledged that the lower barrier of entry has drawn attention from different parties to regulate the market.<sup>33</sup>

To compensate the incomplete governmental regulations in creating trust between service providers and consumers, all platforms normally have an in-built reputational feedback mechanism.<sup>34</sup> This scenario of the achievement of a degree of trust that can compensate for the risk related to missing information in the transition from online to offline interaction is described as '*the leap of faith*'.<sup>35</sup>

#### 5. Effectiveness of online rating system

The online rating system can weed out unmeritorious actors and fraudulent behaviour. A study concluded that "a growing body of empirical evidence seems to demonstrate that these systems have managed to provide remarkable stability in otherwise risky trading environments."<sup>36</sup> Under the absence of formal regulations, this system seems to be the most

27 J. Ziegel, *Op. cit.*, p. 193.

28 H. E. Leland, "Quacks, Lemons, and Licensing: A Theory of Minimum Quality", *Journal of Political Economy*, 87 (6) / 1979, 1328–1346.

29 V. Katz, "Regulating the Sharing Economy", *Berkeley Technology Law Journal*, 30 (4) / 2015, 1067–1126.

30 OECD, Protecting Consumers In Peer Platform Markets: Exploring The Issues, *OECD Digital Economy Papers No.253*, 2016, available at: <http://www.oecd-ilibrary.org/docserver/download/5jlwvz39m1zw-en.pdf?expires=1501348494&id=id&accname=guest&checksum=C4AE5E80C2B2BAA9C92FA5599545D7BE>, (13.6.2017), p. 20.

31 Hire Car Permits (Limitation On Numbers) Notice, (Cap.374L), s. 2(a); Road Traffic (Public Service Vehicles) Regulations (Cap.374D), reg. 19(1).

32 C. Yau, Hong Kong Uber drivers defiant in the face of government crackdown, Hong Kong, 2017, available at: <http://www.scmp.com/news/hong-kong/economy/article/2077911/hong-kong-uber-drivers-defiant-face-government-crackdown>, (5.6.2017).

33 A. T. Bond, "An App for That: Local Governments and the Rise of the Sharing Economy", *Notre Dame Law Review*, 90 (2) / 2015, 77–96, p. 95–96.

34 C. Dellarocas, "Designing Reputation Systems for the Social Web", in H. Masun, M. Tovey (eds), *The Reputation Society: How Online Opinions Are Reshaping The Offline World*, MIT Press, Cambridge, Massachusetts 2011.

35 J. E. Tan, "The Leap of Faith from Online to Offline: An Exploratory Study of Couchsurfing.org", in *Third International Conference on Trust and Trustworthy Computing*, Springer, Berlin 2010, p. 6101.

36 C. Dellarocas, "Goodwill Hunting: An Economically Efficient Online Feedback Mechanism for Environments with Variable Product Quality", in J. Padget et al., *Agent-Mediated Electronic Commerce IV. Designing*

effective way to control information asymmetry,<sup>37</sup> paving the way for more trust and reputation.<sup>38</sup>

Unfortunately, for all of its advantages, the online rating system is a perfect example of a double-edged sword.<sup>39</sup> The accuracy of the system is often questioned due to the potential bias of reviews/ratings, which can positively skew the pool of provided feedback.<sup>40</sup> The concerns of consumers to rate and not rate the services are multifaceted, but they will similarly result in the mere existence of positive feedback on the rating system.

### 5.1. Disappointment and unnecessary

In the United States Federal Trade Commission's report,<sup>41</sup> it was pointed out that bias might occur as most users tend to leave only positive feedback. The main reason is that disappointed consumers often do not leave any feedback and would prefer quitting the service to leaving a negative comment,<sup>42</sup> save for in extreme cases. As for consumers who receive average service, most of them do not care to provide feedback. In the Survey, 27 of the respondents have rated "unnecessary" on 3 or above out of a scale of 5.

### 5.2. Laziness

When compared to the factor of "the service provider truly deserves it" which 15 respondents think this would be their greatest concern to provide positive ratings, "laziness" only captures 5 respondents. However, when it comes to concern of consumers to not rate the service, 33.3% of the respondents see "laziness" as their greatest concern.

### 5.3. Pairing up

Paolo Massa notes that the reputation system and trust metric can be manipulated by

malicious users for personal advantage.<sup>43</sup> Some of the platforms allow both service providers and consumers to rate each other after the services. There is a possibility that they might pair up to leave good comment in each other's review. Since both parties are risky to one another, bearing in mind that they both hold each other's information, people tend not to leave negative feedback.<sup>44</sup> As a result, ratings appear to be skewed towards positivity.

### 5.4. Fear of retaliation caused by privacy issue

Another crucial factor threatening the quality of online rating system is the fear of retaliation.<sup>45</sup> In May 2016, a woman in Lan Cheng, China hired the service of didi and later rated the service negatively. After that, she received continuous harassment calls and messages from the driver.

Through collection of data before and during the service, e.g. the submission of passport copies by consumers during Airbnb stay, service providers could easily possess consumers' personal data. Should consumers provide unsatisfactory ratings, as shown in the didi's case, there are multiple ways for service providers to take revenge at consumers, from texting the consumers to posting defamatory comments quoting the consumers' name or contact. Worrying that their information obtained by service providers during the transaction would be exposed or used against them, consumers do not rate or comment negatively about the service.<sup>46</sup>

Surprisingly, the Survey provides that when answering the questions regarding "to rate positively" or "not rate" the service, only 2 respondents rated "privacy issue" as a grade 5 concern. This shows that most people are not aware of the privacy issue or do not treat it as an important concern. This article suggests that more attention need to be directed towards the privacy issue. This is because from personal photo to service details, every single piece of information one provides is valuable, and

Mechanisms and Systems, Lecture Notes in Computer Science (vol 2531), Springer, Bologna 2002.

37 A. Jøsang, *Op. cit.*, p. 641.

38 C. Koopman, *Op. cit.*, p. 864.

39 A. Stemler, "Feedback Loop Failure: Implications for the Self-Regulation of the Sharing Economy", *Minnesota Journal of Law Science & Technology*, 18 / 2017, 673–712.

40 The results of the Survey shows that out of the 30 respondents, 19 people have rated on the system before, and 84.2% of them have provided an average feedback of 4 points or above out of 5 points.

41 US Federal Trade Commission, The "Sharing" Economy – Issues Facing Platforms, Participants & Regulators.

42 C. Nosko, S. Tadelis, "The Limits of Reputation in Platform Markets: An Empirical Analysis and Field Experiment", *The National Bureau of Economic Research Working Paper*, No. 20830 / 2015, available at: <http://www.nber.org/papers/w20830.pdf>, (19.6.2017).

43 P. Massa, "Trust It Forward: Tyranny of the Majority or Echo Chambers?", in H. Masum, M. Tovey (eds), *The Reputation Society: How Online Opinions Are Reshaping The Offline World*, MIT Press, Cambridge, Massachusetts 2011, p. 151.

44 US Federal Trade Commission, The "Sharing" Economy – Issues Facing Platforms, Participants & Regulators.

45 L. Cabral, A. Hortaçsu, "The Dynamics of Seller Reputation: Evidence from eBay", *Journal of Industrial Economics*, 58 (1) / 2010, 54–78; G. Bolton, B. Greiner, A. Ockenfels, "Engineering Trust: Reciprocity in the Production of Reputation Information", *Management Science*, 59 (2) / 2013, 265–285, p. 282.

46 A. Stemler, *Op. cit.*



this data values as much as money in reality.<sup>47</sup> Aiming to increase awareness and protection before there is an actual serious privacy invasion to alert consumers, this article will pinpoint the challenges to privacy triggered by the online rating system and possible legal improvements.

Summing up, the online rating system is at flaws, flaws which are unavoidable. Out of the identified factors affecting the quality of the online rating system, fear of retaliation caused by privacy concern is a subtler form of bias directly applicable to reputational rating systems, and one which is more plausible to be solved through legal means.

## 6. P2P Privacy

From the online rating system, we can see why information given by consumers is significant to regulate the sharing economy market. Meanwhile, we can also see one major problem of the new sharing economy, namely the struggle between information for trust and privacy. Some may argue that the didi's case was a once out of a blue moon case, particularly when no precedents have occurred in Hong Kong, but privacy issue should never be ignored.

The privacy issue of online rating system will be addressed as follows: between consumers and service providers, and between consumers and platforms.<sup>48</sup> This section considers the first category of relationship. A question at the heart of this discussion is "to what extent the current legislation is able to protect consumers' privacy from being invaded by service providers, in turn secure the trust among peers who are willing to provide information on the rating system for bettering the market."

Privacy protection of individuals in Hong Kong rooted from Art.14 of the Hong Kong Bill of Rights Ordinance, which stipulates that "no one shall be subjected to arbitrary or unlawful interference with his privacy..." The key legislation safeguarding privacy of personal data is the Personal Data (Privacy) Ordinance (Cap.486) (PDPO). S.4 of PDPO states that "A data user shall not do an act, or engage in a practice, that contravenes a data protection principle unless the act or practice, as the case may be, is required or permitted under this Ordinance."

The mentioned data protection principles are stipulated in Schedule 1 of PDPO. Out of the 6 principles, the most relevant principle in

the context of P2P privacy is the third principle, which states that, in the absence of consent of data subject, personal data shall be used for the purpose for which the data were to be used at the time of collection of the data. Data users, i.e. service providers should not abuse consumers' data which is originally used to protect all parties involved in the transactions by facilitating and securing validity of the transaction.

It is certain that service providers would not be using consumers' data for a lawful purpose if they harass or threaten the customers in exchange for better rating, amounting to an abuse of data. In this case, despite protection has been offered to consumers whose data is abused by service providers, it is inefficient or rather unwise to sue the individuals, considering that it is harder to regulate each and every individual's behavior as compared to regulating the company as an overarching policy.<sup>49</sup> Furthermore, according to the deep pocket theory, company possesses greater financial resources therefore is able to better remedy a victim.<sup>50</sup> These are why claims are often brought against the company instead of the employee in breach.

To determine whether a more adequate privacy protection is provided to consumers, the next issue one must address is the liability of the company, i.e. the intermediary platforms such as Uber and Airbnb, when service providers abuse the consumers' personal data.

Following s.65, "any act done or practice engaged by a person in the course of his employment shall be treated...as done...by his employer as well as by him, whether it was done or engaged in with the employer's knowledge or approval." This section presents two basic elements. First, the employer-employee relationship and second, the "course of employment".

The relationship between service providers and platforms has always been controversial and the law in Hong Kong does not seem to have settled down. Traditionally, the courts adopt the "control test" and "integration test" to determine whether one is an employee.<sup>51</sup> Applying the tests to different sharing economy platforms will lead

49 S. Shapiro, *Regulate the Sharing Economy Parent Companies, Not Individual Providers*, [place of publication] 2014, available at: <https://www.theregreview.org/2014/09/22/22-shapiro-sharing-economy-part-ii/>, (30.6.2017).

50 R. J. MacCoun, "Differential Treatment of Corporate Defendants by Juries: An Examination of the Deep-Pocket Hypothesis", *Law and Society Review*, 30 (1) / 1996, 121-161.

51 Poon Chau Nam v Yim Siu Cheung [2007] 10 HKCFAR 156.

47 Case C-362/14, *Maximillian Schrems v Data Protection Commissioner* [2015] ECLI:EU:C:2015:650.

48 G. Ranzini et al., *Op. cit.*

to varying results.<sup>52</sup> For instance, in the case of Uber, the fact that Uber requires the contractors to be available always and denies their ability to choose ride requests indicates that Uber has full control over the drivers. In addition, under the “integration test”, the drivers’ activities form the company’s major source of income which leads to the strong indication that drivers are essential component of the business.<sup>53</sup>

However, the relationship might be different in the context of Airbnb. Unlike Uber drivers who are unable to choose customers, Airbnb hosts have greater discretion to select trustworthy guests. Hence, Airbnb hosts are unlikely to be classified as employees. These examples illustrate the difficulty to apply s.65 to all sharing economy platforms equally.

Moving on to the next element, even if the service providers are treated as employees of the platform, they are unlikely to be considered harassing or spreading the users’ personal data during the “course of employment”, i.e. servicing period. Failing to comply with the two elements renders the impossibility to hold platforms liable for the misconducts of service providers. In short, the current legal framework has limitations in offering protection to consumers if their data is abused or manipulated by the service providers.<sup>54</sup>

## 6.2. Legal solutions to grant stronger protection

To foster a healthy relationship between information and privacy, it is necessary to explore additional legal instruments to safeguard consumers’ privacy and personal data. Below are three proposals to enhance protection at two stages, i.e. prevention and curing.

### 6.2.1. PREVENTION

#### 6.2.1.1. Advance notification on disclosure of information to protect consumers and platforms

Firstly, platforms may mitigate privacy concerns “by clearly and conspicuously disclosing what information will remain private and what will

not.”<sup>55</sup> This method would provide opportunities for consumers to balance the risks and benefits when deciding their participation in the sharing economy platforms and the online rating system. With this regard, platforms need to be very meticulous in drafting the terms and conditions relating to disclosure of information. It is not uncommon that such standard form of terms and conditions would be deemed unconscionable due to its lengthy and technical content.<sup>56</sup>

When determining what constitutes unconscionability, it is for the court to consider all circumstances and factors set out in s.6(1) of the Unconscionable Contracts Ordinance.<sup>57</sup> In this respect, it is proposed that one probable circumstance may be ‘whether consumers has been given a possibility to become acquainted with the T&Cs before concluding a contract.’ This is a crucial factor to the European Court of Justice when deciding whether T&Cs were appropriately incorporated.<sup>58</sup>

Research in EU reveals that a shorter and simpler version of T&Cs would increase attention and readership when consumers are dealing with contracts.<sup>59</sup> It is therefore up to the platforms to decide how they should present their liability to the consumers in a readable and understandable way. Transparency will not only help establish good relationship between consumers’ welfare and reasonable security, but it may also become one of the platforms’ defence to prevent liability arising from failure to ensure consumers are informed of the purpose of the use of data, the kind of personal data, and policies and practices in relation to that data.

#### 6.2.1.2. Anonymity

Secondly, the law may mandate companies to adopt obscurity mechanism to address this dynamic. The policy can be executed in multiple forms, including completely anonymizing name/username of commenter on the rating system and review system.

Many platforms require consumers to create an account with username or social media accounts

52 D. D. Acevedo, “Regulating the employment relationships in the sharing economy”, *Employee Rights and Employment Policy Journal*, 20 / 2016, 1–35.

53 *Mr Y Aslam, Mr J Farrar and others v Uber BV, Uber London Ltd & Uber Britannia Ltd* [2015] 2202551/201; A. Hugill, *Driving for the Boss or Driving as a Boss?*, Hong Kong, 2016, available at: <http://www.hk-lawyer.org/content/driving-boss-or-driving-boss>, (2.7.2017).

54 R. H. Brescia, “Regulating the Sharing Economy: New and Old Insights into an Oversight Regime for the Peer-to-Peer Economy”, *Nebraska Law Review*, 95 (1) / 2016, 87–145, p. 94.

55 US Federal Trade Commission, *The “Sharing” Economy – Issues Facing Platforms, Participants & Regulators*, p. 62.

56 *Interfoto Picture Library v Stiletto Visual Programmes Ltd* [1989] QB 443.

57 *Shum Kit Ching v Caesar Beauty Centre Ltd* [2003] 3 HKLRD 422.

58 *Case C-92/11, RWE Vertrieb AG v Verbraucherzentrale Nordrhein-Westfalen e.V* [2013] ECLI:EU:C:2013:180 at 44.

59 M. Elshout et al., “Study on consumers’ attitudes towards Terms and Conditions (T&Cs) – Final Report”, *Amsterdam Law School Legal Studies Research Paper*, No. 2016–47 / 2016, 1–184.

such as Facebook and LinkedIn.<sup>60</sup> Service providers, who are able to identify the particular customer from the content and timing of the ratings, can obtain his or her information through the account profile and contact accordingly. It is suggested that if the commenter is anonymized, there would be no way for service providers to obtain the customer's personal data or other contact information for retaliating purpose.

To complement the commenter's anonymity, platforms should prevent providing consumers' contact information to service providers, or vice versa. Currently, Uber is using dummy numbers to hide personal contacts of consumers when contacting the drivers.<sup>61</sup> Other than the typical use of Caller ID Spoofing, TaskRabbit ensures that all communications between clients and Taskers are done entirely through its in-app call and chat.<sup>62</sup> Airbnb's policy is not to display the host's actual location, which will only become available after confirmation of booking.<sup>63</sup> All of these are nevertheless not compulsory and merely arise out of companies' voluntariness in order to maintain its reputation. Many platforms including Gogovan do not adopt similar mechanisms. If the law mandates all intermediary platforms to adopt such policy, it absolves the need for either party to exchange contact information. This policy may also create a positive externality, namely the incentive for more tech-companies to provide phone masking services as demand increases. This will possibly lead to a lower price for similar technologies when supply and competition increase.<sup>64</sup> Smaller sharing economy platforms, especially new start-ups, will then be able to gain benefit from the technology at a more affordable price.

While the obscurity mechanisms offer certain degree of anonymity and can be useful for privacy

protection, it may hamper the trust among users. This is because individuals tend to believe someone they know compared to a stranger,<sup>65</sup> or someone with real identity when compared to an anonymous. The initial idea of trust will diminish to a certain extent following the switch to pure strangers' suggestions, presenting a tough task to integrate the identity-based reputation systems with tools to protect individual privacy.<sup>66</sup> On one hand, we want to read the most honest testimonials. On the other hand, one who wants to protect his or her own privacy would prefer to provide as little information as possible.

Despite the decrease in trust or reputation, the Survey points out that more than half of the respondents will feel safer if they can comment or rate anonymously. This shows that anonymity could be an effective way to evade privacy concerns.

#### 6.2.2. CURING

As a plan to compensate the consumers should any breach of law occurred, this third proposal imposes responsibility on companies to bear liability for the acts of service providers. Treating service providers as employees would resolve the doubt in s.65 PDPO, which is only applicable when the data user is the employee of the company, and in turn enable consumers to claim vicarious liability under tort law should the service providers detoured from their task.

Unfortunately, although some jurisdictions have affirmed Uber drivers as employees, most jurisdictions remain stagnant at this stage. As explained above, it is difficult to classify service providers as employees of sharing economy platforms collectively due to the unique characteristics of each platforms. The outmoded bipartite relationship is unable to accommodate the innovative P2P market.<sup>67</sup> Hence, some scholars also suggest introducing a new category of relationship between intermediary platforms and service providers.<sup>68</sup> Yet, whether the creation

60 B. Dambrine, J. Jerome, B. Ambrose, *User Reputation: Building Trust and Addressing Privacy Issues in the Sharing Economy*, 2015, available at: [https://fpf.org/wp-content/uploads/FPF\\_SharingEconomySurvey\\_06\\_08\\_15.pdf](https://fpf.org/wp-content/uploads/FPF_SharingEconomySurvey_06_08_15.pdf), (30.6.2017), p. 7.

61 Uber, Unable to contact riders, available at: <https://help.uber.com/h/1f26f25a-6344-41cd-adf7-bbd2d548e0e0>, (30.6.2017).

62 TaskRabbit, Does the Tasker see my phone number, email, or address?, available at: <https://support.taskrabbit.co.uk/hc/en-gb/articles/204423544-Does-the-Tasker-see-my-phone-number-email-or-address->, (30.6.2017).

63 Airbnb, How can I edit my address?, available at: <https://www.airbnb.co.uk/help/article/478/how-do-i-set-my-map-or-address>, (30.6.2017).

64 Boundless Business, Impacts of Supply and Demand on Pricing, 2016, available at: <https://www.boundless.com/business/textbooks/boundless-business-textbook/product-and-pricing-strategies-15/pricing-products-96/impacts-of-supply-and-demand-on-pricing-449-1939/>, (30.6.2017).

65 B. Dambrine, J. Jerome, B. Ambrose, *User Reputation: Building Trust and Addressing Privacy Issues in the Sharing Economy*, p. 8.

66 J. H. Clippinger, "An Inquiry into Effective Reputation and Rating Systems", in H. Masum, M. Tovey (eds), *The Reputation Society: How Online Opinions Are Reshaping The Offline World*, MIT Press, Cambridge, Massachusetts 2011, p. 25-36.

67 R. L. Redfearn III, "Sharing Economy Misclassification: Employees and Independent Contractors in Transportation Network Companies", *Berkeley Technology Law Journal*, 31 (2) / 2016, 1023-1056.

68 OECD, *OECD Economic Surveys: Belgium 2017*, OECD Publishing, Paris 2017, p. 118.

of a new category of relationship is necessary for the purpose of vicarious liability is subjected to deeper analysis and it might take a long time before settling down on the criterion of the new category.

Therefore, it is suggested that the law may impose limited liability on platforms for the conduct of service providers regardless of the latter being employees or independent contractors, giving platforms more incentive to strengthen quality scrutiny and entry requirements. The limited nature is designed to avoid the excess burden of supervision on platforms. Unlike imposing traditional licensing requirements preventing entry to the market at the beginning, this rule will provide a flexible regulatory framework for platforms to apply their creativeness in conducting quality control, creating a balance between regulation and creativity in the sharing economy.

Through increase in platforms' effort to scrutinize the profile of service providers, the bar of the measurements needed to be taken by platforms for ensuring the integrity, prudence and competence of persons having access to the data under the cap of fourth data protection principle will eventually be raised. The heightened threshold to fulfil PDPO will in turn again levitate the incentive of platforms to secure personal data by any means. This chain reaction may encourage the continuous enhancement of consumer privacy protection.

### 6.3. Overall

The fact that only 31.3% of respondents agreed that protection would be better if platforms were to compensate them depicts that the intermediary platforms play a less significant role in curing a violation of privacy rights. Instead, imposing limited liability on platforms in compensating the victim is better seen a method to supplement the effort for prevention of harm, as the former will ultimately stimulate platforms to strengthen the security of personal data through the different the aforementioned means. As consumers care more in preventing the rise of an actual breach, more focus of the platforms should be diverted to the prevention stage.

## 7. B2P privacy

Going slightly further, while information provided in the reviews and comments are able to uphold quality of service, it might be collected and used at the consumers' disadvantages by platforms other than service providers.

Technology has facilitated information exchange between traders and consumers, collecting huge swaths of consumers' data in the most innovative way. In the current context, for instance, through analysing the content of review or rating, platforms can determine the possibility of customers re-using the system or employing the same service providers, and which service providers deserves better remuneration. With these data, consumers' behaviour and preferences can be uncovered. By no means this is all bad, but this simultaneously causes people to feel that the privacy limits are not set in the right place when these data are being used against them.

Analogous to any problem caused by big data analytics, platforms' ability to discover consumption pattern through the ratings and reviews has posed challenges to the current legal framework established through the PDPO.<sup>69</sup> To create more consumer benefits and organizations' market competitiveness,<sup>70</sup> big data and information sharing are inevitable. Unfortunately, Hong Kong still lack regulations to safeguard benefits of both the consumer and business,<sup>71</sup> urging a need for improvements. Resonating this fact, measurements should be taken to address the challenges respectively.

### 7.1. Definition of "personal data"

To begin with, privacy relating to personal data is safeguarded by the six data protection principles under the PDPO.<sup>72</sup>

Personal data refers only to data that relates directly or indirectly to a living individual, from which the identity of the individual can be directly or indirectly ascertained. This includes name, age, IP address, email, phone number and even photograph.<sup>73</sup> Unlike these traditional examples which would allow others to identify the data subject, a 5 stars rating would not be sufficient in pointing towards a specific person. Hitherto, there has been little discussion in Hong Kong on data privacy regarding behaviours and preferences of the data subject, e.g. satisfaction of service experience

69 M. Bharwaney, A. Marwah, "Personal Data Privacy in the Digital Age", *Hong Kong Law Journal*, 43 / 2013, 801–834.

70 P. Hopper, *How Big Data Can Rescue Struggling Hong Kong Retailers Amid the Tourism Slump*, Hong Kong, 2017, available at: <http://www.scmp.com/comment/insight-opinion/article/2073028/how-big-data-can-rescue-struggling-hong-kong-retailers-amid>, (13.7.2017).

71 N. Sun, *Calls for Hong Kong Government to Bring in Laws Protecting Online Shoppers*.

72 Personal Data (Privacy) Ordinance, (Cap.486), Schedule 1.

73 *Eastweek Publisher Ltd v Privacy Commissioner for Personal Data* [2000] 2 HKLRD 83.



and relationship between the data subject and service providers. Whether the ordinance could be deemed insufficient in guaranteeing privacy in a broad sense remains unclear.

According to the US FTC report, data collected through ratings and written reviews can as well generate concerns about the privacy of consumers.<sup>74</sup> In fact, information shown in the rating and review system can be used to identify an individual indirectly when putting it together with the username, service period, timing of rating etc. Moreover, some comments will explicitly spell out the name/username of the consumers or service providers. Under these circumstances, it is feasible to conclude the information as a piece of personal data, assuming privacy protection under PDPO.

It is suggested that the law should clearly stipulate how information obtained from the rating and review system should be classified. The article now considers applicability of relevant data protection principles in ensuring the privacy of information collected from the rating system. Principles such as notification, proportionality and transparency should be upheld when designing the forms of privacy protection.<sup>75</sup>

## 7.2. Collection and use of data

The next challenge arises from the collection and usage of personal data.

The first data protection principle stipulates that personal data should be collected for a lawful purpose. In the U.S Target Corporation case, data collected was used to create personalized shopping experience for a teenage girl based on her purchasing history.<sup>76</sup> It is hardly arguable that this usage is unlawful as it creates benefits for the consumers.

Applying the Target case in the current context, aside from screening out bad users and improving the service quality, the data collected through online rating system is able to better match consumers with service providers.<sup>77</sup> One

needs to be clear that matching consumers with service providers is different from the function of the general rating system, which is to collect information merely for enhancement of services. There is an involvement of consumer choices and privacy intrusion to a certain degree.

While the matching function is in favour of consumer welfare, it is important for platforms to make sure they provide meaningful notice to the consumers of the intention of platforms to utilize the information for designing service choices. Failing to do so would render the capture of platforms under the first principle due to fatigue notice. After collecting the data, platforms should only use it for a purpose for which the data is collected or for a purpose directly related to the collection.<sup>78</sup> In reality, however, it is very likely that platforms' algorithms would adjust the price of service by evaluating the ability and willingness of customers to pay, or commonly known as the reservation price.<sup>79</sup> The "thoughtful" move of improving service quality will likely be accompanied by differential pricing – higher price for services by service providers consumers have trust in. This poses questions on the limitation of data usage and even the purpose of data collection at the beginning.

Although price discrimination is generally a matter of big data analytics, it is more pronounced in the sharing economy, in which platforms could alter their business algorithms from time to time. In fact, the automated algorithm has often triggered the argument about the trade-off between keeping transaction costs low and eliciting dispersed information.<sup>80</sup> Contrastingly, the increase of price seems to be a reasonable value in exchange for better services. Therefore, it should not account to a use of data disproportionate from the purpose of collection. This is a topic which requires further research on the true intention of platforms and whether price discrimination does amount to an abuse of market power.

In order to apply the proportionality principle accurately, there needs to be clarification on the nature of price increase, or any other purposes other than improving the services itself. For the

74 US Federal Trade Commission, The "Sharing" Economy – Issues Facing Platforms, Participants & Regulators

75 PCPD, Big Data, Artificial Intelligence and Privacy, Hong Kong, 2016, available at: [https://www.pcpd.org.hk/english/news\\_events/whatison/files/Big\\_Data\\_Artificial\\_Intelligence\\_and\\_Privacy\\_20161214.pdf](https://www.pcpd.org.hk/english/news_events/whatison/files/Big_Data_Artificial_Intelligence_and_Privacy_20161214.pdf), (27.6.2017).

76 C. Duhigg, How Companies Learn Your Secret, New York, 2012, available at: <http://www.nytimes.com/2012/02/19/magazine/shopping-habits.html>, (10.7.2017).

77 EU Commission, "Commission Staff Working Document on Online Platforms, accompanying the document "Communication on Online Platforms and the Digital Single Market", COM, 288 / 2016, available at: <https://ec.europa.eu/digital-single-market/en/news/commission-staff-working-document-online-platforms>, (3.7.2017), p. 6.

78 Yiu Wing Ching John V ONC Lawyers (A Firm) And Others [2017] HKCU 1765.

79 N. Newman, "The Costs of Lost Privacy: Consumer Harm and Rising Economic Inequality in the Age of Google", *William Mitchell Law Review*, 40 (2) / 2014, 849–889, p. 867.

80 L. Einav, C. Farronato, J. Levin, "Peer-to-Peer Markets", *Annual Review of Economics*, 8 / 2016, 615–635, p. 619.

sake of consumer welfare, it is preferred to classify this as a purpose or tactic of platforms to maximize profits by exploiting consumers' preference. Consequently, platforms should bear responsibility to either notify consumers about the potential increase of price or eliminate price discrimination in its practice. Principles of notification and proportionality are crucial to preserve privacy in the collection and usage of data.

### 7.3. Transparency

As mentioned above, platforms concoct their own algorithm that employs big data and artificial intelligence to discover patterns and find correlations to make predictions from data.<sup>81</sup>

It is unpredictable on how these algorithms run, especially when they are changing according to external factors. This poses challenge to the fifth data protection principle which lays down that "a data user must take reasonable steps to make personal data practices known to the public regarding...how the data is used".

To remedy this, scholars suggest exposing the algorithms to the public.<sup>82</sup> One on hand, transparency is one of the way to make consumers feel safer. Yet, the market power held by platforms ultimately depends on the depth of data they possess. Algorithms could be run and tested, but it means nothing when there is lack of data such as real name and IP address, which is stored by the platforms. The assurance of security of information collected during registration and lawful use of data obtained through review and ratings are more effective methods compared to exposure of algorithms.

On the other hand, exposing the algorithms means that companies are to publicize their business secrets and techniques, which ultimately decrease their competitiveness in the market. The ongoing tension between competition and consumer protection is perfectly illustrated in this situation. Nevertheless, disclosing to consumers the profiling, logic and envisaged consequences of data collection is able to soothe privacy concern to a certain extent.

### 7.4. Retention of data

To further protect privacy interests of consumers, the duration for which businesses can retain electronic information needs to be

limited.<sup>83</sup> Platforms must not retain personal data for longer than is necessary to fulfil the original collection purpose or a directly related purpose. Generally, data users often retain personal data up to the statute of limitation period for which a claim can be brought by or against them in relation to the data subject. But in the business world, any piece of previous data is a valuable asset to determine the future market, providing commercial incentives to corporations to retain the gathered metrics. In principle, sharing economy firms can systematically augment data indefinitely as there is no specific time limitation.

To avoid misuse of data during the storage of information, consumers should have the right to request platforms to cease using their personal data for certain purposes (e.g. matching with highly reputed service providers), which the platforms must comply with. Unfortunately, there is no express right under the existing regime for individuals to request deletion of their personal data held by a data user. Rather, individuals only have the right to request the correction of their personal data.

For most of the rating and review system of the sharing economy platforms, consumers are not allowed to delete or amend their rating or comment. This is to ensure that comments are genuine, and consumers will subject to lesser threats as there is no point for service providers to threaten consumers when the ratings or comments are final. However, according to Bambauer, it may be callous to forever retain electronic databases containing embarrassing and disreputable information.<sup>84</sup> This is rather true when service providers or consumers have later developed different perspectives towards each other, but they are unable to delete or amend the ratings or reviews. A maximum time for retaining information would diminish the risks of harms persons can experience from third party retention of their information.<sup>85</sup>

Whilst the maximum period of retention is unclear, it is suggested that Hong Kong may implement the "right to be forgotten" to balance the platforms' power. Being one of the major highlights in the EU General Data Protection Regulation (GDPR), the "right to be forgotten" allows data subject to delete the data they have supplied,<sup>86</sup> and require data users to

81 A. Ezrachi, M. E. Stucke, *Virtual Competition – The Promise and Perils of the Algorithm-driven Economy*, Harvard University Press, 2016, p. 94.

82 F. Pasquale, *THE BLACK BOX SOCIETY: The Secret Algorithms that Control Money and Information*, Harvard University Press, 2015.

83 A. Tsesis, "The Right to be Forgotten and Erasure: Privacy, Data Brokers, and the Indefinite Retention of Data", *Wake Forest Law Review*, 48 / 2013, 101–151, p. 111.

84 J. Y. Bambauer, "The New Intrusion", *Notre Dame Law Review*, 88 / 2012, 205–276, p. 260.

85 A. Tsesis, *Op. cit.*, p. 111.

86 European Union General Data Protection Regulation 2016/679, art.17.

permanently remove the data from its own server and those servers under its control.<sup>87</sup> Although some platforms offer consumers the right to be forgotten for deletion of the full account, most platforms merely deactivate the account instead of permanently deleting the data.<sup>88</sup> Granting such right would provide freedom to consumers to delete their data and prevent usage by the intermediary platforms whenever they feel their privacy is invaded, or when they fear the risk.

### 7.5. Data security

The issue here is how the intermediary platforms should secure the data they hold. The fourth principle requires data holder, i.e. the platforms, to take appropriate security measures to protect information collected from the rating system. An obstacle caused by the online rating system is that information is relatively easy to be obtained by anyone else as the information is posted and shown on the public domain by users willingly to build reputation, thereby increasing the threshold of security measurements.

However, the twist here is that information obtained through ratings and reviews alone may not always be able to directly or indirectly identify an individual as explained above. It is only when the information is being processed and analysed by the platforms or anyone else, who possesses the account details and transaction history of the consumers, it becomes a valuable piece of data. Hence, platforms should bear greater responsibility to implement technical and organizational measures in preventing leakage of the processed data after matching with the details of personal accounts.

In the fast evolving technology techniques, to what extend a measurement shall be considered appropriate is unclear.<sup>89</sup> In particular, the sharing of information among multiple parties, e.g. disclosure of consumers' data to service providers or vice versa, has amounted to greater difficulties in securing data.<sup>90</sup> Major cases such as the 2015 VTech data leakage and Sanrio Digital (HK) Limited, which involved leakage of 6.3 million kid profiles and 3.3 million customer

data respectively, depict that promising security is costly to achieve.<sup>91</sup>

Although the PDPO has served well in the past decade, issues on data privacy still exist. Statistics by the Office of Privacy Commissioner for Personal Data (PCPD) showed that there was an increase of 17% in ICT-related privacy complaints from 2014 to 2015.<sup>92</sup> In the world of big data and cloud computing, the inherent lack of privacy is somehow regarded as the price we pay for the digital age.<sup>93</sup>

### 7.6. Overall

During the Survey, respondents were asked to weigh proportionality, transparency and right to be forgotten from a scale of 1 (least important) to 5 (most important). The Survey did not include data security as a factor affecting consumers' willingness to contribute to the online rating system because methods to achieve data security involves rather technical problems relating to information technology. Carving out data security from the Survey was necessary to avoid confusion or misunderstanding on the process of securing data with technological means.

Results of the Survey reveal that one-third of the respondents consider that transparency and right to be forgotten should be of grade 5 concern. The findings strongly support the article's stance to apply a mandatory breach notification system, and to enhance transparency by making personal data policies and practices known to the public. The connection of big data analytics with businesses has undeniably amplified the level of data privacy protection, which traders must confront when seeking to take advantage of the data obtained from the online rating system.

## 8. Miscellaneous

In Hong Kong, although there is no statutory requirement to do so, notification in the event of any use or loss of personal data is recommended. The notification system will require data users to

87 M. L. Ambrose, "It's About Time: Privacy, Information Life Cycles, and the Right to Be Forgotten", *Stanford Technology Law Review*, 16 (2) / 2013, 369–422, p. 381–83.

88 B. Dambrine, J. Jerome, B. Ambrose, *User Reputation: Building Trust and Addressing Privacy Issues in the Sharing Economy*, p. 14.

89 M. N. Helveston, "Consumer Protection in the Age of Big Data", *Washington University Law Review*, 93 (4) / 2016, 859–917.

90 V. Katz, *Op. cit.*

91 Consumer Council, *Online Retail – A Study on Hong Kong Consumer Attitudes, Business Practices & Legal Protection*, Hong Kong, 2016, available at: [https://www.consumer.org.hk/sites/consumer/files/competition\\_issues/online-retail/full%20report\\_e.pdf](https://www.consumer.org.hk/sites/consumer/files/competition_issues/online-retail/full%20report_e.pdf), (4.5.2017).

92 PCPD Media Statement, *Upward Trend in Privacy Complaints Sees Need for Personal Data Protection and respect amongst Individuals and Organisations*, Hong Kong, 2016, available at: [https://www.pcpd.org.hk/english/news\\_events/media\\_statements/press\\_20160126a.html](https://www.pcpd.org.hk/english/news_events/media_statements/press_20160126a.html), (14.3.2017).

93 T. Craig, M. Ludloff, *Privacy and Big Data*, O'Reilly Media Inc, 2011, p. 72.

automatically notify the supervisory authority when they breach the regulation.<sup>94</sup>

This rationale behind a mandatory breach notification system is that it would fulfil the need to safeguard the security of personal data. The burden imposed on data users is balanced off by “the potential detriment that may be suffered by data subjects in the event of unreported data breaches.”<sup>95</sup> The data breach notification system should be implemented to increase data users’ responsibility and accountability. In addition, Hong Kong may also learn from experienced and dedicated jurisdictions, as suggested by the PCPD. With this regard, the European Union General Data Protection Regulation 2016/679, which will enter into application in 2018, serves as a good guidance.

### 9. Consumer protection or business innovation?

From above, we can see various privacy concerns put forward by the online rating system despite its usefulness in addressing information asymmetry in the sharing economy. Ironical enough, many sharing economy firms have inadequate internal safeguards around privacy while they amass treasure troves from consumers’ data.<sup>96</sup> Considering the strong market power of sharing economy platforms, most of the solutions inevitably rely on the platforms to oversee privacy concerns raised in P2P and B2P relationships.

By increasing the regulatory barrier, this innovative business market might risk being transformed back to traditional form of business. However, the Survey reveals that while 50% of respondents consider both consumer protection and innovation to be equally vital, as high as 40.6% think consumer protection shall prevail. Yet, the cost to oversee will be factored into the price of services and borne by consumers eventually.<sup>97</sup>

### 10. Conclusion

Reputational information is widely acknowledged for being able to correct information asymmetries and allows for self-

regulation in the proliferation of P2P economy,<sup>98</sup> representing an invisible hand.<sup>99</sup> Although there is a growing body of evidence that ratings are generally inflated and entail a series of privacy issues,<sup>100</sup> rating systems have nevertheless been sufficient to entice large numbers of people to enter into novel and unknown situations, encouraging altruism among strangers.<sup>101</sup>

There is no panacea for all policy concerns. While profit maximization is a healthy component of competitive markets, regulation is inevitable to govern negative repercussions on consumer privacy to achieve a balance between consumer protection and benefits of sharing economy.<sup>102</sup>

Privacy concerns are currently masked by a pretence that all is well, but things always happen all of a sudden. After all, to prevent is better than to cure.

98 M. Cohen, A. Sundararajan, “Self-Regulation and Innovation in the Peer-to-Peer Sharing Economy”, *Chicago University Law Review Dialogue*, 82 (1) / 2015, 116–133, p. 129.

99 A. D. Amato, “Uber and the Sharing Economy”, *Italian Law Journal*, 2 / 2016, 177–190, p. 190.

100 G. Zervas, D. Proserpio, J. Byers, “A First Look at Online Reputation on Airbnb, Where Every Stay Is Above Average”, Social Science Research Network, 2015, 1–22, available at: [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2554500](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2554500), (24.7.2017).

101 Y. H. Fang, C. M. Chiu, “In justice we trust: Exploring knowledge-sharing continuance intentions in online communities of practice”, *Computers in Human Behaviour*, 26 (2) / 2010, 235–246.

102 M. E. Stucke, “Should Competition Policy Promote Happiness?”, *Fordham Law Review*, 81 / 2013, 2575–2646, p. 2626–29.

94 European Union General Data Protection Regulation 2016/679, art.33

95 G. Kennedy, “I want to be alone! The review of the Data Protection (Privacy) Ordinance”, *Hong Kong Lawyer*, May 2011.

96 R. Calo, A. Rosenblat, “The Taking Economy: Uber, Information, and Power”, *Columbia Law Review*, 117 / 2017, 1623–1690.

97 F. B. Cross, “When Environmental Regulations Kill: The Role of Health! Health Analysis”, *Ecology Law Quarterly*, 22 / 1995, 729–784, p. 758–59.



## DEMYSTIFYING SHARING ECONOMY: A CASE STUDY OF UBER

Ying, Chan

*In 2011, Time Magazine has referred to the Sharing Economy as one of the ten ideas that will change the world.<sup>1</sup> Airbnb, for example, has inspired many by its concept that allows 'regular, local people [to] make a little extra money by sharing their homes with respectful guests from around the world.'<sup>2</sup> However, what is really going on is that only approximately 1% of Airbnb revenues come from spare rooms of everyday, ordinary individual<sup>3</sup> and most of its revenues come from individuals with multiple<sup>4</sup> and full-time<sup>5</sup> Airbnb listings. Based on evidence of market failures caused by Uber, this article argues that the name of 'sharing economy' may not be a fair label to describe what is really going on and the implementation of regulation is necessary in order to protect consumer welfares.*

Keywords: *Sharing Economy, rhetoric, framing, market failures, regulation, lemon problem, privacy*

### 1. Introduction

Part 2 offers a more nuanced conception of sharing economy (thereafter "SE") and outlines some of its identified benefits and costs. Part 3 builds on existing literature<sup>6</sup> to argue that SE firms carefully manipulates word choices and framings to put them in favourable lights, which empowers them to ask for forgiveness rather than permission from the regulatory bodies. Using Uber as the subject of the case study, two issues harming consumer welfares will be covered in greater details in part 3. The first one concerns how SE companies accumulate vast troves of data information about consumers and are positioned

to leverage the power in problematic ways. The second issue concerns the use, disclosure and protection of users' data. Finally, Part 4 seeks to enhance the discussion as to the question of "how to regulate". In this part, some perceived barriers in regulation will be discussed, following by some suggestion to regulating sharing economy generally, as well as some specific solutions to the issues covered in part 3.

### 2. Introduction to the Sharing Economy

In recent years, the SE has begun to fundamentally change the capitalist economy in most countries around the world. As early as 2011, Time Magazine has referred it as "one of the ten ideas that will change the world".<sup>7</sup> Two years later, Forbes estimated that the revenue flowing through the SE would surpass \$3.5 million dollars in the same year, with growth exceeding 25 percent every year.<sup>8</sup> The projection of the worth in 2025, as PwC estimated, is \$335 billion by 2025.<sup>9</sup> EU Parliament also presented in its report in 2016 that it will be worth €572 billion in the EU28 by that date.<sup>10</sup>

What distinguishes the Sharing Economy from the traditional economy is that there is a transition from traditional individual ownership of most assets, towards an accessibility-based economic model. Such a transition can be observed across a wide variety of markets, ranging from accommodation, transport, consumer durables, labour and human capitals to intellectual properties and many more. In a pre-Sharing Economy era, consumers would pay for and use the assets as owners; however, in an accessibility-based system, consumers pay a price in return for a temporary access of such products. For examples, through Airbnb, a platform which many refer to as the 'poster child'

1 Time Magazine, 10 Ideas That Will Change The World, <http://content.time.com/time/specials/packages/0,28757,2059521,00.html>, (26 Jul 2017).

2 Barcelona, AIRBNB, <https://barcelona.airbnb/citizen.com/update-barcelona>, (7 Nov 2017).

3 Tom Slee, *What's Yours Is Mine: Against the Sharing Economy* (2<sup>nd</sup>edn., OR Books, 2015) at 37.

4 *Ibid*, 512–550.

5 From Air Mattresses to Unregulated Business: An Analysis of the Other Side of Airbnb, [http://www.ahla.com/uploadedFiles/\\_Common/pdf/PennState\\_AirBnbReport\\_.pdf](http://www.ahla.com/uploadedFiles/_Common/pdf/PennState_AirBnbReport_.pdf), last visited (7 Nov 2017).

6 e.g. A. Stemler, *The Myth of the Sharing Economy and Its Implications for Regulating Innovation*, *Emory Law Journal*, Forthcoming, 8.

7 Time Magazine, 1.

8 Airbnb and the Unstoppable Rise of the Sharing Economy, <http://www.forbes.com/sites/tomiogeron/2013/01/23/airbnb-and-the-unstoppable-rise-of-the-share-economy>, (7 Nov 2017).

9 N. Yaraghi, S. Ravi, *The Current and Future State of the Sharing Economy*, (14 Nov 2017).

10 P. Goudin, *The Cost of Non-Europe, European Added Value Unit of the Directorate for Impact Assessment and European Added Value*, PE 558.777.

of sharing economy, travellers can pick and rent a room or a whole home as an alternative to staying in a hotel.<sup>11</sup> Through Dog Vacay, dog owners can leave their dog with a host who will take care of the dog.<sup>12</sup> It is often cheaper than a kennel and offers a better environment to the dog.<sup>13</sup> TaskRabbit is a mobile marketplace for hiring another person to perform tasks and jobs like delivery and handyman work.<sup>14</sup>

## 2.1. conceptual clarification and typology

Despite the rapid growth and the growing popularity, there is no “universally accepted definition,”<sup>15</sup> nor a one-size-fits-all definition or label possible (or even desirable) for the variety of emerging sharing activities in the SE. The term “sharing economy”<sup>16</sup> is sometimes used interchangeably with “collaborative consumption”<sup>17</sup>, the “peer-to-peer economy”<sup>18</sup>, the “peer-to-peer consumption”<sup>19</sup> and “access-based”<sup>20</sup> consumption. Although academics have raised doubts as to the conceptual relation of these terms,<sup>21</sup> they most pragmatically accept this semantic confusion that characterizes practice.<sup>22</sup>

11 The Rise of The Sharing Economy, <https://www.economist.com/news/leaders/21573104-internet-everything-hire-rise-sharing-economy>, (7 Nov 2017).

12 Dogvacay: The Nation's Largest Network of 5-star Pet Sitters and Dog Walkers, <https://dogvacay.com/>, (7 Nov 2017).

13 *Ibid.*

14 Task Rabbit: The Convenient & Fast Way to Get Things Done around the House, <https://www.taskrabbit.com/>, (7 Nov 2017).

15 A. Thierer, C. Koopman, A. Hobson, C. Kupier, “How the Internet, the Sharing Economy, and Reputational Feedback Mechanisms Solve the “Lemons Problem”, *University of Miami Law Review* 5/2016, 831; K. Zale, “Sharing Property”, *University of Colorado Law Review* 87/2016, 526.

16 J.J. Horton, R.J. Zeckhauser, “Owning, Using and Renting: Some Simple Economics of the Sharing Economy”, *Harvard Kennedy School Faculty Research Working Paper Series*, RWP16-007/2016.

17 J. Hamari, M. Sjöklint, A. Ukkonen, “The sharing economy: Why people participate in collaborative consumption”, *Journal of the Association for Information Science & Technology* 67/2016, 2049.

18 R. Dyal-Chand, “Regulating Sharing: The as an Alternative Capitalist System”, *Tulane Law Review* 90/2015, 243.

19 S.Y. Oei, D.M. Ring, Can Sharing be Taxed?, *Washington University Law Review*, 93/2016, 991.

20 S.R. Miller, “First Principles for Regulating the Sharing Economy”, *Harvard Journal on Legislation* 53/2016, 150.

21 J. Hamari, M. Sjöklint, A. Ukkonen, “The sharing economy: Why people participate in collaborative consumption”, *Journal of the Association for Information Science & Technology* 67/2016, 2049. (f.14)

22 C. Codagnone, F. Biagi, F. Abadie, “The Passions and the Interests: Unpacking the ‘Sharing Economy’”,

These terms are used as a “floating signifier” for a diverse range of activities.

Law professor Kellen Zale commented that “[t]he debate over the thus remains frustrating and controversial in large part because we lack a doctrinally cohesive and normatively satisfying way of talking about the underlying activities occurring within the sharing economy.”<sup>23</sup> The lack of understanding can largely attribute to the fact that the nature of the SE is likely to change over time as it scope and scale grow.<sup>24</sup>

### 2.1.1. EXISTING DEFINITIONS

Sharing Economy has been defined as:

- ‘peer-to-peer internet platforms (including Airbnb, Uber, TaskRabbit, Just Park...) which empower individuals to monetise their underutilised assets, time and skills’<sup>25</sup>
- ‘... as being activity that is facilitated by digital platforms which enable people or businesses to share property, resources, time, or skills, allowing them to ‘unlock’ previously unused or under-used assets’<sup>26</sup>
- a widely-used broad categorization, identifies four domains: accommodation ‘sharing’ platforms; car and ride ‘sharing’ platforms; peer-to-peer employment markets; and, peer-to-peer platforms for sharing and circulating resources<sup>27</sup>
- an economic system that possesses the following five characteristics: (1) largely market-based; (2) utilize excess-capacity for assets, skills, time and money at a level closer to their full capacity; (3) make use of the crowd-based network rather than state or corporate aggregates; (4) blurs the line between the personal and the professional and (5) blurs the line between fully employed and casual labour, between

*European Commission JRC Science for Policy Report*, doi:10.2791/474555, 20.

23 K. Zale, “Sharing Property”, *University of Colorado Law Review* 87/2016, 526.

24 P. Goudin, 19.

25 C.J. Martin, “The Sharing Economy: A Pathway to Sustainability or a Nightmarish From Neoliberal Capitalism”, *Ecological Economics*, 121/2016, 153.

26 United Kingdom Office for National Statistics, The Feasibility of Measuring the Sharing Economy: Progress Update, <https://www.ons.gov.uk/economy/economicoutputandproductivity/output/articles/thefeasibilityofmeasuringthesharingeconomy/progressupdate>, (7 Nov 2017).

27 C.J. Martin, “The sharing economy: A pathway to sustainability or a nightmarish form of neoliberal capitalism?”, *Ecological Economics* 121/2016, 149– 159.

independent and dependent employment and between work and leisure.<sup>28</sup>

### 2.1.2. LIMITATIONS OF THE EXISTING DEFINITIONS

All of these abovementioned definitions are satisfactory approximations for the purposes of the authors' enquiries. However, they do not fully capture aspects that are important from an analytical-empirical and policy-oriented perspective.<sup>29</sup>

Firstly, one of the key ingredients of the definition "utilizing excess capacity of the assets" is lack of empirical questioning into the types of the assets and the extent to which these assets are being idled. According to Codagnone, whether the asset being leveraged is a property or merely labour can cast a difference in terms of employment and distributional effects; and it is not always the case that some idled assets are being utilized for some extra money, it could in some cases be a way to earn necessary income.<sup>30</sup>

Secondly, these definitions do not consider fully the differences in the interaction modality, including peer-to-peer (P2P), business-to-consumer (B2C), business-to-business (B2B) and government-to-government (G2G).<sup>31</sup>

Thirdly, no distinction is drawn as to not-for-profit platforms and commercial platforms, which is an aspect relevant to the current rhetorical battle.<sup>32</sup>

Fourthly and most importantly, there exist different regulatory and policy implications within each broad-based categorization. Platforms that are being placed in the same broad category, for example, Couchsurfing and Airbnb, may differ drastically in terms of their current regulatory implication (eg. market access and licensing, liability and insurance, consumer protection and labour law) and their ability to disrupt existing markets.

### 2.1.3. FOR THE PURPOSE OF THIS ESSAY

This article suggests that it is helpful to think of the SE as any digital commercial or non-profit platforms that bring together distributed a variety of players to leverage capital assets, skills, or time

through a variety of interaction modalities (P2P, P2B, B2P, B2B, G2G).<sup>33</sup> It encompasses all manner of goods and services shared or exchanged for both monetary and nonmonetary benefit.<sup>34</sup> This is an all-encompassing definition that nonetheless contains better-specified elements. That is, reference is made to the commercial orientation and the interaction modality of the company. If these elements are integrated with a reasoning on policy and regulatory concerns, it is possible to arrive at a more delimited and useful typology by progressive elimination.<sup>35</sup>

## 2.2. the Rewards of Sharing

The SE excited people, entrepreneurs and governments around the world because it appeared to provide economic opportunities for the masses.<sup>36</sup> To those who cannot and do not wish to work a traditional shift or otherwise do not enter the mainstream workforce, driving Uber or participating in other 'gig work' could be an alternative and a perhaps more flexible way to earn income. And obviously, with an influx of new entrants into seemingly every industry, consumers may enjoy the fruits from the increasingly intense competition in the market.<sup>37</sup> Further, by maximising the use of previously under-utilised assets, capital-intensive infrastructure like hotels and newly manufactured durable goods like vehicles could be shared locally.<sup>38</sup>

While the benefits of the SE were and are many, the "honeymoon" phase of its revolution is over.<sup>39</sup> Dark sides has proliferated in many ways, from the lack of consumer protection and worker

33 R. Boston, "The Sharing Economy Lacks a Shared Definition", <http://www.fastcoexist.com/3022028/the-sharing-economy-lacks-a-shared-definition>, (13 Nov 2017). (It may be helpful to think of a sharing economy as a special case of a "two-sided" or "platform" market. It is special because it typically employs technology to bring together large numbers of buyers and large numbers of sellers.).

34 C. Koopman, M. Mitchell, A. Thierer, "The Sharing Economy and Consumer Protection Regulation: The Case for Policy Change", *The Journal of Business, Entrepreneurship & The Law*, 8/2015.

35 Cristiano Codagnone, *supra* at n22.

36 C.J. Martin, "The sharing economy: A pathway to sustainability or a nightmarish form of neoliberal capitalism?", *Ecological Economics* 121/2016, 149– 159. (fn24).

37 Sara Gutterman, Environmental Leader, "'Sharing Economy' Will Save Our Economy and the Environment", <https://www.environmentalleader.com/2014/07/sharing-economy-will-save-our-economy-and-the-environment/>, (13 Nov 2017).

38 *Ibid.*

39 E. Gustavson, Rhetoric: How Politicians Manipulate Language and the Media to Shape Public Thought, *Hinckley Journal of Politics*, 8/2007, 29–30.

28 A. Sundararajan, *The Sharing Economy*, MIT Press, Massachusetts, 2016, 27.

29 C. Codagnone, F. Biagi, F. Abadie, "The Passions and the Interests: Unpacking the 'Sharing Economy'", *European Commission JRC Science for Policy Report*, doi:10.2791/474555, 21.

30 C. Codagnone, F. Abadie, F. Biagi, "The future of work in the 'sharing economy': Market Efficiency and Equitable Opportunities or Unfair Precarisation?" *United Nation JRC Science and Policy Report*, doi:10.2791/431485, 2016.

31 *Ibid.*

32 *Ibid.*



protections, potential social exclusion, damage to the fabric of local communities, anticompetitive effects against other platform-service providers, to name but a few.

However, when regulators and lawmakers raise concerns, SE firms ask for forgiveness instead of permission, that is, to conduct business as if the rules did not exist and ask for forgiveness, or fight new regulations if challenged.<sup>40</sup> Phil Malone, professor of law and director of the Juelsgaard Intellectual Property and Innovation Clinic, explained that the mindset of many entrepreneurs is this: 'Why should we have to kill or delay our great idea that would improve life for many people just because [to borrow from Dickens] "the law is an ass"?' Their view is that it is better to seek forgiveness than ask for permission.<sup>41</sup> The next part will discuss in greater detail how rhetoric empowers SE firms to do so.

### 3. Bridging between rhetoric and reality

Rhetoric is defined as "the art of persuading people".<sup>42</sup> It is powerful because it can be used to shape argument and preclude rebuttals, which can cause people to embrace stances which they might otherwise reject.

It is understood by scholars over two millennia that rhetoric and public policy are often intertwined.<sup>43</sup> In Aristotle's discussion of deliberative rhetoric, for example, offered advice for advocates debating such issues as war, and he instructed citizens that "the security of the state" depended on their being "knowledgeable about legislation."<sup>44</sup> Efficient rhetoricians can convince their audiences efficiently by framing their argument in particular ways and by using specific words that can arouse the audience in the desired way.<sup>45</sup>

Because of the positive and progressive connotation that "sharing" carries, more and more companies claim that they are part of the "sharing

economy".<sup>46</sup> Indeed, large SE firms, including Uber, are 'exploiting' the sharing rhetoric in public relations activities, like official hearings,<sup>47</sup> and releasing their own reports bolstering the benefits they provide.<sup>48</sup>

All these are done for the firms to more aggressively expand in the market, and to call for no-regulation in a classical neo-liberal fashion way.<sup>49</sup>

The following subsections demonstrate how Uber make use of framing and precise wording to exaggerate the positive features of the SE and more particularly its business and hence compel the general public and the governments to support the industry.<sup>50</sup>

#### 3.1. word choice: "sharing" economy

Word choice affects how people perceive issues and how they opine those issues. It has long been a tradition for policy makers to associate words with raw instincts to gain political support from the public. Some politicians would even go to great lengths to conduct research studies to determine the precise language needed for the contexts – just to create a desired public reaction.<sup>51</sup> For example, "death tax",<sup>52</sup> "pro-life",<sup>53</sup> and "intelligent design"<sup>54</sup> are word choices used by politicians to drive regulations in other contexts. Apart from making arguments possible, invoking rhetorical tropes may also provide moral force to them.

Uber is skilful in employing words that put them in a favourable light. Apart from the careful positioning of itself under the umbrella of "sharing economy", it has been careful in calling the drivers as "driver partners".<sup>55</sup> This help elucidating that

<sup>46</sup> *Ibid.*

<sup>47</sup> *Ibid.*

<sup>48</sup> Uber Blog, Uber Data: Uber's Economic Impact On The City Of Chicago, <http://newsroom.uber.com/chicago/2014/03/uberdata-ubers-economic-impact-on-the-city-of-chicago/>, (13 Nov 2017).

<sup>49</sup> Cristiano Codagnone, *supra* at n22.

<sup>50</sup> A. Stemler, The Myth of the Sharing Economy and Its Implications for Regulating Innovation, *Emory Law Journal*, Forthcoming, 8.

<sup>51</sup> E. Gustavson, Rhetoric: How Politicians Manipulate Language and the Media to Shape Public Thought, *Hinckley Journal of Politics*, 8/2007, 29–30.

<sup>52</sup> M.J. Graetz, I. Shapiro, *Death By A Thousand Cuts: The Fight Over Taxing Inherited Wealth*, Princeton University Press, New Jersey, 2005, 76–78.

<sup>53</sup> D. Fagundes, "Property Rhetoric and the Public Domain", *Minnesota Law Review*, 94(2010), 660. (fn42)

<sup>54</sup> S. Poole, *Unspeak: How Words Become Weapons, How Weapons Become a Message, and How That Message Becomes Reality*, Grove Press, New York, 2007, 50.

<sup>55</sup> Dan Levine, 'Uber drivers remain independent contractors as lawsuit settled', <http://www.reuters.com/>

<sup>40</sup> L.D. Wall, Federal Reserve Bank of Atlanta, "Avoiding Regulation: FinTech versus the Sharing Economy", <https://www.frbatlanta.org/cenfis/publications/notesfromthetvault/09-avoiding-regulation-fintech-versus-the-sharing-economy-2016-09-29.aspx>, (22 July 2017).

<sup>41</sup> R. Schmitt, "The Sharing Economy: Can the Law Keep Pace with Innovation?", *Stanford Lawyer*, 96/2017.

<sup>42</sup> Gerald B. Wetlaufer, 'Rhetoric and Its Denial in Legal Discourse', *Virginia Law Review*, 76/1990, 1546.

<sup>43</sup> R.Asen, 'Introduction: Rhetoric and Public Policy', *Rhetoric & Public Policy*, 13/ 2010, pp. 1– 5.

<sup>44</sup> A. O. Rorty (ed.), *Essay on Aristotle's Rhetoric*, University of California Press, 1996, 301.

<sup>45</sup> D. Fagundes, "Property Rhetoric and the Public Domain", *Minnesota Law Review*, 94(2010), 660.

they are “independent contractors” as opposed to employees of the platform so that they can avoid issues relevant to labour law and limit their liability in tort.

As mentioned in part I, the term “sharing economy” is often used interchangeably with “collaborative consumption”<sup>56</sup>, the “peer-to-peer economy”<sup>57</sup>, or the “peer-to-peer consumption”<sup>58</sup> and “access-based”<sup>59</sup> consumption. Amongst these terms, platforms have been eager to position themselves under the “big tent” of the SE because of the “positive symbolic meaning of sharing, the magnetism of innovative digital technologies, and the rapidly growing volume of sharing activity.”<sup>60</sup>

According to Pew Research Center’s recent survey of the new digital economy, around 40% of the interviewee who had heard of the term “sharing economy” focused more on the “sharing” component than the “economy” component.<sup>61</sup> Many of them think of “sharing” in its literal sense.<sup>62</sup> They associate the term with the notion of charity and helping people in need through sharing of resources.<sup>63</sup> Others viewed the term through a local or neighbourhood focus, and use terms like “community”, “friends” or “neighbours” in their response.<sup>64</sup> When Platforms associate themselves with such positive and altruistic images, it is not surprising that they can mobilize their millions of users to advocate on their behalf and politicians become hesitant to appear hostile to “sharing.”<sup>65</sup>

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*article/us-uber-tech-drivers-settlement-idUSKCN0XJ07H*, (7 Nov 2017).

56 J. Hamari, M. Sjöklint, A. Ukkonen, “The sharing economy: Why people participate in collaborative consumption”, *Journal of the Association for Information Science & Technology* 67/2016, 2049. (fn 18)

57 R. Dyal-Chand, “Regulating Sharing: The as an Alternative Capitalist System”, *Tulane Law Review* 90/2015, 243. (fn 15)

58 S.Y. Oei, D.M. Ring, Can Sharing be Taxed?, *Washington University Law Review*, 93/2016, 991. (fn16)

59 S. R. Miller, “First Principles for Regulating the Sharing Economy”, *Harvard Journal on Legislation* 53/2016, 150. (fn17)

60 J. Schor, Debating the Sharing Economy, <http://www.greattransition.org/publication/debating-the-sharing-economy>, (13 Nov 2017).

61 K. Olmstead, A. Smith, How Americans Define the Sharing Economy, <http://www.pewresearch.org/fact-tank/2016/05/20/how-americans-define-the-sharing-economy>, (7 Nov 2017).

62 *Ibid.*

63 *Ibid.*

64 *Ibid.*

65 C. Said, Airbnb, Uber Cast Themselves as Saviors of the Middle Class, <http://www.sfchronicle.com/business/article/Airbnb-Uber-We-are-the-saviors-of-the-middle-6620729.php>, (13 Nov 2017).

However, the term “Sharing Economy” is certainly misleading if not contradictory. To layman understanding, an example of sharing would be me to share my cake with you. But if I charge you for a slice that could hardly be qualified as ‘sharing’ but ‘selling’.

The real “sharing” economy, is where people are linked either geographically or through a platform, and they genuinely share skills, information, knowledge or assets with each other in a way that creates benefits. Like Couchsurfing for example, these platforms allow people to connect and to exchange without payment. However, the dominant firms of the SE, including Uber, are Silicon Valley-based and funded technology companies that use cash to motivate supply-side behaviour.<sup>66</sup> It might be more appropriate to classify these companies as “gig economy” or “on-demand” economy, but none of these terms can spark the positive emotion like the term “sharing economy” does.<sup>67</sup> Therefore, the term “sharing economy” may well muddle our ability to understand fully the ideas and concepts that the term embodies, and hinders a rational debate on regulation and policy-making.

### 3.2. framing

Framing involves “selecting and highlighting some facets of events or issues, and making connections among them so as to promote a particular interpretation evaluation and or solution.”<sup>68</sup> It involves using language to “define the boundaries within which a policy will be considered.”<sup>69</sup> It has a powerful effect on “[shaping] mass opinion and ultimately policy outcomes.”<sup>70</sup> There are plenty of examples of how policymakers make use of framing. For example, the terrorist attacks of September 11, 2001, have reshaped the political agenda and public thinking in the United States.<sup>71</sup> These changes are motivated largely by the interaction of framing of the event like “war on terrorism” and pre-existing public attitudes.<sup>72</sup>

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66 The Economics Foundation, The Sharing Economy: The Good, The Bad and The Real, <http://neweconomics.org/2015/12/the-sharing-economy-the-good-the-bad-and-the-real/>, (7 Nov 2017).

67 A. Stemler, The Myth of the Sharing Economy and Its Implications for Regulating Innovation, *Emory Law Journal*, Forthcoming, 8. (fn 47)

68 K. Callaghan and F. Schnell, Framing American Politics, *University of Pittsburgh Press, Pittsburgh*, 2005.

69 E. Gustavson, Rhetoric: How Politicians Manipulate Language and the Media to Shape Public Thought, *Hinckley Journal of Politics*, 8/2007, 29–30. (fn 36)

70 *Ibid.*

71 J.N. Druckman, “The Implications of Framing Effects for Citizen Competence”, *Political Behavior* 23/2001.

72 K. Callaghan and F. Schnell, Framing American Politics, *University of Pittsburgh Press, Pittsburgh*, 2005 (fn63)

SE Platforms mainly use five basic frames to avoid regulation.

### 3.2.1. THE EXCESS CAPACITY FRAME

"Excess capacity" refers to an underutilised asset.<sup>73</sup> Shervin Pisheva, one of Uber's investors, named Uber as an example of "excess capacity" company that allows owners of cars and spare time to provide transportation services.<sup>74</sup> He said that Uber is the "next generation" of eBay, the original excess-capacity company that "lets people sell unneeded things from their garages".<sup>75</sup>

However, many participants of Uber are not using their excess capacity, or "resurrecting dormant capital".<sup>76</sup> Instead, Uber is helping drivers to lease, rent and buy new cars, which are often deemed as predatory acts.<sup>77</sup> The same applies to other platforms. It is observed that the supply-side users are putting new capacity online, and are competing unfairly with the existing industry. One clear example is Airbnb. It claimed that most of the host income is used to pay the regular household expenses.<sup>78</sup> However, according to Eric T. Schneiderman, the Attorney General of the New York State, nearly half of the revenue of the company came from those who have multiple listings.<sup>79</sup> Also, in 12 of the largest cities of the States, nearly 30% of its revenue came from unregulated full-time hotels that are operated by an individual(s) or entity(ies) throughout the year.<sup>80</sup> These "super hosts" can hardly be said to be making use of the "excess capacity" of their properties.

73 TriplePundit.com, "The Rise of the Sharing Economy", [http://www.triplepundit.com/uploads/The\\_Rise\\_of\\_the\\_Sharing\\_Economy.pdf](http://www.triplepundit.com/uploads/The_Rise_of_the_Sharing_Economy.pdf), (13 Nov 2017).

74 A. Tsotsis, WIRED, For Limo Service Uber, Downtime and Idle Resources Are Fuel for Profits, [https://www.wired.com/2012/06/mf\\_uber/](https://www.wired.com/2012/06/mf_uber/), (3 Nov 2017).

75 *Ibid*.

76 D.M. Rothschild, "How Uber and Airbnb Resurrect 'Dead Capital'", <http://www.theumlaut.com/2014/04/09/how-uber-and-airbnb-resurrect-dead-capital/>, (13 Nov 2017).

77 E. Newcomer, O. Zaleski, "Inside Uber's Auto-Lease Machine, Where Almost Anyone Can Get a Car", <https://www.bloomberg.com/news/articles/2016-05-31/inside-uber-s-auto-lease-machine-where-almost-anyone-can-get-a-car>, last visited 7 Nov 2017.

78 AirBnB, "The Economic Impact of Home Sharing In Cities Around The World", <https://www.airbnb.com/economic-impact/>, (7 Nov 2017).

79 The Office Of The New York State Attorney General, Airbnb In The City. <http://www.ag.ny.gov/pdfs/Airbnb%20report.pdf>, (7 Nov, 2017).

80 American Hotel & Lodging Association, "From Air Mattresses to Unregulated Business: An Analysis of the Other Side of Airbnb", [https://www.ahla.com/sites/default/files/Airbnb\\_Analysis\\_September\\_2016\\_0.pdf](https://www.ahla.com/sites/default/files/Airbnb_Analysis_September_2016_0.pdf), (7 Nov 2017).

It is not genuine to frame the SE in the context of sharing excess capacity. As many platforms publicized in their public relation campaigns, "utilizing excess capacity" is often linked with benefits like positive environmental effects and wider net socio-economic gain.<sup>81</sup> However, as stated, many supply-side users are motivated by money to market their newly acquired property or full-time services using the platform. The idea of this homemade, small-scale, making money out of the invisible businesses is what 'mystify' the SE and in part encourages regulators not to put any constraints on it.

### 3.2.2. THE MICROENTREPRENEUR FRAME

Platforms employ the microentrepreneur frame to characterise platforms participants as microentrepreneurs. Uber's adviser, David Plouffe, explained that the application is designed to "help people who are struggling to pay the bills to earn a little extra spending money, or who are transitioning between jobs".<sup>82</sup> Most drivers are not making a decision to do this for a lifetime or even for a long time. This is crucial: for most people, driving on Uber is not even a part-time job... it's just driving an hour or two a day, here or there, to help pay the bills".<sup>83</sup> Airbnb, likewise, say that it is a "an people-to-people platform and a lifeline for people who need supplemental income".<sup>84</sup>

Platforms have argued that these microentrepreneurs should not be overly burdened with regulations because the amount of work is piecemeal and the margins are so thin for these hardworking people who have very limited resources.<sup>85</sup> However, as the amount of work of the supply-side user increases, they either attain an "employee" status or turn into a full-scale business, as opposed to microentrepreneurs.

As previously mentioned, an increasing portion of Airbnb's revenue is generated by people running full-time rentals without paying taxes and basic health nor compiling safety requirements as other accommodation providers

81 K. Zale, "Sharing Property", *University of Colorado Law Review* 87/2016, 526. (fn12)

82 Uber Newsroom, Uber And the American Worker: Remarks <https://www.uber.com/newsroom/1776/>, (7 Nov 2017).

83 Tim Adams, The Guardian, "My father had one job in his life, I've had six in mine, my kids will have six at the same time", <https://www.theguardian.com/society/2015/nov/29/future-of-work-gig-sharing-economy-juggling-jobs>, (7 Nov 2017).

84 Airbnb, "No on Proposition F: A People-to-People Movement", <https://www.documentcloud.org/documents/2504734-airbnb-prop-f-reduced.html>, (7 Nov 2017).

85 A. Stemler, 8.



in the industry do.<sup>86</sup> These people often have multiple listings for rental throughout the year. As for Uber, according to UCLA law professor Noah Zatz, “A marginal group of full-time drivers actually are doing about half the work, far more than those driving the fewest hours.”<sup>87</sup>

Uber is eager in framing their drivers as independent contractors as opposed to employees. On its website, it states that

*“Drive with Uber and earn great money as an independent contractor. Get paid weekly just for helping our community of riders get rides around town. Be your own boss and get paid in fares for driving on your own schedule.”*<sup>88</sup>

However, when confronted with challenges, Uber’s spokesman reinstated that they are a “technology company” that provides the application connecting passengers and drivers. The drivers are independently contracted and they have the flexibility of being their own boss.<sup>89</sup> Uber’s spokesman confirmed the notion that drivers are “independent contractors” when he stated: “We don’t hire drivers. We’re a technology company. We provide the app that they use, that connects passengers with drivers. They have the flexibility of being their own boss.”<sup>90</sup>

In Uber’s cases, the line between independent contract and employee is not always clear-cut. This is because Uber does have control over many aspects of the service. For example, payment terms, conditions of the cars and the power to deactivate drivers from the platform.<sup>91</sup> In *Berwick v. Uber Techs.*,<sup>92</sup> it is confirmed that many factors that are used to distinguish an independent contractor from employees suggest that Uber drivers are employees.<sup>93</sup> It further weakens the platform’s claim that the supply-side users are microentrepreneur.

86 American Hotel & Lodging Association, “From Air Mattresses to Unregulated Business: An Analysis of the Other Side of Airbnb”, [https://www.ahla.com/sites/default/files/Airbnb\\_Analysis\\_September\\_2016\\_0.pdf](https://www.ahla.com/sites/default/files/Airbnb_Analysis_September_2016_0.pdf), (7 Nov 2017).

87 N. Zatz, “Is Uber Wagging the Dog With Its Moonlighting Drivers?” <https://onlabor.org/2016/02/01/is-uber-wagging-the-dog-with-its-moonlighting-drivers> (7 Nov 2016).

88 Drive, UBER, <https://get.uber.com/drive>, (7 Nov 2016).

89 D. Hogan, “Uber Ride Service Would Bring Controversy” <http://www.news-press.com/story/money/2014/09/10/uber-ride-service-bring-controversy/15421511>, (26 July 2017).

90 *Ibid.*

91 UBER, “Understanding Rating”, <https://help.uber.com/h/99928811-f3a0-4fd6-9fcea3436b5238d0>, (26 July, 2017).

92 *Uber Technologies, Inc v Barbara Berwick* CGC-15-546378 (In the Superior Court of California County of San Francisco)

93 *Ibid.*

### 3.2.3. THE TECHNOLOGY COMPANY FRAME

By claiming themselves as technology companies, as opposed to the provider of the products or services, Platforms have been able to avoid a number of existing regulations.

As Tom Slee observed, platforms often claim that they sell access to software, an algorithm that matches demand and supply, and a reputation mechanism that establish trust among users.<sup>94</sup> On Uber’s website, the company explicitly frame itself as a “technology company that develops applications” and the transportation services are provided by the riders and driver-partner, who are matched via the platform.<sup>95</sup>

The utility of the technology company frame is to allow Platforms to avoid classification as the provider of the transportation, accommodation, or other services and products. This utility may vary from jurisdiction to jurisdiction, depending on the law of the regions. In the United States for example, the technology company frame enables platforms to avoid a range of law from the Americans with Disabilities Act<sup>96</sup> to the Civil Rights Act of 1964.<sup>97</sup> In addition, it allows Platforms to characterize themselves as computer service providers under Section 230 of the Communications Decency Act, thereby avoiding any civil or criminal harms caused by their users.<sup>98</sup> For example, Airbnb was found not liable for illegal rentals in the City of Anaheim.<sup>99</sup>

### 3.2.4. THE SELF-REGULATION FRAME

Nowadays, most if not all SE firms use trust mechanisms like product ratings and reputational feedback systems to establish trust between suppliers and consumers.<sup>100</sup> To some, these mechanisms are considered the “most unsung

94 T. Slee, “What’s Yours Is Mine”, OR Books, 2016, 88–101.

95 Uber, Legal, <https://www.uber.com/legal/other/guidelines-for-law-enforcement>, (25 July 2017).

96 *National Federation of the Blind of California v. Uber Technologies, Inc., et al* [2015] 103 F. Supp. 3d 1073, 1076 (In the United States District Court For The Northern District Of California San Francisco Division).

97 California Public Utilities Commission, Decision Adopting Rules and Regulations to Protect Public Safety While Allowing New Entrants to The Transportation Industry, <http://docs.cpuc.ca.gov/PublishedDocs/Published/Goool/Mod77/K12/77112285.pdf>, (7 Nov 2017).

98 V. Katz, “Regulating The Sharing Economy”, *Berkeley Technology Law Journal*, 30/2015, 1105.

99 L. Leung, “Anaheim Won’t Fine Websites Like Airbnb for Illegal Short-Term Rental Listings, Orange City Register, <http://www.ocregister.com/articles/city-726671-term-short.html>, (7 Nov 2017).

100 H. Masum, M. Tovey, *The Reputation Society: How Online Opinions Are Reshaping the Offline World*, MIT Press, Cambridge Press, MA, 2011, 3.

heroes" of the SE.<sup>101</sup> According to David Friedman, "reputational enforcement works by spreading true information about bad behaviour. People who receive that information modify their actions accordingly, which imposes costs on those who have behaved badly."<sup>102</sup>

Some argued that these reputational feedback mechanisms have created a diminished need for regulation because consumers can police misconducts via the trust mechanism. Likewise, SE firms have relied on such mechanisms to call for minimal regulation. For example, the CEO and founder of Airbnb Brian Chesky stated that "cities can't screen as well as technologies can screen. Companies have these magical things called reputation systems (...) government should exist as the place of last recourse."<sup>103</sup>

However, in practice, the function of these trust mechanism to impose costs on those bad actors may be greatly impaired due to the extremely high feedback scores involved in SE transactions. According to Chris Nosko & Steven Tadelis, a well-functioning reputation system should enable platform users to accurately the chance of having a positive interaction without having a previous experience with the supply-side user.<sup>104</sup> To achieve this goal, firstly, the reputation information has to be accurate and be able to represent the quality of past transactions; secondly, the mechanism has to be guarded against fraudulent reviews, and lastly, users have to be able to correctly interpret the reputation information.<sup>105</sup>

Unfortunately, the reputation information may not be able to precisely reflect the past experiences. Currently, over 95% of Airbnb offerings have an average user-generated rating of either 4.5 or 5 stars (out of 5 stars).<sup>106</sup> In the

same vein, only 1% of Uber drivers receive less than 3 stars out of five. Similarly, Uber, the peer-to-peer driving service, has indicated that only 1% of Uber drivers receive below three stars (out of five).<sup>107</sup>

### 3.2.5. DISRUPTIVE INNOVATION FRAME

SE Platforms claim that they are disrupting existing industries by offering new solutions to the old problems.<sup>108</sup> Ashwini Chhabra, Director of Policy Development at Uber, stated that one of the importance of making sure that P2P ridesharing platforms can flourish is that they bring real innovation to an industry that has been static for decades.<sup>109</sup>

By framing themselves as 'innovative' and to classify themselves from their "stagnant rent-seeking incumbents",<sup>110</sup> SE companies can either avoid existing regulations by distinguishing itself from traditional firms or work with communities to develop new regulations that are beneficial to them.<sup>111</sup>

All in all, through the use of rhetorical word choices and framing, SEconomy platforms have made people into believing that it is made up of platforms encouraging microentrepreneurs to utilize their excess capacity in an altruistic manner. The rhetoric somehow lead people into thinking that those platforms are unique and should not be regulated by the existing law. However, it impairs people's ability to truly understand the nature of this economy.

Cloaked in the positive rhetoric of SE, Platforms have demonstrated the utility of asking for 'forgiveness' rather than 'permission'. Lack of regulation itself would not be a problem if the market functions efficiently with no externalities. However, problems start to proliferate. Part 3 will discuss in greater details the market failures created as a result of the SE.

<sup>101</sup> *Ibid.*

<sup>102</sup> David D. Friedman, *Future Imperfect: Technology and Freedom in an Uncertain World* (2nd ed, Cambridge University Press 2008) 100

<sup>103</sup> Clampet, "Airbnb CEO responds to Illegal Rentals Story", <https://skift.com/2013/01/11/airbnb-responds-to-illegal-rentals-story-first-of-all-its-not-illegal-everywhere/>, (7 Nov 2017).

<sup>104</sup> C. Nosoko, S. Tadelis, "The Limits of Reputation in Platform Markets: An Empirical Analysis and Field Experiment", Working Paper 20830, National Bureau of Economic Research, 23.

<sup>105</sup> A. Stemler, "Feedback Loop Failure: Implications for Self-Regulation of the Sharing Economy", *Minnesota Journal of Law, Science & Technology*, 18/2017.

<sup>106</sup> G. Zervas, D. Proserpio, J.W. Byers, 'A First Look at Online Reputation on Airbnb, Where Every Stay is Above Average (Extended Abstract)', *Boston University School of Management Research Paper Series*, No. 2013-16.

<sup>107</sup> N. Hourdajian, "Feedback Is A Two-Way Street", <https://newsroom.uber.com/2014/04/feedback-is-a-2-way-street/>, (7 Nov 2017).

<sup>108</sup> GrowthHackers, "Uber—What's Fueling Uber's Growth Engine?", <https://growthhackers.com/companies/uber/>, (7 Nov 2017).

<sup>109</sup> FTC, Sharing Economy Workshop Transcript, [https://www.ftc.gov/system/files/documents/public\\_events/636241/sharing\\_economy\\_workshop\\_transcript.pdf](https://www.ftc.gov/system/files/documents/public_events/636241/sharing_economy_workshop_transcript.pdf), last accessed 7 Nov 2017; see also T. Lien, Los Angeles Times, "Lyft CEO Logan Green has a plan that's far bigger than ride-hailing", <http://www.latimes.com/business/technology/la-fi-tn-logan-green-lyft-20160621-snap-htmlstory.html>, (7 Nov 2017).

<sup>110</sup> GrowthHackers.

<sup>111</sup> D. Fagundes, 660.



#### 4. Market Failures

After the honeymoon phase of the SE, many problems have started to proliferate. First, existing industries who are bound by regulations find it extremely difficult to compete with those who are not. And indeed, Uber and Airbnb have prompted outcries by taxis and hotels in every city where their footprints had been left. Second, the regulations surrounding legacy services often exist for a reason that is to protect visitors and city residents. Numerous concerns have arisen, including insufficient pay and benefits of the Uber drivers,<sup>112</sup> sexual harassment,<sup>113</sup> ruthless employees' behaviour, discrimination issues<sup>114</sup>, data protection<sup>115</sup> and passenger safety.<sup>116</sup> These harms manifest themselves as market failures, which are left largely unaddressed under the current regulatory regime.

In this section, three problems will be highlighted. Uber is chosen as the case study because it is generally considered as a SE giant and the company's collection and processing of massive amounts of data is a practice common to most other SE platforms.<sup>117</sup>

This part of the essay will be structured as follows. In the first part of this section, the famous lemon problem will be revisited with the aim to establish that the better-informed party in a transaction can exploit its advantage of information at the costs of the other party in a transaction. The second part involves a case study of how in practice Uber manipulates the digital experience at the costs of other users of the platform. The third part is a critique towards Uber's lack of protection towards user data.

##### 4.1. Problems involving the design of the digital experience

These ride-sharing companies, as all-knowing intermediaries, possess an advantage of information over the two polar ends of platform users. This widens the gap of information empowers the firms to leverage their access to information as well as their control over the user-experience to disadvantage other platform users.

Traditionally, many economists have acknowledged that the difficulty of distinguishing good quality from bad is inherent in all types of transactions.<sup>118</sup> The concern was articulated most famously by the Nobel Prize winner George A. Akerlof in his book: *The Market for "Lemons": Quality Uncertainty and Market Mechanism*.<sup>119</sup>

Using the sales of used-cars as an example, Akerlof argues that information asymmetries create a tendency for the better-informed party to exploit these asymmetries in an undesirable way, which Akerlof named as "moral hazard".<sup>120</sup> As George Akerlof observed, there is an increased likelihood that the sellers will take advantage of the information advantage to pass lemons off as plums, and hence driving the plum sellers, i.e. the honest seller, out of the used car market.<sup>121</sup>

Yet, in modern times, transportation network companies do not only benefit from the advantage of information to the disadvantage of other platform users, they even have the ability to design the whole user-experience from scratch. Due to the lack of access that goes beyond the digital server of the app, it is difficult to evidence Uber's manipulation of the digital experience. However, as Rosenblat observed, some of the acts or practices are observable enough to raise serious questions.<sup>122</sup> The remaining of this section will focus on two types of problematic conducts of Uber, including firstly, problems involving designs of the digital experience and secondly, the handling of user's data.

112 The Ride Shared Guy, "RSG 2017 Survey Results: Driver Earnings, Satisfaction and Demographics", <http://therideshareguy.com/rsg-2017-survey-results-driver-earnings-satisfaction-and-demographics>, (25 July 2017).

113 A. Lafrance, "A Doozy of a Lawsuit Over Self-Driving Cars, <https://www.theatlantic.com/technology/archive/2017/02/waymo-vs-otto-aka-google-vs-uber/517683/>, (25 July 2017).

114 M. Isaac, New York Times, "How Uber Deceives the Authorities Worldwide", <https://www.nytimes.com/2017/03/03/technology/uber-greyball-program-evade-authorities.html>, (25 July 2017).

115 M.W. Daus, *Transportation Network Companies: Passenger Data Security and Privacy Issues*, *Emerging Areas of Practice*, 300:100, 5.

116 A. Bolton, "Regulating Ride-Share Apps: A Study on Tailored Regulation Regarding Transportation Network Companies, Benefitting Both Consumers and Drivers", *Cumberland Law Review*, 46(1), 12.

117 Fortune, "5 Things To Know About How The Feds See The 'Sharing Economy'", <http://fortune.com/2016/06/03/commerce-sharing-economy/>, (14 November 2017).

118 A. Thierer, C. Koopman, A. Hobson, and C. Kuiper, 'How the Internet, the Sharing Economy, and Reputational Feedback Mechanisms Solve the "Lemons Problem"', *University of Miami Law Review*, 70/2016.

119 G.A. Akerlof, 'The Market for "Lemons": Quality Uncertainty and the Market Mechanism', *The Quarterly Journal of Economics*, 84/1970, 488–500.

120 *Ibid* at 495.

121 *Ibid*.

122 R. Calo, *The Taking Economy: Uber, Information, and Power*, *Columbia Law Review* 117/2017.

## 4.2. Digital manipulation

A recent fieldwork conducted by Rosenblat with Uber drivers and passengers have surfaced many issues.

### 4.2.1. TAKING FROM THE PASSENGERS

In a research conducted by Rosenblat and Luke Stark, three issues affecting passengers were identified.<sup>123</sup> In order to get access to the ride-hailing services provided by Uber, users have to download and use an application that was designed by Uber.<sup>124</sup> The first problem identified is that the representation of nearby Uber cars on the software applications could be illusory.<sup>125</sup> Every time passenger tries to request an Uber, a map of the user's present location will be shown on the map, together with the icons of the nearest Uber driver available.<sup>126</sup> Those icons that are shown on the map without the actual presence of Uber are called "phantom cars". Woodrow Hartz criticised Uber for engaging in 'abusive design'.<sup>127</sup> These visual designs suggest that cars are nearby (but are actually not) may entice the user into hailing uber.

The second problem concerns Uber's relentless study into consumer behaviour and their willingness to pay surge price.<sup>128</sup> For example, Uber researchers found that users are more willing to pay for surge price when the batteries of their phones are running low. In response, Uber claims that they do not consider this information in the fare calculation process.<sup>129</sup> Even if we take Uber at their words, concerns are raised as to what information Uber has access to, and which criteria the firm may find suitable for pricing.

Thirdly, a research conducted by computer scientists Le Chen, Alan Mislove and Christo Wilson suggested that Uber may be charging similarly

situated customers different prices.<sup>130</sup> This practice is known as 'price discrimination'. In the study, the scientists measured Uber's return of API for the surge in several areas to several users, and examine the prices against those the users actually received.<sup>131</sup> In the end, discrepancies were found, meaning that users in the same area requesting an uber at the same time to the same place were quoted with different prices.<sup>132</sup> While Uber claimed that it was a bug, the only thing clear is that this technical caveat may only suffice to explain some of the inconsistencies in Uber pricing.<sup>133</sup>

### 4.2.2. TAKING FROM THE DRIVERS

It is rare if not impossible for SE firms to regard themselves a traditional employer.<sup>134</sup> In the case of Uber, the case is no different. This is because by contractually characterising the Uber drivers as independent contractors, the company can limit their obligations at tort and labour law.<sup>135</sup> But in general, Uber characterise all participants, including the drivers and the passengers, as 'consumers'.<sup>136</sup> For example, in the United Kingdom, the drivers are labelled as 'consumers' in its terms of service when they download the app.<sup>137</sup> In the United States, in a class action concerning the employment classification of Uber drivers, Uber also took the stance that all participants are 'consumers', as they pay a 'licensing fee' to Uber in return of the access to Uber's software.<sup>138</sup>

Another problem is that Drivers transact with Uber and other users of the platforms in accordance with contractual terms written by Uber.<sup>139</sup> While one-sided contracts are no

130 L. Chen, A. Mislove, C. Wilson, "Peeking Beneath the Hood of Uber", Proceedings of the 2015 Internet Measurement Conference, 495–508.

131 *Ibid.*

132 *Ibid.*

133 K. Boehret, The Verge, "Uber Needs to Stop Nudging Me into Carpooling", <http://www.theverge.com/2016/5/28/11799584/uber-uberpool-carpool-uberx-app>, (13 Nov 2017).

134 A. Rosenblat.

135 M.A. Cherry, Beyond Misclassification: The Digital Transformation of Work, *Comparative Labor Law & Policy Journal*, Forthcoming.

136 A. Rosenblat, 3761–3762.

137 Uber B.V., Services Agreement, [https://s3.amazonaws.com/uber-regulatory-documents/country/united\\_kingdom/Uber+BV+Driver+Terms++UK+Preview.pdf](https://s3.amazonaws.com/uber-regulatory-documents/country/united_kingdom/Uber+BV+Driver+Terms++UK+Preview.pdf), (13 Nov 2017).

138 *Ibid.*

139 R. Calo, The Taking Economy: Uber, Information, and Power, *Columbia Law Review* 117/2017.

123 A. Rosenblat, L. Stark, Algorithmic Labor and Information Asymmetries: A Case Study of Uber's Drivers, *International Journal of Communication*, 10/2015.

124 *Ibid.*

125 *Ibid.*

126 *Ibid.*

127 W. Hartzog, Privacy Blueprint, forthcoming *Harvard University Press*, 2017. (developing a concept of "abusive design").

128 B. Carson, Business Insider, You're more likely to order a pricey Uber ride if your phone is about to die, <http://nordic.businessinsider.com/people-with-low-phone-batteries-more-likely-to-accept-uber-surge-pricing-2016-5/>, (14 Nov 2017).

129 T. Hwang, M.C. Elish, Slate, The mirage of the marketplace, [http://www.slate.com/articles/technology/future\\_tense/2015/07/uber\\_s\\_algorithm\\_and\\_the\\_mirage\\_of\\_the\\_marketplace.html](http://www.slate.com/articles/technology/future_tense/2015/07/uber_s_algorithm_and_the_mirage_of_the_marketplace.html), (14 Nov 2017).

stranger to the modern commercial world, Uber's contracts involve many short-term promotions and ever-changing contractual terms.<sup>140</sup> Every time Uber driver login the software, he or she may have to agree to terms of service in order to work. As Ryan Calo observed, this is analogous to 'signing a new employee manual every few days'.<sup>141</sup> Oren Bar-Gill also argued that the increasingly dense and complex contracts may represent an attempt to exploit human limitations in processing complexity.<sup>142</sup> David Horton added that "shadow terms" could be added without consumers being aware while unilateral changes to the contract are made.<sup>143</sup> Worse still, Uber can insert aggressive terms for specific terms and then erase it, which Ryan Calo finds a sort of 'fleeting unconscionability'.<sup>144</sup> Drivers are thus being placed in a disadvantaged position. In reality, drivers often do not have a whole set of terms they have agreed to, and they do not even have a complete record of their transactions.<sup>145</sup> This impairs the driver's ability to protect themselves, legally speaking.

Another problem observed by Rosenblatt is that Uber drivers occasionally receive "phantom requests" or "fleeting ride requests".<sup>146</sup> These requests refer to notifications that flash across the driver's screen for a split second, rather than the standard 15 seconds.<sup>147</sup> As a result, the requests disappear too quickly that the drivers could not assess the merits of the requests or even blindly accept it.<sup>148</sup> This may affect the driver's ride-acceptance rate negatively, which could lead to the driver being 'deactivated' from the system.<sup>149</sup>

All of these issues abovementioned suggested that lacking a mutually-accountable system could be problematic.<sup>150</sup> Due to the fact that all users of the platforms rely on Uber to fulfil the expectations it scaffolds onto users about how the system works, any issues in the platforms tend to be impactful on the users and their welfares are likely to be harmed.

At this stage, it is unclear whether these "phantom cars" and the "shadow terms" and many other issues are part of Uber's underhand business practices, or whether they are merely technical issues prompting improvements in Uber's algorithm, or whether they are caused by 'network glitches' that are beyond Uber's control, the inescapable consequence is that the welfares of the users, both the drivers and the passengers are being harmed. The takeaway points are that firstly, regulators need to develop a better understanding of the architecture behind these SE firms and to uncover the entire range of offending conducts. Secondly, regulators have to find a means to address those practices. This will be discussed in greater detail in part 4.

### 4.3. Privacy

Privacy is defined as a fundamental human right for humans. Its meaning has evolved with the society.<sup>151</sup> As the digital economy develops, this "right to be left alone" is developed into a trade-off, in which risks relevant to personal privacy are weighted against the benefits of participating in those transactions.<sup>152</sup> In addition, SE involves monetary exchange, different expectations can alter the privacy calculus of the users involved.<sup>153</sup>

Conceptually, the mere existence of SE raises privacy concern as it involves simultaneous sharing of consumer-data as well as consumer-owned places, goods and services.<sup>154</sup> Ride-hailing companies like Uber collect, retain and process a massive amount of users data,<sup>155</sup> including passenger's name, contact information, payment information, device location, trip history, contact information and browser types and IP addresses.<sup>156</sup> These companies dictate the privacy policies which passenger must consent to in order to access to their services, and as a result control and possess a large volume of passenger

140 *Ibid.*

141 *Ibid.*

142 O.B. GILL, *Seduction By Contract: Law, Economics, And Psychology In Consumer Markets*, Oxford University Press, 2012.

143 D. Horton, *The Shadow Terms: Contract Procedure and Unilateral Amendments*, *UCLA Law Review*, 57/2010.

144 R. Calo,

145 *Ibid.*

146 A. Rosenblatt,

147 *Ibid.*

148 *Ibid.*

149 *Ibid.*, 3771, 3772.

150 R. Calo, 37.

151 D.J. Solove, *Understanding Privacy*, Harvard University Press, Boston, 2008.

152 S. Egelman, *Proceedings of the SIGCHI Conference on Human Factors in Computing Systems*, ACM 2013, 2369–2378.

153 *Ibid.*

154 G. Ranzini, M. Etter, C. Lutz, I. Vermeulen, *Privacy In the Sharing Economy*, Report from the EU H2020 Research Project Ps2Share: Participation, Privacy and Power in the Sharing Economy.

155 Hogan Lovells, "Review and Assessment of Uber's Privacy Program (January 2015)", <https://n/newsroom.uber.com/wp-content/uploads/2015/01/Full-Report>, 3. (13 Nov 2017).

156 M.W. Daus, 5.



data.<sup>157</sup> As reports reveal, these data has turned into a significant source of revenue or valuation to many companies.<sup>158</sup> Currently, it has been observed that ride-hailing companies like Uber have firstly, failed to protect user data; secondly, user customer data and thirdly, improperly disclosed user's data to the third party.

#### 4.3.1. FAILURE TO PROTECT USER DATA

In 2014, Uber fell victim of a major data breach in which Uber driver's names, license number, social security numbers, bank accounts and routing numbers were exposed.<sup>159</sup> Although Uber discovered the breach in September 2014, it didn't inform the affected drivers and Schneiderman's office until February 26, 2015.<sup>160</sup> Following the discovery, Uber filed a lawsuit in an attempt to identify the perpetrator of the breach.<sup>161</sup> Subsequently, media revealed that thousands of Uber user logins were available for sale at the price of \$1 and that some users were charged for rides that they did not take.<sup>162</sup> In February 2017, there is another major data breach impacting 3,400 websites and apps, including Uber.<sup>163</sup>

#### 4.3.2. MISUSE OF USER DATA

Recent reports suggested that Uber is involved in the improper usage of user's data. According to the company's former forensic investigator Samuel Ward Spangenberg, Uber employees regularly abused the company's "god view" to spy on the movement of "high-profile politicians, celebrities and even personal acquaintances of Uber employees, including ex-boyfriends/

girlfriends, and ex-spouses".<sup>164</sup> Subsequently, there has been a series of reports accusing Uber's employees of the misuse of the tool. For example, an Uber official revealed how he would analyse ridership data in order to predict customers' overnight sexual liaisons (which he referred to as "Rides of Glory").<sup>165</sup> In November 2014, a senior employee of Uber claimed that the company could "dig up dirt" of unfavourable reporters.<sup>166</sup> Similarly, another reporter alleged that the executives of the company were spying on her through her app usage. In response, Uber has replied that it had 'a strict policy prohibiting all employees at every level from accessing a rider's or driver's data,' with the exception of a 'limited set of legitimate business purposes'.<sup>167</sup> However, 'legitimate business purpose' is left largely undefined and the series of incidents have left doubts as to who is permitted to have access to users' geolocation data.

Another alarming issue concerns Uber's use of Violation of Terms of Service (VTOS) program to identify and circumvent legal authorities.<sup>168</sup> This program involves a tool called 'greyball,' that combines data from the Uber app and other social media sites in order to tag targeted users with identifiable codes.<sup>169</sup>

#### 4.3.3. DISCLOSURE OF USER'S DATA TO THIRD PARTY

Ride-hailing companies' disclosure of user's data to the third party is another practice that may harm user privacy. Uber, for example, shares user data with some broadly-defined entities, including vendors, consultants, marketing partners, and other service providers who need

157 J. Cox, "Uber Users Say They're", <http://motherboard.vice.com/read/stolen-uber-customer-accounts-are-for-sale-on-the-dark-web-for-1>, (13 Nov 2017).

158 P. Bajpai, Investopedia, How Uber is Selling All Your Ride Data, <http://www.investopedia.com/articles/investing/030916/how-uber-uses-its-/>, (7 Nov 2017).

159 T. Lien, Los Angeles Times, "Uber Security Breach May Have Affected Up to 50,000 Drivers", <https://www.reuters.com/article/us-uber-cybersecurity/uber-security-breach-may-have-affected-up-to-50000-drivers-la-times-idUSKBN0LV2LI20150227>, (7 Nov 2017).

160 Naked Security, Uber in the Privacy Spotlight Again, <https://nakedsecurity.sophos.com/2017/06/16/uber-in-the-privacy-spotlight-again/>, (13 Nov 2017).

161 National Federation of the Blind of California v. Uber Technologies, Inc., et al [2015] 103 F. Supp. 3d 1073, 1076 (In the United States District Court For The Northern District Of California San Francisco Division).

162 J. Cox, Uber Users Say They're, <http://motherboard.vice.com/read/stolen-uber-customer-accounts-are-for-sale-on-the-dark-web-for-1>, (13 Nov 2017).

163 CBS Boston, Major Data Breach Exposed Uber, Fitbit and OkCupid Info, <http://boston.cbslocal.com/2017/02/24/cloudflare-bug-uber-fitbit-okcupid-passwords-breach/>, (13 Nov 2017)..

164 Alex Hem, The Guardian, Uber's Employees Spied On Ex-Partners, Politicians and Beyonce, <https://www.theguardian.com/technology/2016/dec/13/uber-employees-spying-ex-partners-politicians-beyonce>, (13 Nov 2017).

165 C. Timberg et al., The Washington Post, Uber executive stirs up privacy controversy, [https://www.washingtonpost.com/business/technology/uber-executive-stirs-up-privacy-controversy/2014/11/18/d0607836-6f61-11e4-ad12-3734c461eab6\\_story.html?utm\\_term=.b239144d86de](https://www.washingtonpost.com/business/technology/uber-executive-stirs-up-privacy-controversy/2014/11/18/d0607836-6f61-11e4-ad12-3734c461eab6_story.html?utm_term=.b239144d86de), (7 Nov 2017)..

166 B. Smith, Buzzfeed, Uber Executive Suggests Digging Up Dirt On Journalists, [https://www.buzzfeed.com/bensmith/uber-executive-suggests-digging-up-dirt-on-journalists?utm\\_term=.tf3eA9nYa#.cuBZoLOlx](https://www.buzzfeed.com/bensmith/uber-executive-suggests-digging-up-dirt-on-journalists?utm_term=.tf3eA9nYa#.cuBZoLOlx), (13 Nov 2017)..

167 Uber Newsroom, Uber's Data Privacy Policy, <https://newsroom.uber.com/ubers-data-privacy-policy/>, (13 Nov 2017).

168 M. Issac, How Uber Deceives The Authorities World Wide, <https://www.nytimes.com/2017/03/03/technology/uber-greyball-program-evade-authorities.html>, (14 Nov 2017)..

169 Ibid.

access to such information to carry out work on [Uber's] behalf.<sup>170</sup> In addition, Uber has allegedly received 33 regulatory requests involving data from more than 12 million users.<sup>171</sup> Inherent in such disclosure is the tension between the need for government agencies and regulators to access such data for compliance and other purposes, as well as the imperative to protect users' privacy.<sup>172</sup>

Confronting the issue, the interests of different stakeholders ought to be considered. For example, granting academic researchers access to ground transportation data for study and analysis should be allowed to spur innovation and create new technological services and products. It might be hard to determine how much data should be given for this type of study.<sup>173</sup> An example of this type of study is Boston's analysis of the city's traffic pattern based on general anonymised trip data given by Uber.<sup>174</sup> Yet, the city reflected the data given were too broad for any meaningful analysis.<sup>175</sup>

## 5. Regulation

Under the traditional public interest theory of regulation, regulation is sought to protect consumers from externalities, inadequate competition, price gouging, asymmetric information, unequal bargaining power, and a host of other perceived "market failures."

### 5.1. Perceived difficulty

With rhetorical frames and words, any attempt to regulate SE would prove itself as a difficult task. Especially after the start-up stage, dominant SE firms communicate their rhetoric in a more powerful way and they have more venture capital to buy advertising and lobbyists.<sup>176</sup> For example, in 2014, Uber already had a third more lobbyist than Walmart.<sup>177</sup> More importantly, SE firms

can outsmart the government by mobilising its large user base.<sup>178</sup> So long as the political action is mutually beneficial, users of these SE firms would willingly take part in political actions. For example, when two bills were passed to restrict ride-hailing apps, Lyft manipulated its interface to help people to contact certain selected officials.<sup>179</sup> Eventually, from emails alone, Lyft managed to mobilise 28% of its users to oppose to the regulations.<sup>180</sup>

Abbey Stemler called the techniques of using a large group to influence lawmakers as a form of "platform advocacy".<sup>181</sup> However, in deciding its word choices and framing, platforms are often motivated by its self-interests to present one-sided narratives to influence regulators. Platforms users often get behind those messages, even though they are the one being harmed.

## 5.2. Suggestions

In modern times, there is a growing knowledge gap between the entrepreneur and the regulators. In the context of the SE, acts of the companies are often hidden behind the digital scenes which are made up of Internet-based technology, complex algorithm and big data that many regulators find it formidable to understand.<sup>182</sup> To have any meaningful regulation, the first step would be for regulators to acknowledge their lack of expertise and bring industry stakeholders to the table to better understand the nature of these new businesses.

Regulators have two means to explore what SE firms are doing behind the digital scene. The first means is a direct investigation. The law enforcing agent should be empowered by statute to actively investigate into suspected firms. They should be empowered to summon witness and to compel production of documentary evidence in

170 Uber, "User Privacy Statement", [www.uber.com/legal/privacy/users/en/](http://www.uber.com/legal/privacy/users/en/), (13 Nov 2017).

171 Uber Newsroom, "Unveiling Uber's Transparency Report", <https://newsroom.uber.com/transparency-report-2015/> (13 Nov 2017).

172 M.W. Daus, 5.

173 M.W. Daus, 6.

174 Dam Vaccaro, Uber to Hand Over Trip Data to Boston, <https://www.boston.com/news/technology/2015/01/13/uber-to-hand-over-trip-data-to-boston/>, (13 Nov 2017)..

175 *Ibid.*

176 A. Stemler, 8.

177 K. Weise, "This is How Uber Takes Over a City", <http://www.bloomberg.com/news/features/2015-06-23/this-is-how-uber-takes-over-a-city/>, (7 Nov 2017); see also D. Hedgpeth, "Need a Snuggle? Uber Delivers Kittens on

Demand", <http://www.washingtonpost.com/blogs/local/wp/2014/10/29/need-a-snuggle-uberdelivers-kittens-on-demand/>, (7 Nov 2017).

178 A. Stemler, 8, 31.

179 Carolyn Said, "Uber, Lyft, Airbnb Harness Users to lobby Lawmakers for Them", <http://www.sfgate.com/business/article/Uber-Lyft-Airbnb-harness-users-to-lobby-6005562.php>, (7 Nov 2017).

180 *Ibid.*

181 A. Stemler, Platform Advocacy and the Threat to Democracy (forthcoming); see also C. Said, "Airbnb, Uber Cast Themselves as Saviors of the Middle Class", <http://www.sfchronicle.com/business/article/Airbnb-Uber-We-are-the-saviors-of-the-middle-6620729.php>, (13 Nov 2017)..

182 A. Stemler, Regulation 2.0: The Marriage of New Governance and Lex Informatica, *Vanderbilt Journal of Entertainment & Technology Law* 19/2017.

the course of the investigation.<sup>183</sup>In some limited circumstances, they should be empowered to conduct a mandatory visit to necessary investigative purpose.

The second way would be to incentivize third-party researchers to investigate firms<sup>184</sup>An ancillary challenge would be to remove the barriers researcher may encounter when they are investigating the SE firm in question. In the course of the investigation, the researcher may have to reverse the engineering of the platforms, scrap data and conduct other activities with the aim of uncovering firm practices, they may face legal pushback in doing so. Violations of the platform's terms of service, trade secret and copyright are some of the legal barriers to third-party researchers. Therefore, regulators have to set out clear-cut exceptions to these rules in order to empower the researcher to surface harm in a legal manner.

### 5.3. Specific suggestions

#### 5.3.1. MONITORING PLATFORM ACTIVITY

Provided that many decision-making processes of the platforms are done digitally and are invisible to the consumer, they do not amount to fraud or deception per se. However, many of them involve the use of information about consumers that may put consumers in a disadvantaged position. In monitoring these platform activity, the approach of line-drawing can be used to differentiate between legally tolerable and intolerable activities. An agency would have to determine whether the individual practice is unfair to an extent that leads to substantial and unavoidable consumer harm. The vulnerability is a factor to consider in this exercise. For example, we might ask the question of whether a practice of charging people more for ride-hailing service when their battery is low constitute price gouging.

#### 5.3.2. PRIVACY AND DATA PROTECTION

Firstly, SE firms should collect and process personal data only when it is necessary for the fulfilment of a legitimate business purpose. The data should only be used in circumstances as defined unless the consumer expressly consents otherwise.

Secondly, proper safeguards should be implemented and tested periodically to protect the data against unauthorized access.

Thirdly, sensitive data have to be carefully handled by authorized individuals for a defined set of purposes. Companies should provide employees training together with disciplinary actions to make sure that the mechanism is enforceable.

Fourthly, where user's personal data is to be shared with a third party, the company should obtain permission from the users in advance and make sure that the privacy policy of the third party is consistent with the companies' own policy.

## 6. Conclusion

For every technology start-up company, it is almost inevitable that some regulations are going to be violated. To many SE firms, it is often effective to ask for forgiveness rather than permission from the law enforcement agency. They are empowered to do so by their careful word choices and framing that put them in a favourable light and distinguish themselves from other traditional firms. However, this approach often leaves individuals and regulators vulnerable to manipulation. Some observable market failures have proven that regulations are necessary for protecting consumer welfares and their privacy. Regulations should be put in place to an extent that consumers are protected while innovation is not impeded. To achieve this goal, the first step of the regulators is to gain a better understanding of the architecture and technology of the SE. Only since then can they carve out measures to achieve the desired end of regulation.

<sup>183</sup> R. Calo, 51.

<sup>184</sup> *Ibid* at 52.

## RISKS AND REGULATORY FRAMEWORK OF P2P LENDING IN HONG KONG

**Yu Jo Ching Teresa**

*P2P lending is burgeoning in Hong Kong. However, the lack of specific legislation has hindered the development of P2P lending, rendering it the hotbed of risks and loopholes. This paper examines the models and features of P2P lending comparing to the traditional banks, together with the inherent risks of P2P lending and the current regulation in US, UK and China, followed by an analysis of the legal framework in Hong Kong.*

**Keywords:** P2P Lending – Crowdfunding – Regulation – Risks – Hong Kong

### Introduction

P2P lending is a form of crowdfunding, which is an innovation method of raising capital emerged in recent years<sup>1</sup>, burgeoning in the generation of sharing economy. It aims to absorb idle money from individuals and then provide funds to borrowers. Due to the technological advancement and the aftermath of financial crisis<sup>2</sup>, P2P lending begins to be a novel and popular option among people, which has been eliminating the reliance on traditional middlemen.<sup>3</sup> Not only is the rapid growth of the sector has made the alternative investors to embrace the platform<sup>4</sup>, it is also an ideal option for small and medium enterprises (SMEs).<sup>5</sup>

Being the international financial center, the legislation in Hong Kong should be resonate with the trend and the need of the public. This paper argues that there is a need of specific legislation

for P2P lending. A proposal will be introduced based on the review of legislations in other jurisdictions followed by analysis. Hence, in this paper, Part II introduces the definition, different models, features and risks of P2P lending. Then, Part III looks at the regulations of other countries, such as US, UK, and China. Lastly, Part IV addresses the way forward in Hong Kong regarding to P2P lending by giving recommendations.

### 1. Overview of P2P lending

#### 1.1. Background

P2P lending can be defined as 'an internet-based platforms allowing individuals to lend money to other individuals'.<sup>6</sup> People can lend a small amount of money by crowdsourcing from a large group of people.<sup>7</sup> Peer-to-Peer (P2P) is a term describing interaction between two parties 'without the need for a central immediacy'.<sup>8</sup>

Tracing back to the history of P2P lending, it begins with the establishment of the first P2P lending platform Zopa in UK in 2005. Since then there were various forms of lending platforms developed in different countries, including U.S, Canada, Japan, Italy and China.<sup>9</sup> The first U.S based platform Prosper was launched in 2006, followed by the development of Lending Club, which later become the biggest platform in U.S. In China, there is considerable growth in spite of a late development. Among the most successful online platforms in China are Ppai.com, My089.net, Qifang.com and CreditEasy.com.<sup>10</sup> Besides, in Hong Kong, Welend is the first P2P lending platform, followed by the operation of Golend and Bestlend.<sup>11</sup>

1 S. Karina, "Fret No More: Inapplicability of Crowdfunding Concerns in the Internet Age and the Jobs Acts Safeguards" *Administrative Law Review* 2012 474–505.

2 C. Jeffrey, 'P2P Lending: Finally, IT's a Wonderful Life' *Fox Business* 12/2013, <http://www.foxbusiness.com/markets/2013/12/20/p2p-lending-finally-its-wonderful-life.html>, last visited 20 July 2017.

3 Cut out the middlemen, <https://www.forbes.com/1998/08/21/feat.html>, last visited 20 July 2017.

4 NYHFR Survey: P2P Lending Increasingly Popular Among Alternative Asset Managers <http://www.finalalternatives.com/node/32644>, last visited 20 July 2017.

5 Five reasons why P2P lending is ideal for small businesses, <http://economictimes.indiatimes.com/small-biz/money/five-reasons-why-p2p-lending-is-ideal-for-small-businesses/articleshow/49284976.cms>, last visited on 20 July 2017.

6 GAO, "Person-to-Person Lending: New Regulatory Challenge Could Emerge as the Industry Grows", 2011, 1.

7 F. CodyR, "Crowdfunding & Investor Education Empowering Investors to Mitigate Risk & Prevent Fraud", *Suffolk University Law Review* 2015, 135.

8 M. Alistair and P. Paul, "The Business Models and Economics of Peer-to-Peer Lending", *NEMODE* 2016, 5.

9 F. Arne & S. Matthias, "Peer-to-Peer Banking– State of Act", *Arbeitsbericht* 2008, 13.

10 C. Dongyu & H. Chaodong, "A Comparative Study of online P2P Lending in USA and China", *Journal of Internet Banking and Commerce* 2012, 3.

11 Fintechnews Singapore, Peer-to-Peer Lending in China, Hong Kong and Southeast Asia, <http://fintechnews>.



In the recent years, Zopa reports that it currently has 60,000 investors and 277,000 borrowers, having a cumulative loan volume of £2.46 billion.<sup>12</sup> While Prosper claims that it has funded £9 billion loan.<sup>13</sup> Explosive growth is observed in China, where Ppai.com has had nearly 80,000 registered users within one and half years, whereas My089.com has a registered capital of 50 million RMB.<sup>14</sup> In Hong Kong, although P2P is not as popular as the other countries do, Welend still generates a cumulative amount of HK \$4.5 billion.<sup>15</sup> These statistics can reveal the worldwide

*sg/9584/crowdfunding/peer-peer-lending-china-hong-kong-southeast-asia/*, last visited 20 July 2017.

12 Zopa, *http://www.zopa.com/about*, last visited 20 July 2017.

13 Propser, *https://www.prosper.com/plp/about/*, last visited 20 July 2017.

14 C. Dongyu & H. Chaodong, 3.

15 Welend, *https://www.welend.hk/en/about-us*, last visited 20 July, 2017.

success and the popularity of P2P lending, while Hong Kong is still on the infant stage.

## 1.2. Models of P2P lending

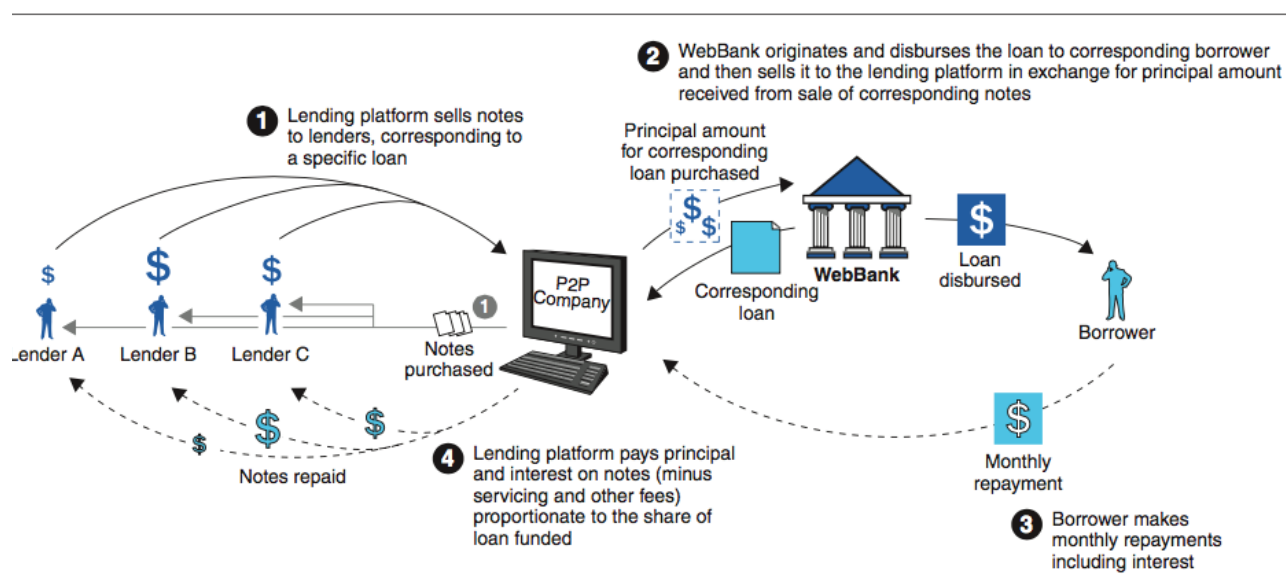
P2P lending platform can be classified as for-profit platform and nonprofit platform.

There are various forms of business model, in which notary model and client segregated account model are the most popular globally, whereas the guaranteed return model is more prevalent in China. Among all this models, they all possess the feature of “fractional loan”, meaning that the invested capital can be diversified over a lot of loans and the investor is only a part of them.<sup>16</sup>

16 W. Jonathan, “The Legal Basis of How Prosper and P2P Lending Work”, *http://p2plendingexpert.com/legal-corner-the-legal-basis-of-how-prosper-and-p2p-lending-works/*, last visited 20 July 2017.

## 1.3. Notary Model

Figure 1 For-profit P2P lending platform<sup>17</sup>



This model is adopted by Propser and Lending Club, which are for-profit platforms. The source of income is from the transaction fees, such as closing fee, service fee, fines on failed payment and late payment fee.<sup>18</sup> Fees are only charged when a loan is successfully funded and money is transferred from the lenders to the borrowers.<sup>19</sup> In general, this model is a “matching service where the loan is originated

by a partnering bank”<sup>20</sup> as shown in the Figure 1. The purpose of cooperating with the WebBank is allowing the platform to circumvent most state usury laws.<sup>21</sup>

17 GAO.

18 C. Dongyu & H. Chaodong, 5.

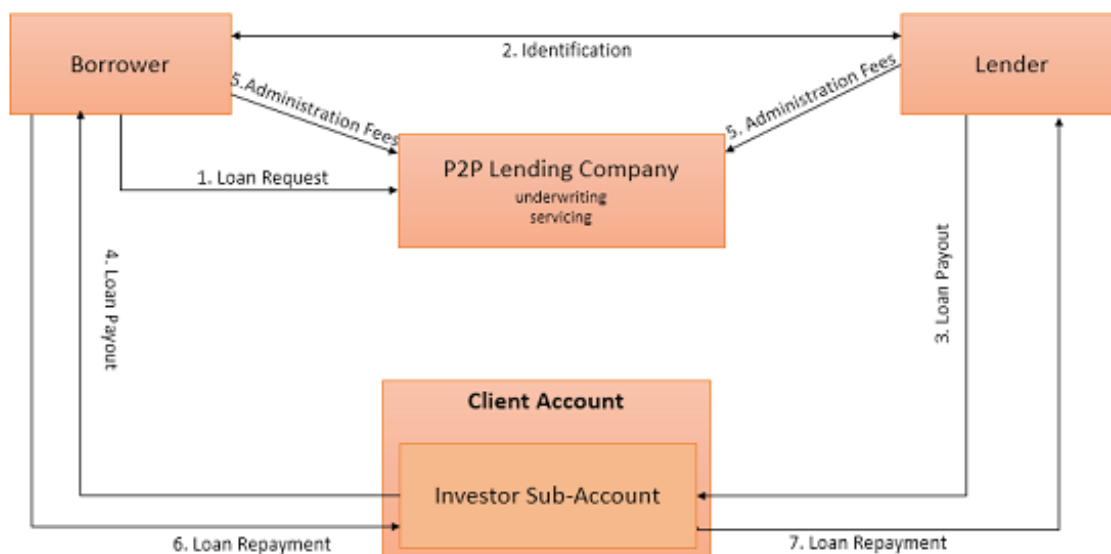
19 Ibid.

20 K.Carson, R.Taylor, G. Ward-Marshall, Report on rapid growth of P2P lending– what does it mean to New Zealand?, *https://www.dlapiper.com/en/newzealand/insights/publications/2017/06/report-on-rapid-growth-in-p2p-lending/*, last visited 20 July 2017.

21 F. Seth Freedman & Z.J Ginger, “Do Social Networks Solve Information Problems for Peer-to-Peer Lending? Evidence from Prosper.com”, *Working Paper 08-43 NET Institute* 2008, 6.



### 1.4. Client segregated account model

Figure 2<sup>22</sup>

This is the simplest and the most traditional model of P2P lending, where the lenders can directly make loan to the borrowers. Generally, it is a “lender-borrower matching service with the platform often providing a risk assessment.”<sup>23</sup> In this model, even if borrowers default, there is a lower or even no risks for the platform to face the claim of the lenders. The lender can take legal action against the borrower directly. Besides, if the platform collapses, the contractual relationship between the lenders and the borrowers are still valid.<sup>24</sup> This is a relatively direct and clear model.

### 1.5. Client segregated account model based on a trust fund

In this model lenders purchase units or shares in a trust structure and the platform is acting as the trustee who manages the fund.<sup>25</sup> The platform then issues loan to the borrowers depending on lenders’ choices. The platform is obliged to manage the loans and repayment.<sup>26</sup>

22 Peer-to-Peer Lending: Business Models, <http://taxguru.in/corporate-law/peer-peer-p2p-lending-business-models.html>, last visited 20 July 2017.

23 K.Carson, R.Taylor, G. Ward-Marshall, Report on rapid growth of P2P lending– what does it mean to New Zealand?, <https://www.dlapiper.com/en/newzealand/insights/publications/2017/06/report-on-rapid-growth-in-p2p-lending/>, last visited 20 July 2017.

24 Assetz Capital, ‘Peer-to-Peer Lending: Industry Overview & Understanding the Marketplace’, [2015] 15.

25 B.Samuel & H. Rafael, ‘An introduction to the P2P lending market’, *ECONS-528 Financial Markets* 2016, 2.

26 Ibid.

Here, platform’s failure will not affect the interest of the lenders same as the above model.

### 1.6. Guaranteed return model

The platform in this model guarantee lenders’ rate of return and compensation in case of default of borrowers. Hence, third-party guarantee agencies, insurance contract, provision funds are normally employed by the platforms.<sup>27</sup>

## 2. Features of P2P lending

P2P lending differs from traditional bank in terms of various aspects as listed in the following.

### 2.1. lower threshold

Some people choose to borrow in P2P lending platform rather than traditional channels because of the lower threshold. In accordance with a recent survey of 531 Funding Circle Business borrowers conducted by Centre for Economics and Business Research, 21% of borrowers believe they would not have been able to secure the external finance in the absence of Funding Circle.<sup>28</sup> It reflects that P2P lending is an alternative to those who are not able to obtain loan in traditional channels. It is because most banks may require certain assets for taking security before granting a loan. In contrast, some platforms do not require security or guarantee as

27 Ibid.

28 Cebr, “Small business, big impact– The changing of business finance”, *Center for Economics and Business Research* 2016, 6.

long as the borrower has fair credit record, which gives a lower threshold to loans.<sup>29</sup>

Moreover, borrowers can get a lower interest rate without collateral whereas investors can obtain a higher return on their investment.<sup>30</sup> For instance, Lending Club claimed that every single investor with 800 or more Notes has experienced positive returns, while 91.06% have return between 6% and 18% as of 15, September 2011.<sup>31</sup> While the low-income borrowers will often be at lower interest rates than are available through traditional channels as shown in the practice in Zopa.<sup>32</sup> Still it is questionable as to whether platforms can really offer better rates, they still lured investors who have been discouraged by the lower interest rates offered by banks and the stock market return.<sup>33</sup> Oxera pointed out that the reason why P2P lending is more socially desirable since it supposedly bypasses the “greedy” banking system.<sup>34</sup>

## 2.2. Transparency

Lenders have access to most of the information of the borrowers through the platform, including some basic information such as borrower's social security number, driving license and address, as well as other hard credit information like total number of delinquencies, current numbers of delinquencies and inquiries of the last six months.<sup>35</sup>

For example, in Prosper, lenders can review information in the listing, involving the purpose of the loan, method of repayment and some other images attached.<sup>36</sup> The progress of the repayment can also be checked by the lenders. The whole process enjoys “a greater level of transparency and a higher degree of direct involvement”.<sup>37</sup>

29 *ibid* 6.

30 R. M Jack, “Peer-to-Peer Lending in United States: Surviving after Dodd-Frank”, *N.C Banking Institute* 2011, 143.

31 How Lending Club Works: A More Efficient Model, <https://www.lendingclub.com/public/more-efficient-model.action>, last visited 21 July 2017.

32 S. Brad, “Peer-to-Peer Lending – An Industry Insight”, *bradslavin.com* 2007, 4.

33 Bloomberg: Peer-to-Peer Lending Lures Investors With 12% Return, <http://money-360.blogspot.hk/2009/07/bloomberg-peer-to-peer-lending-lures.html>, last visited 21 July 2017.

34 *Ibid*.

35 F. Seth Freedman & Z.J Ginger, 5.

36 *Ibid*.

37 K.H Michael K Hulme, Collette Wright, “Internet Based Social Lending: Past, Present and Future”, *Social Futures Observatory* 2006, 8.

## 2.3. Creditworthiness

One of the characteristics of crowdfunding is that the lending is mainly based on trust. Hence, normally there will be a scoring system provided by the platform to indicate the presumed risk and return levels for investors.<sup>38</sup> The platform collects data and predicts the risk of default by analyzing the information provided by the borrowers.<sup>39</sup> Most of the platforms claim that they can reveal more information than the banks do. However, this is disputable because there are no guaranteed models to access the risks. Whether the models adopted are sufficient for the lenders to analyze risks especially in such a self-regulated practice is also doubtful. Some borrowers may exploit the trust underlying in the P2P platform so that lender may suffer losses. If the creditworthiness of the borrowers cannot be accessed, the adverse impact of information asymmetry (as discussed below) will emerge.

To ensure the creditworthiness, various models are adopted. Zopa has its credit rating through one or more of the UK's credit bureaus.<sup>40</sup> The default rate in Zopa was only 0.05 in the first year and a half since it existed.<sup>41</sup> Lending Club has developed its own credit score models with a unique algorithm called Model Rank to analyze the performance of the borrowers by taking into account the credit attributes and other application data.<sup>42</sup> Prosper has created Prosper score, which combines all potential variables.<sup>43</sup>, including numbers of account in borrower's name and mortgage accounts.<sup>44</sup> In China, one of the lending platforms Yirendai also relies on big data technology to access borrowers' credit card, e-commerce transaction and mobile phone carriers.<sup>45</sup>

In addition, P2P lending platform can collect more soft credit information than the banks, including borrowers' friends on Facebook, the activities and posts that borrowers usually

38 B.Samuel & H. Rafael, 4.

39 *Ibid*.

40 S.Brad, 10.

41 *Ibid*.

42 Y. Jiaqi, Y. Wayne and Z. Leon, “How signaling and search costs affect information asymmetry in P2P lending: the economics of big data”, *Financial Innovation* 2015, 6.

43 Including the credit report, the authorization score, income, total revolving balance, delinquencies, other information like credit card utilization, past loan payment performance on prior loans and numbers of recently opened trades at the credit bureau, *ibid* 7.

44 B. Tetyana, “Financial Innovation and borrowers: evidence from Peer-to-peer lending” *Job Market Paper* 2016, 12.

45 *Ibid*.

browse. This is another types of information that the banks could hardly reached due to regulatory restrictions limiting discriminatory lending.<sup>46</sup> Public markets can be superior to financial intermediaries in providing funding because of the diversity of opinion which makes information inexpensive.<sup>47</sup> These opinions may be more reliable and accurate because of the wisdom of crowds. In other words, by obtaining more soft credit information, the lenders can access the background of borrowers easily, and create a general impression of the person.

#### 2.4. Risk allocation

"Fractional investment" is allowed in the platform, which helps minimizing risks. The lender can invest on different borrowers on small amount at the same time<sup>48</sup>, even if one of them default the payment, the lender is still able to receive the rest of the amount. Therefore, the risk of losing all the principal is lower.<sup>49</sup> Zopa is taking a protective approach which requires lenders to diversify their loan across at least 50 borrowers.<sup>50</sup>

On the other hand, there are abundant amount of credit profiles and loan terms that the lender can choose. The platform also provides identity verification in order to avoid fraud by using a fake account. For example, Proper employs data from credit reporting agencies and other anti-fraud verification databases so as to check with the name, date of birth, Security number, details of bank account, address and telephone number.<sup>51</sup> Some other platform gathers information by utilizing social network<sup>52</sup>, this also makes the investment less risky.

#### 2.5. Flexibility

P2P lending platform has less restrictions as to the security, amount of loan and any other requirements in general. Borrowers who are being rejected by the banks will be attracted to P2P lending platforms, since technology makes it possible to implement microfinance approached

that rely upon social collateral.<sup>53</sup> Besides, there is no strict requirement as to the amount of loans, a small amount of loan can also be easily funded in the platform. In Prosper, the minimum amount is \$50 on any loan listing.<sup>54</sup> Further, in terms of geographical investment, people can lend or borrow globally through international lending platform. Even when the lenders want to stop the investment, there are secondary markets where the lenders can sell out their remaining loans to another investor<sup>55</sup>, allowing the lenders to join and exit the investment whenever they want.

Additionally, P2P lending enjoys a high efficiency with lower costs. The procedures are less complicated and lengthy comparing to the traditional banks, resulting in a higher efficiency. Due to the increasing economies of scale that online platforms are enjoying, a lower financing costs have contributed to cost reductions for the micro-lending sites.<sup>56</sup> Lower costs also makes smaller loans possible.<sup>57</sup> The flexibility is comparatively attractive than the rigid rules in traditional intermediaries, the design in setting is generally more considerate.

Moreover, to the borrowers, they can design their loans and propose them to other party.<sup>58</sup> It is greatly different from the stereotyped role that borrowers generally play in the traditional banks, which is receiving a fixed interest rate. In the platform, borrowers can be lenders as well. Borrowers are in a better position since they can employ their expertise to design efficiently.<sup>59</sup>

### 3. Risks associated with P2P lending

In spite of the advantages and merits of P2P lending, risks are the inextricable by-products. Risk-return trade-off can also be observed in P2P lending, similar to cooperate loan.<sup>60</sup> The higher the return, the higher the risks. The level of risks also varies since some platforms provide secured

46 Online Finance Draws on Geographical Data, Raising Questions, <https://www.wsj.com/articles/online-finance-draws-on-geographical-data-raising-questions-1457482366>, last visited 22 July 2017.

47 Allen, Franklin and Douglas Gale, "Diversity of Opinion and Financing New Technologies", *Journal of Financial Intermediation* 1998, 68–89.

48 C. Dongyu & H. Chaodong, 2.

49 Ibid.

50 S. Brad, 11.

51 ibid 13.

52 C. Dongyu & H. Chaodong, 2.

53 B. Tillman, "Cows, Kiva and Prosper.com: how disintermediation and the Internet are changing microfinance", *Community Development Investment Review* 2007, 44–76.

54 S. Brad, 11.

55 Oxera, "The economics of peer-to-peer lending – Prepared for the Peer-to-Peer Finance Association", 2016, 6.

56 A. Ashta and D. Assadi, "An analysis of European online microlending websites", *Innovative Marketing* 2010, 3.

57 F. Yan, F. Xinlu, Y. Yeujun, "Lenders and Borrowers' Strategies in Online Peer-to-peer Lending Market: An Empirical Analysis of Ppai.com", *Journal of Electronic Commerce Research* 2015, 244.

58 Ibid, 246.

59 Ibid, 247.

60 Oxera, 23.

loan, such as mortgages, and some provide unsecured loans, having more risks. No matter which model the platform chooses, the risks below are prevalent.

### 3.1. Credit risk

The credit risk refers to the potential for financial losses resulting from the failure of a borrower to perform on an obligation.<sup>61</sup> The risks can be attributed to two causes, which are information asymmetry and the weak guaranteed model adopted by the platform.

#### 3.1.1. INFORMATION ASYMMETRY

Information asymmetry refers to the situation where one party to an economic transaction possesses greater material knowledge than the other party.<sup>62</sup> In the traditional financial institution, banks have more sophisticated risk assessment instruments which help them attain more information and eliminate information asymmetry.<sup>63</sup> They can access information such as applicant's assets, existing liabilities, to determine the credit risks. Before the existence of P2P lending platform, the banks are important because they lower the costs for the lenders to receive information with their cautious risks analysis. Nevertheless, it is relatively difficult for the lenders to obtain comprehensive information in P2P lending platform<sup>64</sup> considering the high signaling cost of borrowers and the search cost of lenders. Due to the high costs, most of the platforms are basically relying on the information provided by borrowers themselves without further verification, thus the truthfulness and the flow of information cannot be fully guaranteed.

In face of information asymmetry, adverse selection and moral hazard may occur according to George Akerlof.<sup>65</sup> The former means a situation where sellers have information that buyers do not, or vice versa.<sup>66</sup> This always leads to making bad decision, like doing business with a less-profitable and riskier market segments.<sup>67</sup> In P2P lending model, the lender may not be capable of

distinguishing among borrowers and investment project with different credit risks when allocating credit.<sup>68</sup> For example, assume there are two sets of borrowers in the platform, those who have lower default rate and those have higher default rate. Since the lender cannot differentiate between the two groups, the borrowers with higher default rate may exploit the lender's lack of information and lie that they have clear record and has low possibility to default. This leads to adverse selection, where the lender is at a disadvantage and then offer the same interest rate to both groups. Nevertheless, the loan is more valuable to the group having lower default rate than those having higher default rate because one party has more to gain. Hence, this creates mispricing as borrowers of high credit quality subsidize borrowers of low credit quality.<sup>69</sup> Information asymmetry may cause inefficiency in matching borrowers and lenders.<sup>70</sup> It also creates "social costs of a market breakdown in the form of credit rationing, under which riskier borrowers are denied credit".<sup>71</sup>

On the other hand, the other consequence is moral hazard, which occurs "when a party provides misleading information and changes his behavior when he does not have to face consequences of the risk he takes"<sup>72</sup>. For instance, the borrower may apply the borrowed funds to different investment projects than those agreed upon with the lender or never pay it back, yet the lender does not have sufficient information and control over the borrower.<sup>73</sup> The asymmetry may cause a lack of efficiency in the price and quantity of goods and services.<sup>74</sup> Moreover, this exposes the lenders to a greater risk in their investment.<sup>75</sup>

68 Y. Jiaqi Yan, Y. Wayne Yu and Z. J. Leon, "How signaling and search costs affect information asymmetry in P2P lending: the economics of big data", *Financial Innovation* 2015, 3.

69 B. Tetyana, 5.

70 C. Dongyu & H. Chaodong, 3.

71 S. Joseph., and A. Weiss, "Credit Rationing in Market with Imperfect Information", *American Economic Review*, 393–410.

72 Investopedia, What is the difference between moral hazard and adverse selection?, <http://www.investopedia.com/ask/answers/042415/what-difference-between-moral-hazard-and-adverse-selection.asp>, last visited 22 July 2017.

73 Ricardo N. Bebczuk, "Asymmetric Information in Financial Markets: Introduction and Applications", *Cambridge University Press* 2003, 7.

74 Ibid.

75 Y. Haewon, L. Byungtae, and C. Myungsin Chae, "From the wisdom of crowds to my own judgment in microfinance through online peer-to-peer lending platforms", *Electronic Commerce Research and Application* 2012, 470.

61 GAO, 22.

62 Investopedia, Asymmetric Information, <http://www.investopedia.com/terms/a/asymmetricinformation.asp>, last visited 22 July 2017.

63 C. Dongyu & H. Chaodong, 4.

64 M.F. Lin, "Peer-to-Peer Lending: An Empirical Study", *AMCIS 2009 Doctoral Consortium* 2009, 3.

65 George A. Akerlof, "The Market for "Lemons": Quality Uncertainty and the Market Mechanism", *The Quarterly Journal of Economics* 1970, 488–500.

66 Ibid.

67 Ibid.



To mitigate the risk of information asymmetry, the platforms use different models to ensure the creditworthiness as abovementioned. However, the issue is that under an unregulated area, it is not possible to guarantee the effectiveness of the self-regulated platform. To those platforms which are less keen on accessing the creditworthiness of the borrowers, they are not subject to any control or supervision. The law fails to provide protection to the lenders regarding the access to information, imposing risks to the lenders.

### 3.1.2. THE WEAK GUARANTEED MODEL

The model adopted will be affecting the risks the lenders may need to bear. The factors that whether the platform provides secured or unsecured loan, having guaranteed return or not, whether pool of money for compensation is prepared in case of default, whether the scoring system of creditworthiness is comprehensive are determinative. Firstly, there is an inherent risk of default on loan if without any collateral.<sup>76</sup> To provide unsecured loans, the lenders need to assume the risk that they may not recover any of their original investment if the borrower loan become delinquent.<sup>77</sup> The platform will not be legally liable as well due to the lack of contractual relationship. Hence, the risk-return trade-off can only be accessed by the lenders themselves.

Secondly, risks arisen if there is no proper model accessing the creditworthiness. Most borrowers in traditional markets are poor and self-employed.<sup>78</sup> It is not unusual as microfinance serves pre-dominantly disadvantaged customers. Nevertheless, it becomes problematic if the platform fails to ensure the creditworthiness of the borrowers by adopting appropriate model. In China, unlike European countries, specialty organization in credit keeping and calculating is rare, not-to-mention a mature third party credit rating system.<sup>79</sup> In order to lower the costs and make the platform more attractive to the lenders, many platforms are not willing to impose the stringent credit standard and a more thorough application process.<sup>80</sup> On the other hand, surprisingly, it was found that Lending Club only verified 60% of its borrower's employment

or income information in 2011.<sup>81</sup> The minimal efforts has disappointed some P2P lenders as to the uncertainty of the investment return.<sup>82</sup>

In fact, the platform's incentives may not always align with prudent lending practices<sup>83</sup> although it seems to be the platform's duty to access the creditworthiness carefully, it is not a must under the statutory framework, especially in Hong Kong, since this issue remains silent in the legislation. Subject to no control, the platforms have an excessive degree of freedom and thus failing to protect the lenders' interest because of inconvenience.

## 3.2. Operational risk

Operational risk means the potential for unexpected financial losses due to inadequate or failed internal processes, people, and systems, or from external event.<sup>84</sup> There are three situations which may trigger the operational risk, which are the platform failure platform inefficiency and privacy issues.

### 3.2.1. PLATFORM FAILURE

Lenders face the risk that the platform may cease due to unprofitability of the business model or operational events such as failure of the platform even if borrowers are not in default.<sup>85</sup> In this context, the problem arises of the management of ongoing borrower repayments and their transmission to investors to be handled.<sup>86</sup> The first question will generally be which model is the platform adopted. If it belongs to notary model or client segregated account model, the degree of involvement of the platform is relatively low comparing to the guaranteed return model, so that the platform failure may not have significant impact to the lenders and the borrowers, given that the repayment held by the platform has not been appropriated for other purposes.

Hence, to address the problem, the administrators will need to wait for the loans reach maturity before collection since the assets of the

<sup>76</sup> Ibid.

<sup>77</sup> GAO, 22.

<sup>78</sup> S. Mark, "Credit Scoring for Microfinance: Can it work?" *Journal of Microfinance* 2000, 106.

<sup>79</sup> Y. Jiaqi Yan, Y. Wayne Yu and Z. J. Leon, 245.

<sup>80</sup> High rate of defaults hit P2P lending sector, <https://www.finextra.com/newsarticle/30165/high-rate-of-defaults-hit-p2p-lending-sector>, last visited 22 July 2017.

<sup>81</sup> The Gamble of Lending Peer to Peer, <http://www.nytimes.com/2011/02/05/your-money/05money.html>, last visited 23 July 2017.

<sup>82</sup> You are unlikely to Prosper, <http://www.markgimein.com/TBMpdf/Prosper.pdf>, last visited 23 July 2017.

<sup>83</sup> V. Andrew, "Misregulation of Person To Person Lending", *Lecturer and Other Affiliate Scholarship Series* 2012, 471.

<sup>84</sup> GAO, 22.

<sup>85</sup> Kevin Davis SF Sin, "Peer-to-peer Lending: Structures, risks and regulation" *JASSA The Finsia Journal of Applied Finance* 2016, 40.

<sup>86</sup> Ibid.



platform are principally its borrowers.<sup>87</sup> After that, the administrators have an obligation to use the collected funds to satisfy lenders as prescribed by law.<sup>88</sup> For instance, in the case of platform failure of TrustBuddy, a bankrupt P2P lending platform, has been investigated that the company has used lender's capital without permission.<sup>89</sup> After that, an unnamed collection company dealt with the remaining debts although the lender funds were frozen in the bankruptcy proceeding. Lenders were owed around \$ 2.5 million with another \$1.5–2 million in loans funded which were waiting for assigning back to the lenders.<sup>90</sup> Here, the whole process is subject to the control of Financial Conduct Authority (FCA), there are safeguards regarding the platform failure, so that there is a higher possibility for the lenders to claim back the investment and suffer less losses.

However, it is not that fortunate in China. The platform failure in China usually involves the Ponzi scheme. It is a fraudulent investing scam promising high rates of return with little risk to investors, which first generates returns for older investors by inviting new investors, then uses new investors' funds to pay the earlier backers.<sup>91</sup> If there are insufficient newcomers to pay for the original investors for their return, the Ponzi scheme will break down. Last year, Ezubao was found with substantial evidence that it had cheated about 900,000 investors out of more than 7.6 billion U.S dollars.<sup>92</sup> It was claimed that 95% of investment projects on Ezubao were fake and many companies did not even know why they were being promoted by the platform.<sup>93</sup> As a result, lenders suffered losses, which were not able to be recovered. A company employee claimed to loss 100,000 Yuan in the scheme and some even suffered losses up to 800,000 Yuan.<sup>94</sup>

The rampant utilization of fake information and fraud depicted the unregulated P2P lending in China. The technology is used as a disguise which makes it become harder to control the fraudulent investment schemes, as they spread fast and the associated risks snowball in a short period of time.<sup>95</sup> It was also found that one third of more than 3,000 peer-to-peer lending platforms in China are problematic.<sup>96</sup> There are a myriad of unknown risks online, especially when people are so inexperienced in this area, the lack of proper supervision and control are detrimental to further development of P2P lending. The investors face tremendous risks, where all of investment may not be recovered.

### 3.2.2. PRIVACY ISSUES

There is always a 'tug of war' between the privacy of the borrower and the lender information, since there should be adequate information provided to the lenders in order to ensure the creditworthiness of the borrowers, but on the other hand it should protect borrower's personal information. In the current model, the platform collects information from the borrowers and shares it on the website of the platform. In theory, various of lenders can only receive a limited amount of information which uploaded online, whereas the personally identifying information are kept only to the access of the platform. In addition, platform usually provides communication of the borrowers and the lenders only on an anonymous basis, something more is discouraged. Nevertheless, in practice the personal information is not so well-protected. Lenders sometimes can discern the identity of the borrower based on the little information provided online.<sup>97</sup> The GAO report reviewed 275 loan listing and found that there were 47 instances where borrowers potentially revealed information that could determine their identities.<sup>98</sup> If the identity is yet to be determined at the first stage, the interaction via phone or email are not uncommon.<sup>99</sup> Andrew Verstein, professor from Yale Law School, has attempted to lend on Prosper in order to see how does Prosper

87 A wake-up call from TrustBuddy, <http://blogs.lexisnexis.co.uk/fs/a-wake-up-call-from-trustbuddy/>, last visited 22 July 2017.

88 Ibid.

89 TrustBuddy Loses Trust. Peer to Peer Platform Closes Following "Suspected Misconduct", Swedish Police Contacted, <https://www.crowdfundinsider.com/2015/10/75669-trustbuddy-loses-trust-peer-to-peer-platform-closes-following-suspected-misconduct-swedish-police-contacted/>, last visited 22 July 2017.

90 Platform Risk: What Happened to Trustbuddy?, <http://p2plendingexpert.com/platform-risk-what-happened-to-trustbuddy/>, last visited 22 July 2017.

91 Investopedia, Ponzi Scheme, <http://www.investopedia.com/terms/p/ponziscHEME.asp>, last visited 22 July 2017.

92 Xinhua Insight, Online P2P lender suspected of \$US 7.6 billion fraud, [http://news.xinhuanet.com/english/2016-02/01/c\\_135065022.htm](http://news.xinhuanet.com/english/2016-02/01/c_135065022.htm), last visited 22 July 2017.

93 Ibid.

94 China's 7.6 billion Ponzi scam highlights growing online risks, <http://www.reuters.com/article/us-china-fraud-idUSKCN0VB201>, last visited 23 July 2017.

95 Why Ponzi schemes are thriving in china despite crackdowns, <http://www.scmp.com/news/china/money-wealth/article/2104062/chinese-ponzi-schemes-feed-publics-lack-financial-knowledge>, last visited 25 July 2017

96 One third of China's 3000 peer-to-peer lending platforms 'problematic': new report, <http://www.scmp.com/news/hong-kong/economy/article/2022317/one-third-chinas-3000-peer-peer-lending-platforms-problematic>, last visited 22 July 2017.

97 ibid 474.

98 GAO, 65.

99 Ibid.

work. He found out that the lender was able to go beyond the vetting requirement of the platform and arranged interview with the borrower, as well as scrutinizing borrower's financial record.<sup>100</sup>

The leak of personal information can bring undesirable impact to the borrowers. In the narrow sense, if the lenders are not so benevolent, they may take the hands-on approach and collect the loans themselves circumventing the proper procedure offered by the platform in case of default. Worse still, harassment or intimidated collection activities may be employed. Unlike US and UK, there is no specific offence regarding debt collection practices or a separate licensing scheme in respect of operation of debt collection agencies in Hong Kong.<sup>101</sup> Hong Kong only relies on the police enforcement to combat the illegal practices in debt collection, such as assault, criminal damage and criminal intimidation. Therefore, two issues arisen here. Firstly, there is no protection regarding the lenders using borrowers' information to conduct illegal activities. Whether the platform is obliged to keep a close eye, or at least exercise reasonable care, on the communication of the lenders and borrowers remains unclear. It is preferable if the platform can explicitly state the risks of exposing personal information to the borrowers prior to the lending, but if platform fails to do so, it is questionable if any legal liability will be attracted.

In the board sense, it is risky as to the substantial amount of the data collected by the platform may be sold or hacked. P2P platforms possess abundant information regarding personal identification and credit data.<sup>102</sup> If there is any leakage of the information, the personal identifiable information would be available to aggregators, as well as being tracked everywhere the victims go online.<sup>103</sup> The information may be used as trade secret or being engaged in other criminal activities. Although in the prospectus of Prosper it states that "We do not sell, rent or share such information with third parties for marketing purposes unless previously agreed to by the participant"<sup>104</sup>, the risk of leaking cannot be underestimated.

<sup>100</sup> Ibid.

<sup>101</sup> LCQ19, Combating illegal debt collection activities, <http://www.info.gov.hk/gia/general/201106/22/P201106220244.htm>, last visited 23 July 2017

<sup>102</sup> S. Paul, "Square Pegs in a Round Hole: SEC Regulation of Online Peer-to-Peer Lending and the CFPB Alternative", *Yale Journal on Regulation* 2013, 245.

<sup>103</sup> K. Balachander and Craig E. Wills, "On the Leakage of Personally Identifiable Information Via Online Social Networking", *Worcester Polytechnic Institute* 2009, 7.

<sup>104</sup> Prosper Marketplace, INC, "Prospectus For Registration Statement", No.333-204880 2016, 111.

### 3.2.3. LEGAL RISK

Due to the lack of necessary regulation, P2P lending is in the grey legal area, thus several legal problems will give rise to risks to the lenders, including money laundering and illegal deposit-taking.

### 3.2.4. MONEY LAUNDERING

Platforms in P2P lending allow direct transaction between the borrowers and the lenders, the platform is merely playing the role of collecting information prior to the lending and dealing with administration. In other words, the platform does not have control pertaining to the sources and the usage of funds. This gives a golden opportunity to the criminals and it may easily turn the platform into the hotbed of crime. Money laundering usually contains three stages. First, the criminals need to conceal the true ownership and the origin of the money.<sup>105</sup> Second, they need to control the money.<sup>106</sup> Lastly, they need to change the form of the money.<sup>107</sup> The way to commit money laundering in the platform is rather simple. The suspect can lend the dirty money to different borrowers accordingly, or playing a dual role as being the lender and the borrower at the same time, after the loans have been repaid, the form of the money has been changed, it becomes legal. In fact, money laundering is a crime that is relatively hard to discover. The number of people convicted of money laundering fell from 145 in 2014 to 122 last year.<sup>108</sup> The report mechanism from the banks is of paramount importance since it is hard to track the sources and the usage of money in any other way. However, the P2P lending is a novel area, whether the platform can exercise a certain extent of function similar to banks in reporting crimes is negotiable. On top of that, platform may need to be authorized to collect more information from the lenders as well and exercise due diligence in order to prevent crimes.

### 3.2.5. ILLEGAL DEPOSIT TAKING

Illegal deposit taking is defined as an act of receiving, taking or accepting of deposits from members of the public that promises a

<sup>105</sup> Hong Kong Monetary Authority, "A Guideline issued by the Monetary Authority under section 7(3) of the Banking Ordinance", 2011, Guideline No.3.3 2.2.

<sup>106</sup> Ibid.

<sup>107</sup> Ibid.

<sup>108</sup> Hong Kong's anti-money laundering moves will not work without due diligence from firms, <http://www.scmp.com/comment/insight-opinion/article/2096298/hong-kongs-anti-money-laundering-moves-will-not-work-without>, last visited 23 July 2017.

repayment with interest or returns in money or money's worth without a valid license.<sup>109</sup> In general, P2P lending platform is only acting as an intermediary receiving administrative fee as the main source of income, which normally will not disturb the contractual relationship between the borrowers and lenders. However, in some transformed model of P2P lending, the platform is playing a more essential role. For instance, some platforms requiring security, and some platforms are acting as manager of the fund for the lenders to help with their investment. In this case, money will be accumulated in the platform and under platform's management and supervision.

There are several circumstances that the platform may be suspected in committing illegal deposit taking. Firstly, excessive money is deposited in the platform when there is higher supply in loan than demand. In the situation where there are more fund collected from the lenders than what the borrower needs, it is crucial as to how the money is being dealt with. If the extra amount is paying back to the investor, no legal risk will be involved. Nevertheless, it becomes problematic if the amount is kept by the platform, either due to the request of the lender or the default mechanism of the platform's policy, the nature of the money is questionable. Theoretically, the money deposited is the lender's assets. Unless the lender has given specific instruction to the platform as to the utilization of the extra amount, such as leaving it to the next specific project, otherwise the reserve could possibly be utilized by the platform for other purposes.

Second, money is deposited in the platform in a form of security. Some platforms only provide secured loan, the platform will hold the deed or title until the loan has been paid in full.<sup>110</sup> However, when the platform is possessing the security, some risks are emerged. For instance, the platform may use the amount to pay to other lender whose loan is default, so that the amount is not the original security although the platform is able to return it afterwards. Besides, the platforms may take the security to invest on their own. Whenever there are losses suffered by the platform, they are unable to return the original amount to the borrowers. In China, a total of 58 P2P platforms went bankrupt in the forth

quarter of 2013, while another 47 P2P websites disappeared with money raise in the first half of 2014, were found to have committed fraud or had difficulty repaying investors.<sup>111</sup>

In Hong Kong, the appropriation of the deposit in the platform would possibly be charged of theft in criminal law. Since the act of the platform has constituted a dishonest appropriation of property belong to another with the intention of permanently depriving the other of it.<sup>112</sup> However, it does not provide sufficient protection to the investors and borrowers, therefore, other mechanisms need to be considered to prevent the appropriation of the money in a supervisory perspective.

## 4. Regulating P2P lending in other jurisdiction

### 4.1. United Kingdom

The Financial Conduct Authority (FCA) has regulated P2P lending since 1 April 2014. In the past, P2P platform operators were required to hold a debt administration licence from the Office of Fair Trading.<sup>113</sup> Currently, FCA introduced P2P lending named as "operating an electronic system in relation to lending" into the Financial Services and Markets Act 2000 under section 36H,<sup>114</sup> with the following features:

- a) Regulated lending intermediaries: Authorization is needed before the operation of the platform. The platform is defined as a firm uses an electronic system to operate a loan-based crowdfunding platform.<sup>115</sup>
- b) Maximum lending to an individual: The maximum amount that is allowed to borrow is £25,000, which is around HK\$ 263,000.<sup>116</sup>
- c) Minimum capital of platform operators: The platform operating should hold regulatory capital in order to help them withstand any future financial shock. Started from 1 April 2017, the financial resources requirement is a fixed minimum amount of £50,000 (HK\$

111 The dark side of the lending spree, <http://gbtimes.com/business/dark-side-lending-sprees>, last visited 23 July 2017.

112 Theft Ordinance (Cap 210) (HK) s.2.

113 Legislative Council Secretariat, 'Regulation of crowdfunding in selected places', *Information Note* 2016, 10

114 FCA Handbook, operating an electronic system in relation to lending, <https://www.handbook.fca.org.uk/handbook/glossary/G3215.html>, last visited 23 July 2017.

115 FCA Imposes New Regulation on Crowdfunding, <http://gdknowledge.co.uk/fca-imposes-new-regulation-on-crowdfunding/>, last visited 23 July 2017.

116 Legislative Council Secretariat, 10.

109 Illegal Deposit Taking, <https://zh.scribd.com/document/341367618/Illegal-Deposit-Taking>, last visited 23 July 2017.

110 Secured vs Unsecured Loans, <http://www.greenpath.com/resources-tools/financial-library/loan-types/secured-vs-unsecured-loans>, last visited 23 July 2017.

525,500), or 0.05%-0.2% of the value of loaned fund, whichever is higher;<sup>117</sup>

- e) Risk management of the platforms: Platforms need to take reasonable steps and have appropriate arrangement for existing loan to continue in case of platform failure.<sup>118</sup> Also, the platform holding client money are subject to the rules of Client Assets Sourcebook (CASS) which require the platform "to ensure adequate protection of client money when the firm is responsible for it"<sup>119</sup>
- f) Disclosure of information: Platforms need to ensure that investors have the information they need to be able to make informed investment decisions and that all communication is fair, clear and not misleading.<sup>120</sup> For example, the disclosure of expected and actual default rates, investment security mechanisms, comparative information and periodic reporting to clients.<sup>121</sup> Besides, regular report should be submitted to FCA regarding the platforms' financial position, client money held, complaints and details of loans arranged each quarter.<sup>122</sup>
- g) Cooling off period: Borrowers are given 14 days of cooling-off period and they could withdraw from the deal within the period.

#### 4.2. United States

The P2P lending sites are subject to the control of Securities and Exchange Commission (SEC). The Jumpstart Our Business Startups Act (the "JOBS" Act) signed in 2012 and the final rules adopted in 2015 by the SEC are also applicable to the P2P lending platform in US. In general, P2P lending and equity crowdfunding are subject to the same regulation, except where consumer credit is involved. Therefore, the approach may be different pertaining to different models of platform under the US's regulatory framework.

In the notary model, platform operates as a third-party service provider of banks and is subject to examination by the bank regulator.<sup>123</sup> When the platforms sell notes, they are subject to securities laws and regulation.<sup>124</sup> Hence, they

need to prepare prospectus and register their securities with SEC. On the other hand, in the client segregated account model, since it concerns consumer credit, the platforms need to obtain a lending licence in the belonging state. In this context, privacy, data protection and anti-money laundering are highlighted. The Truth in Lending Act, Equal Credit Opportunity Act, Fair Credit Reporting Act, Electronic Fund Transfer Act and Fair Debt Collection Practices Act etc. are applicable.

There are some features of the regulation regarding crowdfunding in US:

- a) Registration of online platform: All crowdfunding platforms need to be registered with SEC according to Securities Act Section 4A(a)(1) and 4(a)(6).<sup>125</sup>
- b) Capital raised: Rule 100 (a) of Regulation Crowdfunding provides that an issuer may sell up to \$1 million in any 12-month period to investors in an offering made pursuant to the exemption.<sup>126</sup>
- c) Disclosure of information: Platforms need to disclose all basic information to the investors, such as the names of the directors and officers<sup>127</sup>, business plan and risks<sup>128</sup>, the price to the public of the security or the method of determining the price<sup>129</sup> etc.
- d) Investment limit: The amount of securities sold to any investor by an issuer, cannot exceed (i) The greater of \$2000 or 5% of the annual income or net worth of such investor, if either the annual income or the net worth of the investor is less than \$100,000; and (ii) 10% of the annual income or net worth of such investor, not to exceed a maximum aggregate amount sold of \$100,000, if either the annual income or net worth of the investor is equal to or more than \$100,000<sup>130</sup>
- g) Risk acknowledgement and right of withdrawal: US investors need to filling in the questionnaire of acknowledging the potential risks.<sup>131</sup> They have unconditional right to withdraw until 48 hours prior to the close of the offering.<sup>132</sup>

117 FCA, 'The FCA's regulatory approach to crowdfunding over the internet, and the promotion of non-readily realizable securities by other media', PS14/4 2014, 18–22.

118 *ibid* 6.

119 *ibid* 22.

120 *ibid* 30.

121 *Ibid*.

122 *ibid* 32.

123 Legislative Council Secretariat, 8.

124 *Reves v. Ernst & Young*, [1990] 494 U.S 56.

125 Securities and Exchange Commission, 'Final Rules', 2016, 245.

126 *Ibid*, 1.5

127 Securities Act Section 4A(b)(1)(B).

128 Securities Act Section 4A(b)(1)(C).

129 Securities Act Section 4A(b)(1)(G).

130 Securities and Exchange Commission (n 161), 20.

131 *Ibid*, 190.

132 *Ibid*, 238.



### 4.3. China

The China Banking Regulatory Commission issued Interim Measures for the Administration of the Business Activities of Online Lending Information Intermediary Institutions ("The Measures") on 17 August 2016 and the Guidelines on Depositing and Managing Online Lending Capital ("The Guidelines") on 24 February in 2017. The Measures and The Guidelines sets out the basic principles in managing online capital since there have been lots of platform failure involving fraud and other illegal activities. Some important principles are as follow:

- a) Registration of online platform: Platforms should obtain business licence for enterprise legal person, conduct recordation and registration with the local finance regulatory department.<sup>133</sup>
- b) Risk management of the platform: Platform should, in accordance with the principle of legality, good faith, voluntariness and fairness, provide information services for borrowers and lenders, not concentrate funds in a direct or indirect manner or raise funds illegally.<sup>134</sup> Besides, the platform should conduct verification as to the information collected<sup>135</sup> and access the creditworthiness of the borrowers.<sup>136</sup>
- c) Capital raised: The platform should access and control the investment limit based on borrower's and lender's ability to avoid risks.<sup>137</sup> Individuals cannot raise more than \$200,000 in a single platform, whereas any legal entity or organization cannot raise more than \$1,000,000 in one platform. The maximum amount for the individuals and organizations to lend in different platforms is \$5,000,000.
- d) Disclosure of information: Platforms should provide the basic information of the borrowers online, including details of the project, risk assessment and the potentials risks etc.<sup>138</sup> Additionally, annual report should be submitted to the supervisory authority.<sup>139</sup>

133 Interim Measures for the Administration of the Business Activities of Online Lending Information Intermediary Institutions, Article 5.

134 Ibid, Article 3.

135 ibid Article 9(2).

136 ibid Article 27.

137 Ibid, Article 17.

138 Ibid, Article 30.

139 Ibid, Article 31.

## 5. Proposed regulations in Hong Kong

### 5.1. Existing legislative framework

Hong Kong does not have specific law governing crowdfunding, yet it is potentially subject to the regulation of three ordinances<sup>140</sup> and the supervision of Securities and Futures Commission ("SFC"). However, it is arguable that whether the distinctive model of P2P lending is able to fit in the current legislation.

### 5.2. Companies (winding up and miscellaneous provisions) ordinance (cap.32) ("CWMPO")

Under s.38 (1), a company must not issue any form of application for shares or debentures of the company unless it is issued with a prospectus.<sup>141</sup> It refers to any written document containing an offer or invitation to take up shares or debentures. Further, the prospectus for subscription must comply with the requirements and be authorized by the SFC.

It is questionable whether P2P lending platform is subject to the requirement of prospectus here. Since in US, P2P lending and equity crowdfunding are treated in the same way. Once banks are involved in the process, the P2P lending platform is subject to bank regulator. However, in UK, two are treated differently. FCA seems to be less restrictive to P2P lending as it seems to be less risky comparing to equity crowdfunding.<sup>142</sup> In fact, other than the relatively lower risk, a clear and structured legislation seems to be more beneficial regarding the application of law. In this sense, it is not recommended to split different models of P2P lending into different area of law. Rather, all the models are subject to one particular law is a better practice and is able to provide legal certainty as well. Hence, this law may not be applicable to P2P lending.

### 5.3. Securities and Futures Ordinance (Cap.571) ("SFO")

Under s.103(1)(10) and s.105, it is an offence to issue any advertisement, invitation or document which contains an invitation to the public to acquire securities or participate in a collective investment scheme, unless obtaining the authorization of SFC.<sup>143</sup> Advertisement includes every form of

140 Notice on Potential Regulations Applicable to, and Risks of, Crowdfunding Activities, <https://www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/doc?refNo=14PR53>, last visited 23 July 2017.

141 Cap. 32 S. 38(1).

142 FCA, 38.

143 Cap 571 s.103(1) (10), s.105.

advertising, whether made orally or produced mechanically, electronically, magnetically, optically manually or by any other means.<sup>144</sup>

P2P lending platforms are potentially subject to the restriction here since the nature of P2P lending involves securities by selling notes to the lenders in the notary model.

Besides, SFO stipulates that any person carrying on business in a regulated activity in Hong Kong must be licenced or registered with the SFC. Different types of regulated activity are listed in Schedule 5. P2P lending may fall within Type 1 “Dealing in Securities”, which is defined as “any person making or offering to make an agreement with another person, or inducing or attempting to induce another person to enter into or to offer to enter into an agreement for acquiring, disposing of, subscribing for, or underwriting securities”.<sup>145</sup> As note can be regarded as a form of security, therefore P2P lending requires to be licenced in order to carry on business.

#### 5.4. Money lenders ordinance (cap. 163) (“MLO”)

Money lender means “every person whose business is that of making loans or who advertises or announces himself or holds himself out in any way as carrying on that business” according to s.2 of MLO.<sup>146</sup> It is an offence if carrying on business as a money lender without a licence stipulated in s.7.<sup>147</sup> Currently, most of the P2P lending platform in Hong Kong such as Welend, Bestlend are registered according to MLO.<sup>148</sup> However, they are not pure P2P platforms.<sup>149</sup> Welend only accepts loans from lenders in the company’s private network,<sup>150</sup> whereas Bestlend merely aims to accumulate credit data which Haitong needed for other business purposes such as securities.<sup>151</sup> Both are not the original form of P2P lending, yet Bestland will be closer to the definition since it matches borrowers in need of funding with licensed money lenders in Hong Kong.<sup>152</sup>

144 Cap 571 s.102(1).

145 Cap 571 s. Schedule 5.

146 Cap 163 s.2.

147 Cap 163 s.7.

148 Development and Regulation of P2P Lending and Equity-based Crowdfunding in Hong Kong, [https://www.p2p-banking.com/countries/china-development-and-regulation-of-p2p-lending-and-equity-based-crowdfunding-in-hongkong/#\\_edn13](https://www.p2p-banking.com/countries/china-development-and-regulation-of-p2p-lending-and-equity-based-crowdfunding-in-hongkong/#_edn13), last visited 23 July 2017.

149 Regulation of crowd funding in Hong Kong, <https://www.charltonslaw.com/hong-kong-law/regulation-of-crowd-funding-in-hong-kong/>, last visited 23 July 2017.

150 Ibid.

151 Ibid.

152 Ibid.

In fact, it may not be necessary for P2P lending platforms to apply as a money lender in Hong Kong.<sup>153</sup> Firstly, the nature of the platform cannot be described as a money lender in practice. Platforms may not involve any business of lending since it is only an intermediacy, bridging connection between the lenders and borrowers, but not being the real lender. The platform does not receive any interests from the loan other than the administrative fees. Monexo, a P2P lending in Hong Kong responsible for matching the lenders and borrowers, does not show any lending licence on the website as stipulated in s.26 of the MLO.<sup>154</sup> It is possibly because of the discrepancy between the nature of money lender and the real role performed by the platform. Secondly, some sections in the MLO may not fit the practice of P2P lending. For example, s.18 stipulates that the agreement must be signed,<sup>155</sup> however, one of the most important features of P2P lending is that all the transaction is done through the online platform, which makes agreement in writing with signature inapplicable. Hence, based on the abovementioned illustration, even P2P lending is managed to be categorized as money lender, but apparently it is not the most appropriate one.

## 6. Necessity in legislation

Legislation here refers to a specific ordinance addressing all the laws regarding crowdfunding by using a consolidated approach. There are several reasons of doing so.

### 6.1. Increasing demand

In 2015, total transaction value of crowdfunding in Hong Kong was just US\$9.3 billion, which is around HK\$72 million, far less than other jurisdictions.<sup>156</sup> Hong Kong is dubbed as the international financial center, the chances accompanied with the innovative model of microfinance should not be overlooked. Meanwhile, the government is now actively encouraging the development of SMEs, there are more demand to raise capital to start their own businesses. This can definitely strengthen and sustain the growth of financial innovation as being one of the greatest driving forces to make Hong Kong more prosperous.

153 Development and Regulation of P2P Lending and Equity-based Crowdfunding in Hong Kong, [https://www.p2p-banking.com/countries/china-development-and-regulation-of-p2p-lending-and-equity-based-crowdfunding-in-hongkong/#\\_edn13](https://www.p2p-banking.com/countries/china-development-and-regulation-of-p2p-lending-and-equity-based-crowdfunding-in-hongkong/#_edn13), last visited 23 July 2017.

154 Ibid.

155 Cap 163, s.18.

156 Legislative Council Secretariat, 4.

## 6.2. Inappropriateness in categorization

There is over-complexity of legislation in the current situation. For instance, whenever the platform falls within several areas of law, multiple licenses may be required. In the case of P2P lending, they need to obtain at least more than one licence under the SFO and MLO, which are unnecessary. A specific legislation of law only governing crowdfunding can ensure legal certainty. As all the procedures can be clarified and written in a more detailed manner, it is convenient for application of law, as well as legal enforcement. Also, it is not necessary to distinguish the law adopted for different models in P2P lending, which will make things easier.

## 6.3. Mitigation of risk

Someone still suggest keeping the original framework which would suffice for the development of P2P lending. However, as the market of crowdfunding is now expanding, it is time to start the reform with references to other jurisdiction. If there is a consolidated approach, there will be more rooms for protecting the lenders and borrowers by listing out all sort of requirement. Under the current regulatory framework, the details, such as investment limit, disclosure requirement and the definition of P2P lending etc., remain silent. Thus, the lenders and the borrowers lack comprehensive protection from the statutes. How the risks can be mitigated will be discussed in the following section.

## 7. Recommendations

P2P lending can be regulated under the Crowdfunding Ordinance. A specific part can be reserved to stipulate the legal requirements and protection for P2P lending.

### 7.1. Primary aim

The aim of the legislation is to facilitate the development of crowdfunding and give more protection to the lenders and borrowers with exhaustive requirements. In addition, a healthy and fair P2P lending environment must be promoted.

### 7.2. specific measures

The measures can be categorized as registration, business rule and risk management, lenders' and borrowers' protection, disclosure of information, legal liabilities.

#### 7.2.1. REGISTRATION

P2P lending platform should be registered and obtain business licence from SEC. There will

be different licences offered depending on the model that the platform is running. If the model itself may involve legal concern, SEC is entitled reject the application unless there is amendment. Moreover, the platforms no longer need to apply for licences under other ordinances, such as MLO and SFO, since this Ordinance has categorized P2P lending platform into a new area of law, and this law will be directly applied without circumventing other mechanisms. Besides, P2P lending will be exempted from Type 1 "Dealing in Securities" in regulated activities stipulated by SFO and the Advertisement restriction can also be exempted since the date this Ordinance become effective.

By cutting the over-complex procedures, the registration can be more efficient. While registration itself might be seen as a process ensuring material financial information disclosure, being a safeguarding hurdle<sup>157</sup> and to guarantee the model is reliable.

#### 7.2.2. BUSINESS RULE AND RISK MANAGEMENT

The platform has duty to access the creditworthiness of the borrowers, take measures to prevent fraudulent conduct, fully inform the borrowers and the lenders of their potential risks, perform client identification to verify the identity of the borrower. Any indirect or direct raising funds, accepting or concentrating the lender's funds are forbidden. The imposition of obligation of the party will draw relevant legal liabilities if the platform fails to exercise its obligation. The platform needs to make sure that no fake account is used among the borrowers. The model of accessing the creditworthiness should also be monitored by SEC. After that, it helps eliminate the problem of information asymmetry.

Besides, investment limit can be imposed. This can help cope with the risk of business default and illiquidity. The amount could be set as \$100,000 for each individual in requesting loan.

#### 7.2.3. LENDER'S AND BORROWER'S PROTECTION

Without authorization, the platform cannot make decision on behalf of the lender or borrower. Data should be well protected and its collection, possessing, usage should be legal and safe, especially for personal identifiable information. The data protection is crucial since the consequences of the leak of information can be detrimental. The platform needs to exercise reasonable care to prevent the platform being hacked as well, for example, installing anti-virus

<sup>157</sup> S. Karina, 483.

software. On the other hand, each platform should have a provision pool preparing for any incidents that cause loss to the lenders, so that the lender can later reimburse the amount if he or she suffer losses.

#### 7.2.4. DISCLOSURE OF INFORMATION

The platform should inform the lender thoroughly with borrower's basic information, purpose of the loan, credit history, potential risks. This can help mitigate the information asymmetry with the help of the platform. The platform itself should also disclose internal information to the public via annual report. The deposit in the platform's possession should be carefully scrutinized. Accountant may be needed yearly to examine the cash flow. On the other hand, if the platform has aware of some problematic loan

which is suspected to be money laundering, the platform has a duty to report it to the police.

## 8. Conclusion

The regulatory framework of P2P lending is undoubtedly lagging behind. Only by reforming and updating the law can Hong Kong maintain its unique advantages as an international financial center with talented investors. This essay outlines the models, features of P2P lending and underscores the potential risks. Hong Kong should legislate crowdfunding as soon as possible in order to provide better protection to the investors. By establishing a healthy and secured platform, can P2P lending assist Hong Kong fight for the better future.



## REGULATING UBER IN HONG KONG

**Cherry Chow**

*Since ride-hailing giant Uber's entry into Hong Kong, China, it has been met with mixed reactions from the public and a strong opposition from the government. Undercover 'sting' investigations by the police have slapped heavy fines on drivers, only to be met with resistance from the public. Despite a clear need for the service, the legislature of the city has refused to acknowledge or move towards legalization, without banning the company outright, as has been done in other jurisdictions.*

*This paper aims to examine the challenges to regulating Uber and Uber-like services in Hong Kong, viewing the current regulations and offering suggestions as to how they may be changed to adapt the changing needs of Hong Kong society by regulating (1) the platform; and (2) the users.*

Key word: Hong Kong. – Regulation. – Uber. – Sharing Economy.

### 1. The Uber crackdown and other cases

In late May 2017, Hong Kong police arrested twenty-two Uber drivers, concluding a three-week undercover police operation that targeted Uber drivers. The main charges were that the drivers had neither valid car hire permits from the Transport Department nor valid insurance for hire car services.<sup>1</sup>

This undercover operation made headlines for being the largest police raid targeting Uber drivers, despite not being the first of its kind. In August 2015, five Uber drivers, as well as three members of Uber Hong Kong's staff, were also arrested following a similar undercover operation.<sup>2</sup> The high-profile arrests caused controversy at the time for being carried out as a result of pressure from the protests by taxi drivers in the previous months.<sup>3</sup> In the various

protests, taxi drivers accused the competition from Uber and other similar applications 'unfair'<sup>4</sup> and others displayed signs on their taxis that read "Where is justice, [our] livelihoods are at stake".<sup>5</sup> Hong Kong's taxi drivers were not alone in that endeavor, however, for the year saw taxi drivers around the world rise in protest against the company.<sup>6</sup>

Closer to home in Macau, several hundred ordinary citizens — users of Uber — took to the streets advocating the legalization of Uber in 2016. Uber had initially decided to exit the Macau market in September of that year, after less than one year of operations in Macau; over 370 prosecutions had been made in Uber-related cases in that single year alone.<sup>7</sup> Uber then reversed its decision to leave the market after the protest in support of the company,<sup>8</sup> only to announce suspension of its operations in July 2017.<sup>9</sup>

This paper aims to explain the controversy revolving around Uber and similar 'car-sharing' platforms in Hong Kong, and provide suggestions on how some aspects of 'car-sharing' can be regulated, as well as the concerns legislators may have in the different areas.

article/1833345/more-100-hong-kong-taxi-drivers-protest-against-uber-and-other-car, last visited 30 May 2017.

- 4 Hong Kong Taxi Drivers Stage Protest Against Uber-Style Car-Hailing Apps, *South China Morning Post*, <http://www.scmp.com/tech/apps-gaming/article/1819604/hong-kong-taxi-drivers-stage-protest-against-uber-style-car-hailing>, last visited 30 May 2017.
- 5 More Than 100 Drivers Staged Protests Against Uber And Other Car-Hailing Apps On Monday, *South China Morning Post*, <https://cdn1.i-scmp.com/sites/default/files/styles/980x551/public/2015/07/06/againstuber.jpg>, last visited 30 May 2017.
- 6 Enraged Cabbies Unite Worldwide Against Uber In 2015, *Daily Mail Online*, <http://www.dailymail.co.uk/wires/afp/article-3368482/Enraged-cabbies-unite-worldwide-against-Uber-2015.html>, last visited 30 May 2017.
- 7 Macau protesters demand legalisation of Uber as ride-hailing company set to leave city, *South China Morning Post*, <http://www.scmp.com/news/hong-kong/economy/article/2014608/macau-protesters-demand-legalisation-uber-ride-hailing>, last visited 5 June 2017.
- 8 Uber on! Ride-hailing firm performs U-turn and decides to stay in Macau, *South China Morning Post*, <http://www.scmp.com/news/hong-kong/article/2018027/uber-ride-hailing-firm-performs-u-turn-and-decides-stay-macau>, last visited 7 June 2017.
- 9 Uber suspends ride-Sharing services in Macau, *Reuters*, <https://www.reuters.com/article/us-uber-macau-idUSKBN1A20C3>, last visited July 23, 2017.

1 22 Uber Drivers Arrested in Undercover Police Operation, *South China Morning Post*, <http://www.scmp.com/news/hong-kong/law-crime/article/2095336/21-uber-drivers-arrested-hong-kong-undercover-police>, last visited 29 May 2017.

2 Five Uber Drivers Arrested in Hong Kong Sting On unlicensed Car-Hailing Services, *South China Morning Post*, <http://www.scmp.com/news/hong-kong/law-crime/article/1848726/five-uber-drivers-arrested-hong-kong-sting-unlicensed-car>, last visited 30 May 2017.

3 More Than 100 Hong Kong Taxi Drivers Protest Against Uber And Other Car-Hailing Apps, *South China Morning Post*, <http://www.scmp.com/tech/start-ups/>

## 2. Uber

Uber markets itself as a “technology platform”<sup>10</sup>, an intermediary that allows passengers and drivers to find each other via the Uber application. Using the application is simple enough; all a potential passenger needs to have is a smartphone with the Uber application installed and a valid payment method registered. The potential passenger then requests a pickup, and a nearby driver accepts the request using a ‘driver’ version of the smartphone application. Information pertaining to the driver will then be sent to the passenger, and fare is calculated at the end of the trip and charged to the passenger’s registered payment method. A confidential rating system allows passengers to rate drivers and vice-versa, to ensure a “high-quality experience” for passengers;<sup>11</sup> drivers receive weekly feedback which they can use to maintain or improve their ratings.<sup>12</sup> After each trip, the application provides the driver with the fare for the journey, and the drivers receive their money weekly via bank transfer.<sup>13</sup> Some cities allow the passenger to pay in cash at the end of the journey.

Uber itself does not own any vehicles; these are all owned by drivers. Registering to become a driver does involve some form of screening. Particular requirements vary from country to country, but generally, potential drivers have to provide their driver’s license, vehicle registration, proof of insurance and other information.<sup>14</sup> In some countries like the US, registration involves an additional background check which reviews the potential driver’s criminal record, prior traffic violations and licensing history, with the checks performed by a third party.<sup>15</sup>

### 2.1. The sharing economy

Uber is just one of the many companies that play a part in the sharing economy. The sharing economy, or collaborative economy, is “an

economic system in which assets or services are shared between private individuals, either free or for a fee, typically by means of the internet.”<sup>16</sup> The main difference, at least in theory, between the traditional economy and the sharing economy seems to be that the traditional economy is based on owning property and/or goods and services, while the sharing economy is built around accessing, or sharing the use of such property and/or goods and services.<sup>17</sup>

Take one of the more popular players in the sharing economy, AirBnB,<sup>18</sup> for example. When a user places a booking for a stay at a property owner (a ‘host’)s property, the user does not legally own the property, or rent the property from the host; the host still has full access to his own property. In many cases the user does not gain full access to the entire property, only the areas which the host designates for the user’s sole or shared use.

With Uber, the passenger gains access to the use of the driver’s vehicle — but arguably, the passenger is not so much paying for the use of the vehicle as paying for the services of the driver, hiring the driver and the vehicle for a specific time frame, much like a traditional taxi service. Zipcar, a ‘car sharing’ platform, allows users to drive vehicles upon gaining access for flexible periods of time.<sup>19</sup> The user, who has to pay separately for membership and car reservation, gains access to the vehicle or vehicles according to his/her own needs, and does not otherwise own or possess any control over the vehicles. However, this too is not true ‘sharing’; it is merely a form of flexible car rental. The vehicles are owned by Zipcar, not another private individual; the users are not gaining access to another individual’s property, but rather renting a piece of property owned by the company in question, except that unlike traditional car rentals, there is no need for the user to physically visit the company’s premises to obtain a reservation.

As illustrated, the major players in the sharing economy have very little to do with sharing at all. The sharing model has been defined as one that involves “an online intermediary that acts as a market for P2P services and facilitates

10 How Does Uber Work?, UBER Help, <https://help.uber.com/h/738d1ff7-5fe0-4383-b34c-4a2480efd71e>, last visited 30 May 2017.

11 Understanding Ratings, UBER Help, <https://help.uber.com/h/300cbf58-4a59-4b41-be2d-b8d0ffe12ee7>, last visited 30 May 2017.

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13 Earnings: Get the most from driving, UBER, <https://www.uber.com/en-HK/drive/partner-app/>, last visited 20 July 2017.

14 Start Driving with Uber, UBER, <https://www.uber.com/en-HK/drive/>, last visited 20 July 2017.

15 What does the background check include? UBER Help, <https://help.uber.com/h/1bde7f02-9eb0-4111-bf29-6c984e2146ad>, last visited 20 July 2017.

16 Sharing economy, Oxford Dictionaries, [https://en.oxforddictionaries.com/definition/sharing\\_economy](https://en.oxforddictionaries.com/definition/sharing_economy), last visited 20 July 2017.

17 T. Puschmann *et al*, “Sharing economy”, *Business & Information Systems Engineering* 56/2016, 93.

18 Vacation Rentals, Homes, Experiences & Places, AirBnB, <https://www.airbnb.com/>, last visited 19 July 2017.

19 How Does Zipcar Work? Car Sharing from Zipcar: How Does Car Sharing Work?, <http://www.zipcar.com/how>, last visited 20 July 2017.

exchanges by lowering transaction costs.”<sup>20</sup> This generally involves an online platform (which does not provide services of its own) that allows users and providers to communicate and arrange transactions.<sup>21</sup> The P2P part of this definition refers to how, on most sharing economy platforms, users and providers are both private individuals (‘peers’) acting on a small scale,<sup>22</sup> unlike traditional online platforms like Amazon which involves a marketplace for business-to-consumer (B2C) transactions. Finally, sharing platforms reduce transaction costs for the individual user by implementing safety or quality guarantees, such as insurance policies, platform-wide cancellation and refund policies, reputations systems (e.g. rating systems for other users), and background checks.<sup>23</sup> This makes the potential transactions conducted through the platform safer than if the users had negotiated without platform support.

Applying this model to Uber, the Uber smartphone application acts as an intermediary between drivers and passengers, facilitating transactions by providing users with a platform with which to connect. Both drivers and passengers are private individuals operating on a small scale; the drivers do not manage a fleet of vehicles, only one, and the private individuals only make bookings for one ride at a time. Uber has a variety of guarantees for their users to facilitate a better business environment for users, for example: 24-hour customer service support from the company, a rating system for both drivers and passengers, a narrowing of potential transaction partners by geographical location, a requirement for both drivers and passengers to create an online profile before accepting or making requests for rides, and background checks for drivers.

## 2.2. Uber in hong kong

Uber has a limited range of services in Hong Kong: uberASSIST (wheelchair-friendly rides), UberX (the most affordable option), UberBLACK (a more expensive ride that comes with bottled water, cell phone chargers and a professionally-dressed driver<sup>24</sup>, usually in a luxury or high-end

car), and 7-Seater (vehicles with larger carrying capacity). Fares for different classes of rides vary, with minimum fares for each ride<sup>25</sup>, and may fluctuate according to demand.<sup>26</sup>

Localized requirements for becoming an Uber driver in Hong Kong include being above 18 years of age with a valid Permanent Identity Card, and a Full Driving license. If the driver uses their own car, a Vehicle Registration Document and valid Vehicle Insurance must also be provided. An interesting point to note is that Uber does not require the drivers to produce a Vehicle Insurance policy that also covers use for hire or reward.<sup>27</sup> Vehicles are generally required to have a minimum of four doors, to be clean and to have been manufactured within the last 10 years.<sup>28</sup>

In Hong Kong, Uber provides two additional services other than the traditional Uber setup where passengers look for drivers with vehicles and vice-versa. The first is the option for a person with a car to look for a driver, and the next option allows a person to rent a car on Uber Marketplace.<sup>29</sup> For the first option, Uber Marketplace provides a platform for drivers to advertise with a simple profile showing their name, photograph, their driver’s license classification and relevant experience: driving experience and experience driving with Uber. Users looking for drivers then contact the driver through the Uber Marketplace platform. The rental car option involves a platform where car owners with idle cars advertise their car on the page. Users then select their desired car models from the available listings, which contain relevant information about the vehicle, such as make, age,

<sup>25</sup> *Ibid.*

<sup>26</sup> Explore your options, UBER Hong Kong, <https://www.uber.com/en-HK/cities/hong-kong>, last visited 21 July 2017.

<sup>27</sup> 車輛保險 Vehicle Insurance, UBER Hong Kong, <https://www.uber.com/zh-HK/drive/hong-kong/resources/doc/>, last visited 23 July 2017.

This page contains Sample Documents for potential drivers’ reference. Under the Vehicle Insurance section, a Certificate of Insurance for a Motor Vehicle issued under the Motor Vehicle Insurance (Third-party risks) Ordinance (Cap 272) is pictured. The sample document shows a policy which only covers ‘social domestic and pleasure purposes and for the policyholder’s business or profession’, and expressly excludes use for hire or reward. In the text below this pictured policy on the website, there is no mention of requiring a different kind of third-party insurance that covers use for hire or reward.

<sup>28</sup> Vehicle Requirements – Hong Kong, UBER Hong Kong, <https://www.uber.com/en-HK/drive/hong-kong/vehicle-requirements/>, last visited 23 July 2017.

<sup>29</sup> Uber Vehicles Market, Uber Vehicles Market 2017, <https://ubersena.com/>, last visited 21 July 2017.

<sup>20</sup> V. Katz, “Regulating the Sharing Economy”, *Berkeley Technology Law Journal* 30/2015, 1067, 1070.

<sup>21</sup> *Ibid.*, 1071.

<sup>22</sup> *Ibid.*, 1073.

<sup>23</sup> V. Katz, 1075.

<sup>24</sup> Vehicle Requirements – Hong Kong, UBER Hong Kong, <https://www.uber.com/en-HK/drive/hong-kong/vehicle-requirements/>, last visited 23 July 2017.



appearance and rental price per day. This option appears to be the closest to a true 'car sharing' opportunity, as it allows car owners to generate additional income with idle assets, and allows people who only occasionally need a car to use one without having to legally own a car.

### 2.3. "Car sharing" in hong kong

Hong Kong is also home to several other Uber-style services, including GoGoVan,<sup>30</sup> Ryde<sup>31</sup> and Hopsee.<sup>32</sup> GoGoVan is an online van hiring service. Ryde is a Singapore-based application based on carpooling, and Hopsee is a Hong Kong-based application that allows users to share taxi rides. These less controversial names may spark less debate than Uber, as they are not necessarily part of the recently-developed sharing economy.

While not a part of the sharing economy, taxis in Hong Kong also have their own smartphone applications, which generally allow taxis subscribed to the application to be matched with potential passengers looking for rides in the general vicinity.<sup>33</sup> Unlike Uber-style applications, these taxi applications charge the drivers a fixed subscription fee without dealing with individual driver-passenger transactions; in effect, these are the same as traditional taxi radio channels.

## 3. The current law in Hong Kong

### 3.1. Taxi regulations

At present, taxis are motor vehicles that are licensed as such under the Road Traffic Ordinance (Cap 374).<sup>34</sup> 'Motor vehicle' refers to any mechanically propelled vehicle under the Road Traffic Ordinance.<sup>35</sup> By this definition, private cars, motorcycles, motor tricycles, light buses and goods vehicles are all considered motor vehicles, and this excludes vehicles that are propelled by pedals, including but not limited to bicycles, rickshaws and multi-cycles.

### 3.2. hire car permits

In the Uber crackdowns, the drivers were found to be operating in contravention of Section 52 (3) of the Road Traffic Ordinance:

*'No person shall— (a) Drive or use a motor vehicle; or (b) suffer or permit a motor vehicle to be driven or used, for the carriage of passengers for hire or reward unless... [omitted] (iii) a hire car permit is in force in respect of the vehicle.'*

On the surface, the drivers could have been operating legally if they had applied, and been successful in their application, for a hire car permit. At present, there are several categories of hire car permits for different types of services that exist in Hong Kong: hotel, tour, airport, school and private hire car services.<sup>36</sup> Section 19(1) of the Road Traffic (Public Services Vehicles) Regulations (Cap 374D) grants the Commissioner the power to limit the maximum number of hire car permits that may be issued, which is put into effect by the Hire Car Permits (Limitation on Numbers) Notice (Cap 374L). The Road Traffic (Public Services Vehicles) Regulations' power in turn stems from sections 7 and 14 of the Road Traffic Ordinance. Specific requirements exist for every category of hire car permit.<sup>37</sup>

#### 3.2.1. HOTEL HIRE CAR SERVICES

For an application to be successful, the registered owner of the car must either be the proprietor of the hotel (in which case the hotel shall be the applicant)<sup>38</sup>, or the owner must be able to produce written approval from the hotel proprietor or manager that a hotel hire car service will be provided exclusively for that hotel.<sup>39</sup> In the application, matters pertaining to the hotel's operations, such as its location, the number of bedrooms, the general standard of service will be taken into account in determining the existence of a reasonable requirement for such a service.<sup>40</sup> The number of hotel car hire service permits are limited to 400.<sup>41</sup>

#### 3.2.2. TOUR HIRE CAR SERVICES

Similarly in this case, the registered owner of the car must either be the tourist agent, with

30 Van Hire Platform, GoGoVan Hong Kong, <https://www.gogovan.com.hk/en/>, last visited 30 July 2017.

31 RYDE | World's First Real-Time Carpooling App, RYDE, <http://www.rydesharing.com/hk/home/>, last visited 30 July 2017.

32 HOPSEE | Hong Kong's Ride Sharing Community, HOPSEE, <http://www.hopsee.me/index-en.html>, last visited 30 July 2017.

33 J.W.Y. Chan *et al*, "Taxi App Market Analysis in Hong Kong" *Journal of Economics, Business and Management* 4/2016, 239.

34 Road Traffic Ordinance (Cap 374), Section 2.

35 *Ibid*.

36 Road Traffic (Public Service Vehicles) Regulations (Cap 374D), Reg 14(1).

37 *Ibid*, Reg 15.

38 *Ibid*, Reg 15 (1)(a).

39 *Ibid*, Reg 15 (1)(b).

40 *Ibid*, Reg 15 (1).

41 Hire Car Permits (Limitation on Numbers) Notice (Cap 374L), Para 2(b).



the permit issued to the tourist agent,<sup>42</sup> or the registered owner must produce written approval from a tourist agent that a tour hire car service will be provided exclusively for the agent.<sup>43</sup> Other factors that may be taken into account in the application include existing tour facilities for visitors in Hong Kong<sup>44</sup> and whether the applicant has the means and experience to provide visitors with a suitable standard of service.<sup>45</sup> The number of tour hire car service permits is limited to 400.<sup>46</sup>

### 3.2.3. AIRPORT HIRE CAR SERVICES

Applicants for a hire car permit for an airport hire car service must be the registered owner of the private car, and produce written approval from the Airport Authority to provide an airport hire car service.<sup>47</sup> The permit will only be issued after taking into consideration factors such as the existing facilities for persons travelling to and from Hong Kong International Airport, either to depart from or arrive in Hong Kong by air.<sup>48</sup> In the Road Traffic (Public Services Vehicles) Regulations, 'by air' is expressly stated, which implies that existing facilities for persons travelling to and from the Hong Kong International Airport for reasons other than to travel by air (e.g. for work or other purposes) will not be taken into account.

The exclusivity requirement in this category is somewhat relaxed; Reg 15 (3)(b) states: 'No other type of hire car permit shall be issued in addition to a hire car permit for an airport hire car service in respect of the same private car without further approval in writing of the Airport Authority.' This seems to mean that other types of permits *may* be issued to the same car if the Airport Authority provides express approval for such a service to be provided. The number of airport hire car service permits is limited to 60.<sup>49</sup>

### 3.2.4. SCHOOL HIRE CAR SERVICES

In addition to the requirement that the permit may only be issued to the registered owner of the private car,<sup>50</sup> to provide a school hire car service, the applicant's car has to be licenced to carry

7 passengers.<sup>51</sup> Like the other categories, the applicant must also be able to prove that there is a need for the proposed service to specified school or schools by producing written approval from the head(s) of school(s) mentioned in the application.<sup>52</sup> The number of school hire car service permits is limited to 1500.<sup>53</sup>

### 3.2.5. PRIVATE CAR HIRE SERVICES

For a private hire car service, the applicant has to be the registered owner of the private car.<sup>54</sup> Factors that may be taken into consideration include: the extent of public transport services in the area in which the applicant proposes the operation of a private hire car service,<sup>55</sup> reasonable demonstration by the applicant that there is a requirement in the proposed area for a private hire car service,<sup>56</sup> and the availability of a suitable (as deemed by the Commissioner) area to park the private car when it is available for hire.<sup>57</sup> The number of private hire car permits is also limited to 1500.<sup>58</sup>

The requirements for the 5 different categories of hire car permits share 2 main things in common: necessity and exclusivity. In each category the applicant must show that there is a reasonable requirement for the proposed service; in the hotel, tour, airport and school categories, reasonable requirement is relatively simple to prove from the view of the applicant; the applicant merely needs written approval from the parties who will be having an important interest in the proposed service.

However, in the case of a private hire car service, there are no guidelines or suggestions as to how the applicant may demonstrate reasonable requirement for the service in the proposed area of operations. It is also unclear as to what the level of reasonable requirement may be, and the Commissioner is given a wide margin of discretion to decide whether there may or may not be a need for the service, as in addition to the demonstration by the applicant, the Commissioner may also, on his own, evaluate the proposed area in terms of availability of public transport, and evaluate the 'suitability' of

42 *Ibid*, Reg 15 (2)(a).

43 *Ibid*, Reg 15 (2)(b).

44 *Ibid*, Reg 15 (2)(i).

45 *Ibid*, Reg 15 (2)(ii).

46 Hire Car Permits (Limitation on Numbers) Notice (Cap 374L), Para 2(e).

47 *Ibid*, Reg 15 (3)(a).

48 *Ibid*, Reg 15 (3)(a)(i) and (3)(a)(ii).

49 Hire Car Permits (Limitation on Numbers) Notice (Cap 374L), Para 2(c).

50 *Ibid*, Reg 15(4).

51 *Ibid*, Reg 15 (4)(a).

52 *Ibid*, Reg 15 (4)(b).

53 Hire Car Permits (Limitation on Numbers) Notice (Cap 374L), Para 2(d).

54 *Ibid*, Reg 15 (5).

55 *Ibid*, Reg 15 (5)(a).

56 *Ibid*, Reg 15 (5)(b).

57 *Ibid*, Reg 15 (5)(c).

58 Hire Car Permits (Limitation on Numbers) Notice (Cap 374L), Para 2(a).

the proposed parking spot for when the private car is for hire.

Aside from the limit on the number of permits that may be issued, all three of these factors pose problems for any (hypothetical) Uber driver wishing to apply for a private hire car permit. As the area of operations will vary depending on the presence of passengers wishing to use the service, an Uber driver will not have a fixed area of operations. The whole concept of Uber is that drivers are able to pick up passengers in the vicinity; the area of operations depends on the location of the vehicle at that particular time.

Suppose an Uber driver, 'A', whose permanent address is in the New Territories, has a valid car hire permit which allows him to operate in the New Territories. A has a full-time job in Central, and during his after-work commute from Central to the New Territories, he receives several requests on his Uber application requesting rides from Central to New Territories. If A accepts these requests, he could share the cost of his commute with other people headed in the same direction and contribute to reducing congestion on the roads and other forms of public transport by sharing the ride. However, since his permit only allows him to operate in the New Territories, A cannot pick up any passengers until he returns to the New Territories, where he will be able to ferry passengers to and from different places within the New Territories. Already this severely limits A's ability to turn an after-work commute into an opportunity to make additional income, and this frustrates his original motives for ride-sharing — to utilize his resources efficiently.

The above example illustrates how the requirement for having a limited area of operations is difficult to comply with for an Uber driver. In the Hong Kong context, the entire city is geographically limited, and many people, especially those who own cars, live and work in different parts of the city. The concept of the sharing economy is that property that was previously idle, or otherwise not fully utilized, can be used as a means of generating secondary income for the owner. If the property so happens to be idle in an area in which the owner cannot generate secondary income from it, this would be detrimental to the owner, as well as potential passengers that may be looking to get a ride in that area.

However, if zero geographical limitations were imposed, this could quite possibly lead to over-congestion in the busiest parts of the city, and insufficient rides for those in more rural areas. Referring to the Regulations and how each

category requires the applicants to demonstrate a reasonable requirement for proposed services, it is quite probable that the reason behind this requirement is to reduce congestion on the roads by not allowing vehicles for hire to operate in areas where there is no need for such services.

#### 4. Ways to regulate Uber

The main dilemma faced by legislators seems to be that the new 'car sharing' platforms need to be regulated in a way that balances the need to create a favorable business environment for the companies and individual consumers in a growing sharing economy, while protecting traditional interests such as those of taxi drivers, and controlling traffic congestion in a geographically small city.

At present, the practical impossibility for an Uber driver to be operating legally appears to only benefit the existing taxi services in Hong Kong. The existing services hold what is effectively a monopoly over the provision of such services, and the market is highly controlled in terms of numbers — there are 18,163 taxis in Hong Kong and the Transport Department is not currently issuing new taxi licenses. Fares for the three different operating areas vary.<sup>59</sup> These problems arising from conflicting interests of car sharing platforms and traditional taxi services are not unique to Hong Kong. Indeed, many other countries have, in their own ways, dealt with Uber-style platforms, through different forms of regulation. The latter half of this paper aims to examine some of these regulatory approaches with regard to licensing, and discuss whether these approaches can be applied to the Hong Kong situation.

##### 4.1. Enforcing current legislation or bans

The first Uber drivers currently operate illegally, as discussed earlier in this paper. One form of regulation would involve keeping these activities illegal, either by enforcing current legislation or by banning the company from operating in the region entirely.

An example of the first option would be the situation in Macau; authorities adhered strictly to the existing legislation, with legislators refusing to change or discuss changes in order to protect the taxi industry from competition. After the announcement in July 2017 that Uber was going

<sup>59</sup> Taxi Operating Areas, Transport Department, [http://www.td.gov.hk/en/transport\\_in\\_hong\\_kong/public\\_transport/taxi/index.html](http://www.td.gov.hk/en/transport_in_hong_kong/public_transport/taxi/index.html), last visited 23 July 2017.

to suspend its services for a second time since entering the Macau market, some claimed that the government was under pressure to protect the traditional taxi industry.<sup>60</sup>

The second option can be illustrated by what happened in Italy in April 2017: The Uber application was banned in Italy by a court in Rome, giving the company ten days to stop operating, promoting and advertising its applications in the country. The application was said to have an unfair advantage over traditional taxi drivers for being able to purchase less expensive small town licenses and using them to work in cities alongside regular taxis.<sup>61</sup> However, less than two months after the ban, part of the ban was lifted for the UberBlack service, but not the main version of the application.<sup>62</sup>

The main rationale for not allowing Uber-style applications to operate legally appears to be to protect the interests of the taxi industry, an industry with significant barriers to entry on its own. In 2013, Hong Kong taxis combined with licenses reached a record price of HK\$ 7.66 million.<sup>63</sup> Not all owners are taxi drivers; many view the licenses as an investment. If demand for taxi services falls, and taxi drivers leave the industry, the licenses lose their value, which affects the investors. Taxis are also subject to stringent requirements — those who do not own their vehicle and license have to pay daily rental fees, taxis may only pick up and drop off passengers in designated areas, taxis are legally required to perform frequent checks on their vehicles and most taxis are subject to pre-defined operating areas, in contrast with Uber drivers, who have low operating costs and almost no restriction on where they can operate. Ubers have a competitive advantage over taxis as they operate illegally, while having lower costs and very low barriers to entry, as discussed earlier.

There is also the issue of congestion; there is a reason why taxis are limited in number, and it is the same as the reason for which hire car permits are limited in number. Hong Kong is a geographically small place with an efficient public transport system and an already overloaded road network, and legalizing Uber services will only lead to more people joining the market as drivers, increasing congestion on roads, especially during peak hours in the city center. However, banning the operations of ride-sharing companies outright would result in the up-and-coming industry to close without dissipating the demand for the service. As the service is currently illegal, there must be a significant demand for rides and a significant driver base willing to offer such rides for extra income. The same can be said for other gaps in services that sharing economy might be able to fill. Banning may have far-reaching consequences, such as making Hong Kong an unfavorable location for other similar businesses to invest in.

#### 4.2. legalization

Across the border, the central authorities in Beijing issued the *Interim Measures for the Administration of Online Taxi Booking Business Operations and Services*<sup>64</sup>; departmental rules issued by several State departments that legalized online ride-sharing services by allowing them to operate with a Certificate of Online Ridesharing Service and after registering at local departments of communication for internet information services. Other requirements for vehicles operating with ride-sharing platforms were also included, as well as some provisional requirements for ride-sharing platforms and standards for drivers and vehicles.<sup>65</sup> The rationale for the new departmental rules, provided for in Article 1:

*"In order to better satisfy the diversified travel demands of the public, promote the integrated development of the taxi industry and the Internet, regulate online taxi booking business operations and services, and safeguard the operation safety and the lawful rights and interests of passengers... [omitted]"*

The same arguments for legalizing ride-sharing exist in Hong Kong. It is undeniable that the-

60 Ride-Sharing giant Uber to suspend service in Macau, South China Morning Post, <http://www.scmp.com/news/hong-kong/economy/article/2102917/ride-sharing-giant-uber-pull-out-macau>, last visited 23 July 2017.

61 Uber banned in Italy nationwide after court rules app provides unfair competition to taxi drivers, The Independent, <http://www.independent.co.uk/news/business/news/uber-italy-ban-app-taxi-driver-unfair-competition-court-ruling-decision-trade-unions-legal-action-a7677881.html>, last visited 23 July 2017.

62 Italian court lifts Uber ban, The Local, <https://www.thelocal.it/20170526/italian-rome-court-lifts-uber-black-ban-taxis-app>, last visited 23 July 2017.

63 Hong Kong taxi licenses hit record high of almost US\$1m, South China Morning Post, <http://www.scmp.com/business/money/markets-investing/article/1294823/hong-kong-taxi-licences-hit-record-high-almost-us1m>, last visited 23 July 2017.

64 Ministry of Transport, the Ministry of Industry and Information Technology, the Ministry of Public Security, the Ministry of Commerce, the State Administration for Industry and Commerce, the General Administration of Quality Supervision, Inspection & Quarantine, and the Cyberspace Administration of China, Order No. 60/2016.

65 China Gives Green Lights To Ridesharing Services – TMTPost – Medium, Medium, <https://medium.com/@TMTpost/china-gives-green-lights-to-ridesharing-services-ed1e6610f3dd>, last visited 25 July 2017.

re is now a demand for a service that allows people to hail rides with a smartphone connected to the Internet rather than calling taxi operators or hailing a taxi from a taxi stand. If the operations of such services are carried out legally, the government will be able to regulate the businesses' safety or quality standards; the platforms and drivers will be subject to control by the government, instead of allowing the platforms to self-regulate their activity.

Legalizing Uber-style ride-sharing applications may also promote healthy competition with traditional taxis, who now have what is essentially a monopoly over the market. Data compiled by the Hong Kong Transport Complaints Unit under the Transport Advisory Committee shows that there are some problems with the overall standard of taxi services in Hong Kong. In the first quarter of 2017, the Transport Complaints unit received a total of 2410 complaints pertaining to taxi services, of which over 600 were for refusing hire, and almost 450 were for improper behavior.<sup>66</sup> Previous data also showed that complaints and suggestions for taxis had been increasing, in addition to being the mode of public transport with the most complaints: in 2015 there had been 10,359 complaints and suggestions made towards taxis (29.52 cases per million passenger journeys), while the category with the second highest number of complaints, franchised buses, had 5,738 complaints and suggestions (4.02 cases per million passenger journeys).<sup>67</sup> As taxi fares are regulated by the Transport Department, the only way for taxis to be able to keep up with the competition if ride-sharing applications are legalized would be to improve their services.

#### 4.2.1. CASE STUDY: CHICAGO, ILLINOIS, USA

Referring to the earlier discussions of obtaining hire car permits, the general approach in Hong Kong appears to be based on enforcing the existing legislation with respect to the drivers; the current law requires drivers to be holders of a specific permit, much like the system for taxis and other vehicles for commercial hire.

However, the need for platforms to have barriers to entry into the market is often overlooked. Requiring platforms to obtain a certain license to operate their own ride-sharing businesses allows the authorities to control the growth of the industry and also monitor the operations of such platforms. One such jurisdiction that regulates ride-sharing platforms

in this manner is the City of Chicago, Illinois, in the United States: the platforms (transportation network providers, according to Chapter 9–115 of the Municipal Code of Chicago) are to apply for one of two different license classes according to their average weekly hours of operation.<sup>68</sup> The two classes, Class A for an average of less than 20 hours of weekly operation<sup>69</sup> and Class B for more than 20 hours of average weekly operation,<sup>70</sup> charge different annual fees; Class A licenses cost less than half that of a Class B license.<sup>71</sup>

Standards for vehicle inspections also differ for the two classes of licence; Class B vehicles are held to a higher standard and are expressly required, by the ordinance, to pass a minimum of 21 inspections (22 if the vehicle is wheelchair-accessible),<sup>72</sup> while Class A vehicles are only required to pass regular vehicle inspections similar to the ones for private vehicles.<sup>73</sup> Requirements for becoming a Class B platform's driver are also higher than one for a Class A platform driver; the former needs to have a restricted public chauffeur license,<sup>74</sup> while the latter requires no such license, but is still required to satisfy some other requirements pertaining to a training program for transportation network drivers,<sup>75</sup> the driver's criminal<sup>76</sup> and vehicle offences<sup>77</sup> records, among others. Class A transportation network providers are required to ensure that the requirements for drivers are met,<sup>78</sup> whereas a public chauffeur license is issued by the city as a separate part of the Municipal Code of Chicago.<sup>79</sup>

Not all legal requirements vary between classes, however. The legal requirement for insurance is uniform, and the minimum coverage from the insurance policies that the platform (or license holder) required to take out is expressly stated by law.<sup>80</sup> Other requirements that are constant between classes include the qualifications for being a transportation network provider and requirements for the vehicles.

68 Chicago, Illinois, Code § 9–115–030(a) (2014) .

69 *Ibid*, (a)(1).

70 *Ibid*, (a)(2).

71 Chicago, Illinois, Code § 9–115–040(a)(i), (a)(ii) (2014).

72 Chicago, Illinois, Code § 9–115–110(b) (2014).

73 Chicago, Illinois, Code § 9–115–110(a) (2014).

74 *Ibid*, (a) (2014).

75 *Ibid*, (b)(1)(iv).

76 *Ibid*, (b)(1)(v).

77 *Ibid*, (b)(1)(iii).

78 *Ibid*, (b)(2) — (4).

79 *Ibid*, (a).

80 Chicago, Illinois, Code § 9–115–090(c) (2014).

66 Transport Advisory Committee, *Transport Complaints Unit*, Quarterly Report No. 1/2017, 33.

67 Transport Complaints Unit Report 2015.



The above is an example of how tiered regulations can come into play when regulating Uber-style platforms. At present, Hong Kong Uber drivers only have one permit option available to them (assuming it is possible to obtain one), which assumes that all private hire drivers act in a similar capacity. In reality, most Uber drivers are employed full-time, and only drive for Uber as a way to generate additional income. If all drivers were required to apply for the same permit it would act as a deterrent to entering the industry, as the costs would be too high for a driver who only intends to work a few hours a week.

Introducing tiered licenses for platforms which act in different capacities avoids the situation where the average driver is barred from the opportunity to earn extra income from driving and picking up passengers in his spare time because of the costs required to obtain a valid permit. The platform pays for the permit, and is placed in charge of selecting potential drivers according to the requirements stipulated by law.

In the case of Chicago, vehicles and drivers which operate longer hours are subject to more stringent requirements. The license fees are different, possibly because the city wishes to deter network providers from allowing drivers to operate for too many hours a week, but does not discourage part-time drivers, or the city aims to subject network providers who act in the same capacity as taxis to similar requirements as taxis, reducing the competitive advantage ride-sharing companies hold over traditional taxis. The safety concern that a driver with little to no commercial driving experience can be allowed to carry passengers almost full-time is also avoided by requiring that all Class B drivers be licensed by the city to do so. Placing the burden of ensuring that Class A drivers meet statutory requirements on the platform also prevents the administrative offices from being overloaded with applications from individual drivers.

As the primary concern of most jurisdictions is the negative impact ride-sharing platforms have on the traditional taxi industry, using tiers based on average weekly hours of operation also encourage the platforms to control the number of hours each driver can work per week. This discourages people from becoming full-time drivers under a network provider as a 'back-door' to entering the taxi industry.

## 5. Suggestions

### 5.1. stakeholder interests

In order to introduce, or even suggest, effective and useful regulations for ride-sharing platforms and their drivers, there are several main stakeholder groups whose interests need to be taken into consideration.

#### 5.1.1. TAXI INDUSTRY

The taxi industry consists of taxi drivers, taxi vehicle and license owners, and other entities involved in the industry, such as taxi radio channel operators and applications. The increased competition from ride-sharing platforms, particularly Uber, affect the industry as a whole. As discussed earlier in this paper, taxi drivers in Hong Kong and around the world are concerned that Uber-style applications are unfair competition as their drivers face fewer barriers to entry than traditional taxi drivers; they have been able to avoid the stringent legal requirements and high costs that taxi drivers face by operating 'outside' the law.

Decreased patronage could very well set off a chain reaction: as taxi drivers' incomes fall, more drivers leave the industry, or are unable to keep up with the costs of renting taxi vehicles and licenses; the attractiveness of taxi licenses as a stable investment option will decrease, driving down the values of licenses. The main concern here would be to protect the industry from being driven obsolete by ride-sharing applications, while at the same time improving the competitiveness of taxi services.

#### 5.1.2. PLATFORMS

Platforms that have an interest in potential changes or additions to legislation include existing ride-sharing platforms in the Hong Kong market, platforms that do not currently have operations in the Hong Kong market, as well as other sharing economy-based platforms that involve services other than ride-sharing (such as AirBnB).

Regulation allows existing platforms to grow, introduce more services into the market (for example, Uber introducing different service options, such as Uber 7-seater and UberPOOL). The existence of sound, sharing economy-friendly legislation would make the city a favorable place for sharing economy investment, attracting other platforms to set up regional offices in Hong Kong, in line with the principle that the Hong Kong Government should provide 'an economic and legal environment for encouraging investments,

technological progress and the development of new industries.<sup>81</sup> Consumers also benefit from this; there would be a larger selection of services on the market to choose from, with different firms competing with each other, forcing service providers to become more competitive whether in terms of price or quality.

### 5.1.3. DRIVERS

Drivers for ride-sharing platforms' main concern would be to safely generate income, whether full-time or additionally, although there should be limitations on different elements such as hours of operation, eligibility of potential drivers and the number of drivers operating in the city. If their activity is to be legalized, drivers also need protection from consumers in different situations; whether the existing law on this matter is sufficient will be a matter subject to further debate. As far as the drivers are concerned, they are operating a service that is different from traditional public transportation, or existing private hire cars, and should be treated as such by the law. This needs to be balanced with taxi industry interests to not be subjected to unfair competition.

### 5.1.4. CONSUMERS

Consumer interests include the freedom to choose to bring their patronage to whichever ride-provider they wish. The existence of demand on the market shows that the service is a required one, and that there are gaps in the market that can be filled by ride-sharing applications. As mentioned earlier, it also highlights the fact that there are problems with the taxi industry that make traditional taxi services unattractive to consumers. Issues that concern consumers that may affect potential reforms to legislation include the degree of consumer protection that may be granted by law. In addition to protection during transactions, vehicle and driver requirements also contribute to the protection of consumer interests in terms of consumers' personal safety while riding with ride-sharing platforms.

<sup>81</sup> The Basic Law of the Hong Kong Special Administrative Region, Article 118. The Basic Law, which came into effect on 1 July 1997, is the constitutional document for the Hong Kong Special Administrative Region, adopted by the National People's Congress of the People's Republic of China (PRC). The relevant Article provides: "The Government of the Hong Kong Special Administrative Region shall provide an economic and legal environment for encouraging investments, technological progress and the development of new industries."

For further reading on the Basic Law, please visit: <http://www.basiclaw.gov.hk/en/>.

## 5.2. possible changes to legislation

### 5.2.1. PLATFORM LEGISLATION

One possible way to subject ride-sharing platforms to further control would be to create a category of licenses for ride-sharing platforms, much like the example of the Municipal Code of Chicago's regulations governing transportation network providers.

An important consideration for legislators here is the number of licenses that can be issued to platforms. If the allowed numbers are too few, there would be an effective oligopoly with several large companies dominating the industry, affecting the quality and competitiveness of the services, much like the taxi industry. Yet the geographical area of the Hong Kong Special Administrative Region would not be able to accommodate a large number of platforms, each with their own fleet of vehicles. Issuing licenses according to different categories — or classes — of platform might be the answer to several concerns of different stakeholders. Categorization by hours of operation can be used to discourage platforms from allowing their drivers to work for long, regular periods of time as one would at a full-time job. This retains the spirit of ride-sharing — of making extra cash with an idle asset — without posing an immediate threat to traditional taxi services. The impact on taxi drivers' income is lessened, congestion in the busier parts of the city can be controlled, and allows drivers seeking extra income to fill in the gap in the market and cater to consumers' demands.

### 5.2.2. USER REGULATION

The main issue with drivers connected to Uber-style applications is that they currently operate illegally as they are unable to obtain valid Private Hire Car Permits. There are two broad options (other than banning the service entirely) to solve this matter: (1) allow anyone to be an Uber driver, or (2) allow them to obtain a permit. The first option is both impractical and impossible; without some sort of licensing system there would be no way to guarantee that drivers meet a certain quality standard throughout the industry. The second option splits into two paths: should the drivers be made to obtain (1) an existing permit or (2) a newly-created one? The first option again splits in two; the drivers can either be required to obtain a private car hire permit or a taxi license.

### 5.2.2.1. Hire car permit

At present, Hire Car Permits are impossible to obtain for Uber drivers because there is a limitation on numbers and there are no more new licenses to be issued, although even if the quota had not been exhausted, it would still be impossible for drivers for ride-sharing platforms to obtain a permit as they would not be able to produce the necessary information required to process an application for a permit. The information requirement could be altered to include drivers for ride-hailing platforms, but that would affect existing Hire Car Permit owners by forcing private hire cars to be affiliated with an application or platform, instead of being fully private.

### 5.2.2.2. Taxi license

If the ride-sharing vehicles are treated as taxis and made to obtain taxi licenses, this would pose some problems; the authorities would have to issue new taxi licenses, and this would affect the values of the existing licenses and negatively impact both taxi drivers and license owners. Allowing ride-sharing vehicles the same pick-up rights as traditional taxis would directly affect the patronage of individual taxis, and since taxi fares are set by the government, a ride-sharing vehicle cannot be registered as a taxi by default as their fares are decided by the platform.

The only logical conclusion is to create a new category of license for drivers that is neither the hire car permit nor the existing taxi license. This is also similar to the Chicago Municipal Code's transportation network driver license discussed earlier in this paper. This new category should require the drivers to be affiliated to a platform; if no platform is involved, the driver would be the sole operator of the service, and that would make it a private hire car service. Having a special license to operate a ride-sharing vehicle would also allow the driver to be easily traceable by the passenger if so required.

Legislators can either force all drivers to obtain licenses, or, like the Chicago Municipal Code, allow the lower tier drivers to operate without a special license. However, in a geographically limited city like Hong Kong, the number of drivers that can act as a ride-sharing driver should be limited by the government, instead of being left to the platform to decide. Even if each driver only works a few hours a week, this would greatly affect the already congested roads of the city. However, this would

also deter many people entering the industry due to the hassle and cost of obtaining a license before any extra income can be made.

Alternatively, the platforms can be allowed to self-enforce the regulations. Rather than having to process individual driver applications at the Transport Department, the legislation can place the burden of ensuring that the regulations are followed on the platform. In turn, the platform operates in line with the regulations, providing insurance, registering the drivers for a license and making sure that vehicles comply with statutory requirements. The platform can also be used to limit the number of hours an individual driver may work per week. A major downside to this is that the platform will become too restrictive and lose its original appeal for being a flexible way to generate additional income with idle vehicles.

## 6. Conclusion

The ride-hailing platform Uber has sparked controversy in recent years both in Hong Kong and worldwide. In Hong Kong it made headlines on a few separate occasions when several Uber drivers were arrested after an undercover sting operation; the drivers had been operating without a valid hire car permit and without valid third party insurance.

With Uber's drivers being unable to obtain hire car permits as the government is no longer issuing new permits — and applications for permits involve presenting information such as intended service area and proof that the area in question requires such a service to exist — drivers operate illegally in Hong Kong.

Two ways of regulation were identified: enforcing current legislation and legalization. Keeping the activity illegal would protect the interests of one party (i.e. taxi industry as a whole) without benefiting other stakeholders, while legalization would negatively impact the taxi industry but bring benefits to the other stakeholders. Legislators must balance the needs of the different parties. One might argue that the taxi industry involves too many full-time jobs to be put at risk. Yet there are many problems concerning the quality of services that may have contributed to the rise in demand for alternatives to taxi services.

A case study was used as an example of how legalization might be carried out. The Chicago Municipal Code uses tiered regulations

to distinguish between networks that allowed drivers to act part-time, and networks that allowed almost full-time operation, similar to a taxi. Those who acted similar to a taxi were expected to be professional, with city-issued licenses, while those who acted part-time did not require licenses, and had their requirements checked by the network instead of the government.

Similar legislation may be introduced in Hong Kong. However, allowing platforms to decide, on its own, how many drivers (albeit part-time drivers) it can hire does not seem applicable in Hong Kong due to the geographical constraint, although one might also argue that if the government were to decide how many individual

drivers could operate, it would take away the flexibility that attracts drivers to the platform in the first place.

Other factors also need to be taken into account by legislators; namely, public interest. It can be argued that a great part of Hong Kong does not require additional taxi-like services as there already exists a convenient public transport system. Improving the traditional taxi services may very well be more environmentally-friendly than allowing fleets of vehicles to roam the streets in competition with traditional industries. For now, Uber's fate is still uncertain; will it remain illegal, or will it pave the way for reform?



# SAFEGUARDING UBER'S INVESTMENTS IN ARGENTINA

**Lam, Oliver Hiu-Fung**

*This thesis will start by discussing Uber's legal issues in the country of Argentina and subsequently analyze all of the elements necessary to bring a claim under investment law. In doing so, it will identify the arguments which Uber can cite, to successfully sue the Argentine government, as well as their weaknesses. It will then end by giving recommendations as to how Uber can consider investment law principles when planning out its future business strategy.*

Key words: Uber – sharing economy – regulation – international investment law principles

## 1. Introduction

### 1.1 Uber and the sharing economy

As an old concept currently being re-popularized by millennials and members of generation Z, the sharing economy challenges the notion of self-ownership with the intention of maximizing the value of our unused belongings.<sup>1</sup> This, in turn, helps to establish an economy which is more efficient, environmentally friendly and prevents overconsumption while improving the quality of life for impecunious individuals.<sup>2</sup>

Uber is a shining example of a company which has facilitated the functions of these ideals through its platform which allows over a million drivers worldwide to get more out of their cars by providing private transportation services on their own time.<sup>3</sup> Furthermore, as Uber's platform prescribes fares to potential riders prior to acceptance and payment, consumers also benefit in that they now have a more convenient and certain alternative to taxis.<sup>4</sup>

### 1.2. The importance of investment law in the sharing economy

Law is a continuous conversation within a society concerning what it values and prioritizes. Having said this, it is estimated that by 2020, 40% of the entire workforce in America alone will become freelance workers, proving convincingly that platforms like Uber will continue to grow in popularity and transpire in droves.<sup>5</sup> In turn, international investments made by newly emerging, sharing economy based companies, will become a major source of economic growth as they create jobs, stimulate the development of infrastructure, introduce competition, and nurture innovation and human progress.<sup>6</sup> Unsurprisingly, however, competitors in the transportation industry have persistently lobbied to oust Uber from their communities, pushing many governments to pass stricter regulations with the aim of protecting their domestic markets.<sup>7</sup> In light of these considerations, companies like Uber can harvest the potential of the sharing economy by drawing upon international investment law principles to protect their business interests abroad.<sup>8</sup>

## 2. Case facts

### 2.1. Background on uber in argentine market

Argentina is one of 49 countries to hold a BIT with America meaning, the application of investment law principles is crucial to Uber's modus operandi as it can potentially protect and enforce its investment rights in 48 other

1 The Economist, The rise of the sharing economy: On the internet, everything is for hire <https://www.economist.com/news/leaders/21573104-internet-everything-hire-rise-sharing-economy>, (March 9, 2013).

2 Ibid.

3 Kia Kokalitcheva, Fortune, Uber Now Has 40 Million Monthly Riders Worldwide <http://fortune.com/2016/10/20/uber-app-riders/>, (March 9, 2013)

4 Luz Lazo, The Washington Post, Uber turns 5, reaches 1 million drivers and 300 cities worldwide. Now what? [https://www.washingtonpost.com/news/dr-gridlock/wp/2015/06/04/uber-turns-5-reaches-1-million-drivers-and-300-cities-worldwide-now-what/?utm\\_term=.9d4ece4ed4b3](https://www.washingtonpost.com/news/dr-gridlock/wp/2015/06/04/uber-turns-5-reaches-1-million-drivers-and-300-cities-worldwide-now-what/?utm_term=.9d4ece4ed4b3), (June 4, 2015)

5 Brendon Schrader, Fast Company, Here's Why the Freelancer Economy Is On The Rise <https://www.fastcompany.com/3049532/heres-why-the-freelancer-economy-is-on-the-rise>, (June 4, 2015)

6 Business and Industry Advisory Committee to the OECD, Why International Investment Agreements Matter, <http://biac.org/wp-content/uploads/2016/07/FIN-2016-03-IIA11.pdf>, (March, 2016).

7 Taxi drivers protest against Uber in Argentina, The San Diego Union-Tribune (June 9, 2016). <http://www.sandiegouniontribune.com/hoy-san-diego/sdhoy-taxi-drivers-protest-against-uber-in-argentina-2016jun09-story.html>.

8 Newcombe and L. Paradell, *Law and Practice of Investment Treaties – Standards of Protection*, Kluwer Law International, 2009, 1–57.

countries.<sup>9</sup> Such a tactic could potentially save them tremendous amounts of money. In following, this thesis focuses on Argentina because it is part of Latin America, one of Uber's primary targets.<sup>10</sup> Aside from being home to a 43 million person market, a large proportion of Argentina's population forms the middle class, meaning that a majority of its citizens possess strong purchasing powers.<sup>11</sup> In addition to this, Argentina is a crucial country for Uber to operate in, because, aside from there being at least one taxi for every 60 citizens, public transportation holds a notorious reputation for being unsafe and unreliable.<sup>12</sup> This, in turn, translates to a heavy reliance on car hire services, presenting an appealing business opportunity for Uber.<sup>13</sup>

Another important point to note is that foreign investments in Argentina are greatly encouraged. Due to Argentina's default on a USD 100 Billion debt in 2001, one of its top priorities has been that of attracting foreign investments to restore economic growth by increasing employment and improving the nation's productive capacity.<sup>14</sup> In addition to this, in 2015, President Macri of Argentina began to place extreme emphasis on correcting macroeconomic imbalances by severely reducing market distortions and trade restrictions, lifting capital controls, re-unifying the exchange rate, and revising economic reporting data.<sup>15</sup> This desire to attract foreign investments is further supported in that, during his first months in office, Macri's administration also began signing economic and investment cooperation agreements with countries such as Italy and France.<sup>16</sup> He has also decided to revive talks of

establishing a bilateral trade investment treaty with Brazil which previously failed in 2012.<sup>17</sup>

Furthermore, according to a Presidential decree governing foreign investment in Argentina, foreign companies may invest in the local market without registration or prior government approval, on the same terms as investors domiciled in Argentina.<sup>18</sup> They are also free to enter in mergers and acquisitions, joint ventures, and greenfield investments<sup>19</sup> with relatively few restrictions.<sup>20</sup> Aside from being highly welcoming, Argentina's recent desire for foreign investments is primarily transportation-focused.<sup>21</sup> According to its Investment report for April 2016, Argentina intended to take on additional debts with a highly ambitious view of redeveloping the infrastructure in its transportation sector starting in June of the same year.<sup>22</sup> In doing so, the Argentine government was aiming to use this development as a means of paying off its preceding international debts.<sup>23</sup>

Following this report, Uber decided to invest in Argentina, first purchasing an incorporated company and then a commercial office space where it employs local citizens and now hosts executives who regularly manage and control its operations.<sup>24</sup> It then launched in the city of Buenos Aires on April 12, 2016, receiving requests from 20,000 passengers, applications from 25,000 new drivers and a total of 90,000 app downloads in a single day.<sup>25</sup> Thus, there is no doubt about the existence of a great desire amongst local passengers seeking an alternative to taxis, and local drivers looking for autonomy, flexible work hours and additional income. In this way, Uber has revolutionized Argentina's transport

9 United States Department of State: United States Bilateral Investment Treaties. <https://www.state.gov/e/eb/ifsd/bit/117402.htm> (Last visited July 5, 2017).

10 Eric Newcomer, Bloomberg Technology, Can Uber Conquer Latin America? (October 13, 2016). <https://www.bloomberg.com/news/articles/2016-10-13/can-uber-conquer-latin-america>, (October 13, 2016).

11 Merco Press, Over half of Argentina households belong to the middle class; only to Uruguay <http://en.mercoress.com/2015/07/23/over-half-of-argentina-households-belong-to-the-middle-class-only-second-to-uruguay>, (July 2015).

12 *Ibid.*

13 *Ibid.*

14 Bureau of Economic and Business Affairs, 2015 Investment Climate Statement – Argentina <https://www.state.gov/e/eb/rls/othr/ics/2015/241462.html> (July 2015).

15 *Ibid* To clarify, market distortions pertain to events in which governing bodies intervene in markets by either creating price ceilings, price floors, or tax subsidies.

16 Patrick Archer, Invest BA, The Argentina Investment Report for April 20, 2016 <http://investba.com/2016/04/argentina-investment-report-april-20-2016/>, (April 19, 2017).

17 *Ibid.*

18 Bureau of Economic and Business Affairs, 2015 Investment Climate Statement – Argentina <https://www.state.gov/e/eb/rls/othr/ics/2015/241462.htm>, (Last visited July 2, 2017).

19 Green Field Investment, Investopedia, <http://www.investopedia.com/terms/g/greenfield.asp> (Last visited June 15, 2017) "A green field investment is a form of foreign direct investment where a parent company builds its operations in a foreign country from the ground up. In addition to the construction of new production facilities, these projects can also include the building of new distribution hubs, offices and living quarters."

20 *Ibid*, 16.

21 *Ibid.*

22 *Ibid.*

23 *Ibid*, 18.

24 VAMOS Spanish Academy, Your Guide To Uber In Buenos Aires Argentina, <https://vamospanish.com/uber-taxi-buenos-aires-argentina/>, (June 10, 2017).

25 *Ibid* 16.

industry by selling private ride-hailing services to consumers and introducing healthy competition to a community once plagued by less efficient transport services.<sup>26</sup>

## 2.2. uber case history in argentina

Although Uber's inception brought a multitude of benefits to Argentina's transportation market, taxi drivers were infuriated by its presence and began attacking the app's drivers; crimes which, for the most part, have still gone unpunished.<sup>27</sup> Government officials also responded by immediately ordering Uber to leave the country a day after its launch, claiming that it was an illegal service due to its failure to obtain taxi licenses for its drivers.<sup>28</sup> In order to encourage this, city officials cut off all credit card payments directed towards Uber, thereby forcing the company to respond by collecting payments from customers in the form of bitcoins.<sup>29</sup>

Frustrated with Uber's lack of compliance, officials then deployed police forces to arrest Uber drivers and company executives on grounds of violating Article 74 of the City's misdemeanour code because it exceeded the limits of their drivers' licenses; an offense which called for a 10-day imprisonment sentence.<sup>30</sup> When Uber executives refused to comply and continued operating the app, they were further accused of ignoring an official order for imposed closure, an action which, according to Article 73 and Article 83 of the Code Contravencional, constitutes a serious risk to the health and security to the people of Argentina.<sup>31</sup> In addition to this, the city

prosecutor also argued that Uber's controlling officer should be subjected to another 2 years imprisonment for tax evasion.<sup>32</sup> Most recently, it was found that a "mystery driver" was given a suspension of two days arrest along with a two-month driving ban.<sup>33</sup>

In spite of the Argentine government's qualms, however, a recent criminal case in October 2016 saw Judge Alberto Zaya<sup>34</sup> rule that Uber drivers were in fact involved in a legal commercial activity.<sup>35</sup> In doing so, he decreed that Uber "does not incur in any crime [nor] complicate transport in the city."<sup>36</sup> There may be administrative infringements and traffic offenses, but not crimes." He further stated that "everything [seemed] to revolve around the unhappiness of the plaintiffs in the appearance of a new competitor," and that it was only appropriate to bring a case on civil rather than criminal grounds.<sup>37</sup> Most recently, in January 2017, another Buenos Aires judge ordered Uber to be blocked<sup>38</sup> while President Macri expressed his view on the matter stating that he will continue to "support the city government's position defending taxi drivers. They are a symbol of the city and of Argentina."<sup>39</sup>

Based on the above case facts, this thesis will discuss whether or not Uber can successfully bring a claim against the Argentine government under international investment law.

26 Jordan Yahoo, Heat Street, What Uber Can Teach Us About Efficiency (March 15, 2016). <https://heatst.com/biz/what-uber-can-teach-us-about-efficiency/> accessed July 1, 22017, (March 15, 2016).

27 Valentina Iricibar, The Bubble, A Buenos Aires Judge Has Finally Ruled That Uber is Legal (October 24, 2016) <http://www.thebubble.com/a-buenos-aires-court-has-finally-ruled-that-uber-is-legal/>.

28 Christopher Woody, Business Insider, A court in Argentina has ordered a crackdown on Uber's operations <http://uk.businessinsider.com/argentina-crackdown-on-uber-2016-4>, (April 2016).

29 Pete Rizzo, Coin Desk, Uber Argentina Enlists Bitcoin Partner in Fight to Continue Service <https://www.coindesk.com/uber-argentina-bitcoin-partnership/>, (July 5, 2016).

30 Demian Bio, The Bubble, Argentina Is Taking Fight Against Uber to A Whole New Level of Ridiculousness <http://www.thebubble.com/argentina-is-taking-its-fight-against-uber-to-a-whole-new-ridiculous-level/>, (September 9, 2016).

31 Tylar Durden, Zero Hedge, Argentine Judge Orders Arrest of Local Uber Executives, Shut Down of Uber Mobile App <http://www.zerohedge.com/news/2017-01-30/argentine-judge-orders-arrest-local-uber-executives-shut-down-uber-mobile-app>, (January 30, 2017).

32 The Star Online, Argentina threatens to arrest Uber drivers, managers <http://www.thestar.com.my/tech/tech-news/2016/12/07/argentina-threatens-to-arrest-uber-drivers-managers/>, (December 7, 2016).

33 Katie McCay, The Bubble, Bad News For Uber: First Buenos Aires Driver Convicted <http://www.thebubble.com/bad-news-for-uber-first-buenos-aires-driver-convicted/>, (April 18, 2017).

34 Court of Appeals in Criminal Matters and Misdemeanors of the City of Buenos Aires, Division II, "Incidente de apelación de clausura preventiva art. 29 LPC en autos UBER SRL s/ infr. 83 CC", Docket 4790-02-CC/2016, decision dated May 5, 2016.

35 Valentina Iricibar, The Bubble What's The Deal With The Buenos Aires Court Ruling That Uber Is Legal? <http://www.thebubble.com/whats-the-deal-with-the-buenos-aires-court-ruling-that-uber-is-legal/>, (October 25, 2016).

36 *Ibid*, 26.

37 *Ibid*, 26.

38 Tylar Durden, Zero Hedge, Argentine Judge Orders Arrest of Local Uber Executives, Shut Down of Uber Mobile App' <http://www.zerohedge.com/news/2017-01-30/argentine-judge-orders-arrest-local-uber-executives-shut-down-uber-mobile-app>, (January 30, 2017).

39 Thomson Reuters, Argentina's Macri sides with taxis as Uber arrives in Buenos Aires' <https://uk.reuters.com/article/us-uber-tech-argentina-idUKKCN0XB2MG>, (April 14, 2016).



### 3. Application

#### 3.1. selection of arbitral forum

The International Center for Settlement of Investment Disputes (ICSID) should be selected as the platform to launch this claim because it possesses a number of characteristics which will be beneficial to Uber. The first is that it has 161 signatories and contracting states as of 2016, 44 of which are countries which have signed BITs with the United States, including Argentina.<sup>40</sup> Thus, the blueprint of this argument can potentially be replicated by Uber 44 times. ICSID also has the function of appointing arbitrators to oversee claims even if the parties are unwilling to do so themselves. In this way, it is tougher for the system of proceedings to be threatened by non-cooperation by the respondent.<sup>41</sup>

Another benefit is that the ICSID Convention possesses several provisions which ensure that Uber would be able to collect any damages it obtains from the proceedings.<sup>42</sup> According to Article 55 of ICSID Convention, should Uber succeed in its claim, the Argentine government would not be able to invoke sovereign immunity to prevent Uber from receiving damages.<sup>43</sup> Rather, enforcement can be made against the government's commercial assets, an option which is extremely important when considering the fact that Argentina is heavily in debt and would have difficulty offering monetary compensation.<sup>44</sup> As

part of Uber's global business strategy is to extend to other forms of transportation, they could claim for assets which aid this expansion in the form of planes<sup>45</sup> and boats.<sup>46</sup> Another option would be to enforce it against real estate where Argentine GDP is heavily focused. In addition, under Article 27, if Argentina were to disregard a potential ICSID award to Uber, America could offer diplomatic protection and bring a supporting claim.<sup>47</sup>

Finally, there is the notion of annulment. Because Uber is such an expansive company with investments to look after all over the world, ICSID will prove to be an effective option. Compared to other platforms, ICSID awards offer a greater degree of finality through the provision of Article 53 which ensures that its decisions are not subject to appeal. In other words, should Uber win an award from succeeding in the present case, the respondent will likely be unable to seek recourse through its local courts.<sup>48</sup>

#### 4. Elements of claim

In order to successfully bring a claim under international investment law, four elements must be proven, including, consent, jurisdiction, expropriation, and unfair and inequitable treatment must be established.<sup>49</sup>

#### 5. Consent

The first issue is to resolve whether the scope of consent is sufficient enough to allow for the present case to be heard through arbitration under ICSID.<sup>50</sup> This consent to arbitration between the host state of Argentina, and by the investor, Uber, is an indispensable requirement for a tribunal's jurisdiction as per ICSID Article 36 (1) and Article 25.<sup>51</sup> There are three main types of consent, namely: 1) treaty-based consent 2) consent based on domestic legislation and 3) direct agreement between the parties.<sup>52</sup>

40 International Centre for Settlement of Investment Disputes: Database of ICSID Member States, <https://icsid.worldbank.org/en/Pages/about/Database-of-Member-States.aspx>, (Last visited June 11, 2017).

41 *Ibid*.

42 Administrative Council of the International Centre for Settlement of Investment Disputes, ICSID Convention, Regulations and Rules (April 10, 2006).

43 Aceris Law, The Enforcement of ICSID Awards <https://www.acerislaw.com/enforcement-of-icsid-awards/>, (April 24, 2017).

"According to Article 55 of the ICSID Convention, laws relating to sovereign immunity from execution remain applicable, thus ratification of the ICSID Convention is not a waiver of sovereign immunity from execution. The law of sovereign immunity from execution is governed by customary international law, although many countries have enacted legislation that codifies relevant rules, and the position varies according to jurisdiction. In general, States have moved past the theory of absolute sovereign immunity from execution, to the so-called restrictive theory of sovereign immunity, according to which the execution of judgments and awards is allowed against certain assets of States' property. In particular, execution is allowed against commercial assets of States, or assets used for commercial purposes, while it is prohibited for assets of either a public nature or assets used for official or governmental purposes."

44 *Ibid*, 19.

45 Pedestrian, Yes: Uber is bringing its private jet to OZ & you can fly for free <https://www.google.co.uk/search?q=Uber+private+jet+service+australia&oq=Uber+private+jet+service+australia&aqs=chrome..69j57.8943j0j4&sourceid=chrome&ie=UTF-8>. (October 27, 2016).

46 Tom Sweetman, CNN, Uber: Transportation company turns its hand to yacht rides with UberYACHT <http://edition.cnn.com/2016/04/28/sport/uber-yacht-launches-dubai/index.html>. (April 29, 2016).

47 *Ibid*, 44,

48 *Ibid*

49 *Ibid*.

50 *Ibid*.

51 Administrative Council of the International Centre for Settlement of Investment Disputes, ICSID Convention, Regulations and Rules (April 10, 2016).

52 *Ibid*, 50.



Beginning first with treaty based consent, section 3 and 4 of the USA/Argentina BIT states that “[each] party consents to the submission of any investment dispute for settlement by binding arbitration in accordance with the choice specified in the written consent of the national or company.”<sup>53</sup> Section 3(b) further states that “once the national or company concerned has consented, either party to the dispute may initiate arbitration with the choice so specified in the consent.”<sup>54</sup> Furthermore, for the second element of consent based on domestic legislation, section 499 of Argentina’s National Civil and Commercial Code of Procedure also allows for domestic arbitral awards to be enforced in the same manner as local judgments provided that both parties have consented.<sup>55</sup>

Finally, in accordance with treaty and domestic legislation based consent, the notion of a direct agreement ties in with the consent provided by the America/Argentina BIT. According to *SPP v Egypt* (2003), offers of consent contained in domestic legislation must be perfected by an acceptance on the part of the investor, either in writing at any time prior to instituting proceedings, or by simply instituting proceedings under the platform of ICSID.<sup>56</sup> Thus, in the present case, Uber can choose to either write to the Argentine government to inform them of its consent, or it can simply commence proceedings.

### 5.1. jurisdiction

In establishing a case against Argentina, jurisdiction is crucial, for without it, the merits of the case, no matter how strong, become nullified. According to Brownlie, “objections to jurisdiction, if successful, stop all proceedings in the case, since they strike at the competence of the tribunal to give rulings as to the merits or jurisdiction of the claim.”<sup>57</sup> Having said this, determining whether the tribunal has the jurisdiction to preside over a dispute between Uber and Argentina, requires the establishment of both personal and subject matter jurisdictions.

53 United States Department of State: United States Bilateral Investment Treaties <https://www.state.gov/e/eb/ift/bit/117402.htm> (Last visited July 5, 2017).

54 *Ibid.*

55 Civil and Commercial Procedure Code (Consolidate version of 1981, as last amended by Law No. 25.561 of January 6, 2002 on Public Emergency and Currency Exchange Reform).

56 ICSID case no. ARB/84/3 1992.

57 I. Brownlie, *Principle of Public International Law*, 1998<sup>5</sup>, 479.

### 5.2. personal jurisdiction

Personal jurisdiction, also referred to as “jurisdiction *ratione personae*” must be proven by showing that an investor is both a national of a country holding a BIT with the host state as well as a signatory/state party under the dispute resolution platform that they are applying to.<sup>58</sup> Moreover, companies cannot sue their home state meaning that the investor must prove that it is of a foreign nationality in order to bring a claim. In other words, Uber would not be able to sue America, where it is headquartered, under investment law.<sup>59</sup>

With respect to natural persons, Article 25(2) (a) of the convention defines “Nationals of another Contracting State” to mean “Any natural person who had the nationality of a Contracting State other than the State party to the dispute on the date on which the parties consented to submit such dispute to conciliation or arbitration as well as on the date on which the request was registered pursuant to paragraph (3) of Article 36, but does not include who on either date also had the nationality of the Contracting State party to the dispute.”<sup>60</sup> In other words claimants must establish that they had the nationality of a Contracting State on two different dates: the date at which the parties consented to ICSID’s jurisdiction and the date of the registration of the request for arbitration.<sup>61</sup>

With this in mind, in order to prove the nationality of an investor, any one of four different sets of tests

58 Administrative Council of the International Centre for Settlement of Investment Disputes, ‘ICSID Convention, Regulations and Rules’ (April 10, 2006).

With respect to natural persons, Article 25(2) of the ICSID Convention defines “National of another Contracting State to mean: “a) Any natural persons who had the nationality of a Contracting State other than the State party to the dispute on the date on which the parties consented to submit such dispute to the conciliation or arbitration as well as on the date on which the request was registered pursuant to paragraph (3) of Article 28 or paragraph (3) of Article 36, but does not include any person who on either date also had the nationality of the Contracting State party to the dispute.” The ICSID Convention requires claimants to establish that they had nationality of a Contracting State on two different dates: the date at which the parties consented to ICSID’s jurisdiction and the date of the registration of the request for arbitration.

59 Avery Hartmans and Nathan McAlone, Business Insider, The story of how Travis Kalanick built Uber into the most feared and valuable startup in the world <http://uk.businessinsider.com/ubers-history>, (August 1, 2016).

60 Administrative Council of the International Centre for Settlement of Investment Disputes, ICSID Convention, Regulations and Rules (April 10, 2006).

61 *Ibid.*

can be applied including the 1) incorporation test; 2) corporate seat test; 3) economic activity test and 4) control test.<sup>62</sup>

The first of these tests decrees that a company's nationality will depend on the location of its incorporation.<sup>63</sup> According to the case of *Tokios Tokelés v Ukraine*, it was held that a business enterprise established under the laws of Lithuania was considered to be a foreign investor despite 99 percent of its shares being owned by Ukrainian nationals.<sup>64</sup> A majority of the tribunal also found this to be a genuine incorporation because the claimant did not create *Tokios* with the specific purpose of gaining access to Lithuania as the enterprise was found six years before it even formed a BIT with Ukraine.<sup>65</sup> In all, Uber is able to satisfy this test because it was incorporated in America in 2009 and did not create its company with the singular aim of entering Argentina.

As a small modification from the test of incorporation, the corporate seat test considers whether the company has its seat in the territory of one of the contracting states.<sup>66</sup> Uber passes this test as well because its office headquarters are located in San Francisco, USA.<sup>67</sup>

The real economic activity test requires the bonding of economic substance between the corporate investor and the state which it claims to be a national of.<sup>68</sup> As such, it looks at where the effective operation of the company is taking place, where the headquarters are located, where the directors meet, and where the employees are mainly located.<sup>69</sup> While Uber places directors and employees in over 633 countries throughout the world, its headquarters in America are where all major executive decisions are also made.<sup>70</sup>

The final test, according to *Lietchtenstein v Guatemala* is that of ownership or control and looks at the dominant nationality of the

controlling individual of the company.<sup>71</sup> In the case of *Mobil v Venezuela*, it was found that the controlling individual of a company is he or she who holds a significant majority of its shares and exercises direct or indirect control over the investment vehicle.<sup>72</sup> One drawback of this test however, is that it can lead to complexities for it is often difficult to identify the shareholders among multiple layers of owners who exercise genuine control of the company.<sup>73</sup> Fortunately, however, this problem is easily reconciled in the present case. Former CEO, Travis Kalanick, who resigned in June 2017, after Uber entered the Argentine market,<sup>74</sup> and current controlling officers, Francis Frei<sup>75</sup> and Bozoma Saint John,<sup>76</sup> all reside in California and are predominantly American citizens.

### 5.3. subject matter jurisdiction

Now that we have determined Uber to be an all American company, the next step is to identify the existence of subject matter jurisdiction by discerning whether or not Uber's purchase of an office space and an incorporated company amount to a qualified investment under the BIT. To do so, we must show 1) that a valid legal dispute over an investment has arisen; 2) that an investment as defined by the BIT has been made and 3) if the purchased assets reside "within the territory of the host state."<sup>77</sup>

### 5.4. validity of dispute

For the first element, *Fedax v Venezuela* (1998), ICSID, establishes that a valid dispute between parties is one which pertains to a disagreement on a point of law or fact, or a conflict of legal views or interests.<sup>78</sup> The word legal is interpreted

62 Dolzer and C. Schreuer, *Principles of International Investment Law*, 2nd ed. (Oxford University Press, 2012).

63 *Ibid.*

64 *Tokios Tokelés v Ukraine*, ICSID Case No. ARB/02/18 (29 April 2004), paras 1–4, 14–71 and Dissenting Opinion of Proper Weil.

65 *Ibid.*, 67.

66 Krista Nadakavukaren Schefer, *International Investment Law: Text Cases and Materials* Edward Elgar Publishing, 2016<sup>2</sup>

67 Avery Hartmans and Nathan McAlone, The story of how Travis Kalanick built Uber into the most feared and valuable startup in the world, *Business insider*, <http://uk.businessinsider.com/ubers-history>, (August 1, 2016).

68 *Ibid.*, 69.

69 *Ibid.*

70 *Ibid.*, 70.

71 Dolzer and C. Schreuer, *Principles of International Investment Law*, 2nd ed., Oxford University Press, 2012.

72 *Ibid.*, 74.

73 *Ibid.*

74 Julia Carrie Wong, The Guardian, Uber CEO Travis Kalanick resigns following months of chaos <https://www.theguardian.com/technology/2017/jun/20/uber-ceo-travis-kalanick-resigns>, (June 21, 2017).

75 Catherine Shu, Tech Crunch, Uber hires Harvard Business School Professor Frances Frei to solve its leadership problems.

76 Olivia Solon, The Guardian, Can Bozoma Saint John repair Uber's troubled image <https://www.theguardian.com/technology/2017/jul/28/bozoma-saint-john-troubled-image>, (July 28, 2017).

77 Dolzer and C. Schreuer, *Principles of International Investment Law*, 2nd ed., Oxford University Press, 2012.

78 *Fedax NV v The Republic of Venezuela*, ICSID Case No. ARB/96/3. If decisions were published, it is recommended to write the name of the publication.

as meaning that which “concerns the existence or scope of a legal right or obligation or the nature or extent of reparation to be made for a breach of legal obligation.”<sup>79</sup> For the present case, the dispute is indeed legal in nature because it gives rise to a claim for compensation for a potential violation of rights and breaches of international law by the Government of Argentina.<sup>80</sup>

### 5.5. is there a qualified investment

According to the American/Argentine BIT, the denial of benefits clause states that “Each Party reserves the right to deny to any company of the other Party the advantages of this Treaty if (a) nationals of any third country, or nationals of such Party, control such company and the company has no substantial business activities in the territory of the other Party, or (b) the company is controlled by nationals of a third country with which the denying Party does not maintain normal economic relations.”<sup>81</sup>

As such, depending on how they are classified, the purchases of an office space and local company by Uber may be invalidated by the respondent. As evidenced by the cases of *CEAC Holdings Ltd v Montenegro*,<sup>82</sup> the purchase of real estate and an incorporated company alone do not necessarily amount to investments. This is because any company could simply purchase assets in a foreign country for the sole purpose of claiming the benefits provided by its BIT.<sup>83</sup> In *CEAC* the claimants had failed because despite purchasing a tax office in the host state, they failed to utilize it on a regular basis, causing the tribunal to conclude that it did not form an integral part of their business and could not be considered as a true investment.<sup>84</sup> Secondly, in the case of *CEAC* the claimant failed when trying to bring a claim for jurisdiction under Article 1139(g) of NAFTA which considers “real estate or other property, tangible or intangible, acquired in the expectation or used for the purpose of economic benefit or other business purposes.”<sup>85</sup> The reason for the failure of their case was that the claimant could not prove that its purchases of American assets were being used to facilitate the operation of its business.

However, to discern whether or not Uber’s investments are qualified, we must first pay reference to the conventions before delving into the intricacies of specific cases. According to Article 25(1) of the ICSID Convention, “The jurisdiction of the Centre shall extend to any legal dispute arising directly out of an investment.”<sup>86</sup> A major issue with this statement however, is that the convention fails to expressly define the meaning of “investment.” However, “investment” can be better understood by referencing Article 31 of the Vienna Convention on the Law of Treaties, which proclaims that “A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.”<sup>87</sup> Uber can overcome these arguments against their jurisdiction with relative ease by bringing the true definition of “investment” in this context, to the attention of the tribunal. The purchases of office space and an incorporated company are expressly and undisputedly provided for in the plain text of the USA/Argentina BIT.<sup>88</sup> As per Article 1(a) of the BIT: the definition of investment includes 1) “tangible and intangible property, including rights, such as mortgages, liens and pledges; and subsection.”<sup>89</sup> Moreover, although no public information exists on the nature of how Uber will be utilizing the Argentine company it has purchased, whether or not they actually use it becomes irrelevant as subsection 2 of Article 1(a) extends to “a company or shares of stock or other interests in a company or interests in the assets thereof.”<sup>90</sup> The present case could also be further differentiated from that of *CEAC* if Uber could prove that its Buenos Aires headquarters is regularly used by its staff to maintain its operations.<sup>91</sup> Thus, there are substantive economic activities being carried out in Argentina.

86 Administrative Council of the International Centre for Settlement of Investment Disputes, ICSID Convention, Regulations and Rules (April 10, 2006).

87 United Nations, Vienna Convention on the law of treaties (with annex) (May 23, 1969).

88 United States Department of State: United States Bilateral Investment Treaties <https://www.state.gov/e/eb/ifd/bit/117402.htm> (Last visited July 5, 2017).

89 *Ibid.*

90 ICSID Case No. ARB/14/8.

91 Andrew Matthews, Fortune Uber Troubles Pile Up in Argentina <http://fortune.com/2016/04/27/uber-argentina-crackdown/>, (April 27, 2016).

No information could be found that expressly mentions whether Uber employees regularly use its Argentine office. However, the fact that it has been raided by police may connote that it was being utilized for business activities.

79 *Ibid.*

80 *Ibid.*

81 United States Department of State: United States Bilateral Investment Treaties <https://www.state.gov/e/eb/ifd/bit/117402.htm>, (Last visited July 5, 2017).

82 ICSID Case No. ARB/14/8.

83 *Ibid.*

84 *Ibid.*

85 *Ibid.*



The case of *Fedax v Venezuela*<sup>92</sup> which was later reinforced by *Salini v Morocco*<sup>93</sup> had a major influence on the understanding of investment. In *Fedax v Venezuela*, ICSID, the court created the double key-hold approach which includes four factors which also helps to establish that Uber has invested in Argentina, namely (1) money contribution; (2) duration; (3) risk and (4) contribution to the host state's economy.<sup>94</sup> According to the *Fedax* approach, proving the existence of a qualified investment depends on the substantiality of the four elements. These include 1) the duration of the investment; 2) the regularity of profit and return; 3) assumption of risk and commitment to the investment and 4) whether or not there has been significant contribution to the development of the host state.<sup>95</sup>

In addressing the first element, *Fedax* held that the duration of an investment which extends beyond the fiscal year in which it is made is to be considered significant.<sup>96</sup> As Uber has already invested in Argentine assets prior to April 2016 and is utilizing them on a daily basis, the argument can be made that their investment had lasted for a duration which was just short of 10 months, and was intended to be a long-term, ongoing engagement before its services were forcibly suspended in January of 2017.<sup>97</sup>

As for the second element, it was decreed that a regularity of profit and return is met by stable payments derived from the investor's business operations within the host state.<sup>98</sup> This requirement is also consistent with Article 1 (a) subsection (iii) of the BIT which states that the meaning of investment shall encompass any "claim to money or a claim to performance having economic value and directly related to an investment."<sup>99</sup> In accordance with this, Uber is able to command and control the performance of its office staff and has a claim to a portion of every transaction made by drivers through their platform.

92 *Fedax NV v The Republic of Venezuela*, ICSID Case No. ARB/96/3.

93 *Salini v The Republic of Morocco*, ICSID Case No. ARB/00/4.

94 *Ibid*, 96.

95 *Ibid*.

96 Tylar Durden, Zero Hedge, Argentine Judge Orders Arrest of Local Uber Executives, Shut Down of Uber Mobile App <http://www.zerohedge.com/news/2017-01-30/argentine-judge-orders-arrest-local-uber-executives-shut-down-uber-mobile-app>, (January 30, 2017).

97 *Ibid*, 96.

98 *Ibid*.

99 United States Department of State: United States Bilateral Investment Treaties <https://www.state.gov/e/eb/ifa/bit/117402.htm> (Last visited July 5, 2017).

The third element Uber must prove is that it is committed to its operations in Argentina and has assumed some form of risk.<sup>100</sup> Here, merely selling goods or services in a new market will not constitute a legitimate risk for there must be a potential for the investor to incur a loss in capital.<sup>101</sup> Furthermore, this risk cannot arise from a change in government policy and must present itself as a natural part of the subject market.<sup>102</sup> Uber is able to prove this because rather than simply acting as an overseas platform provider, it has actually committed a tremendous amount of money for the use of its office space, employee salaries, advertising, and app maintenance and updates.<sup>103</sup> If such assets fail to generate enough economic activity, their investments will be lost.

Under the fourth element, Uber has indeed contributed to the local Argentine economy by providing employment opportunities to willing members of its citizenry. Furthermore, consumer welfare is also promoted in that the introduction of new competition will help to lower prices and improve the quality of services within the transportation industry.<sup>104</sup> What is more is that in America, where Uber has operated for the past eight years, Uber has generated an estimated \$6.8 billion in consumer surplus, twice the amount of revenue earned by Uber drivers collectively.<sup>105</sup> In this way, not only has the Argentine economy already benefitted, it is highly valued in the eyes of its users and, with the right degree of regulation, stands to obtain even greater gains in the foreseeable future from Uber's presence.<sup>106</sup>

In following this Argentina can draw upon *Phoenix v Czech Republic* to counter Uber's case of unlawful expropriation.<sup>107</sup> As a case which reinforced *Fedax* and *Salini*, *Phoenix* further added

100 Dolzer and C. Schreuer, *Principles of International Investment Law*, 2nd ed. Oxford University Press, 2012.

101 *Ibid*.

102 *Ibid*.

103 Demian Bio, The Bubble, Argentina Is Taking Fight Against Uber to A Whole New Level of Ridiculousness (September 9, 2016) <http://www.thebubble.com/argentina-is-taking-its-fight-against-uber-to-a-whole-new-ridiculous-level/>.

104 *Fedax NV v The Republic of Venezuela*, ICSID Case No. ARB/96/3 1998.

105 Peter Cohen, Robert Hahn, Johnathan Hall, Steven Levitt and Robert Metcalfe, Using Big Data to Estimate Consumer Surplus: The Case of Uber <http://www.datasciences.org/sites/default/files/Using%20Big%20Data%20to%20Estimate%20Consumer%20Surplus%20at%20Uber.pdf>, (August 30, 2016).

106 *Ibid*, 110.

107 *Phoenix Action v The Czech Republic*, ICSID Case No. ARB/06/5 2009.



that because a contribution to state development is nearly impossible to ascertain, as the presence of a commitment of assets for a substantial time while accepting risks, would be enough to prove an investment.<sup>108</sup> This may have been good for Uber because it lowers the burden of proof to show that they are allowed to claim for rights under the BIT. However, *Phoenix* goes further than this and adds two additional requirements including, the need for the investment to be made in accordance with the law of the host state, and the need for the assets to be bona fide.<sup>109</sup> As such Argentina could raise the argument that Uber's claim for making a qualified investment fails because they failed to apply for the relevant licenses and are therefore taking part in an illegal economic activity.<sup>110</sup>

Another popular approach aside from *Fedax* and *Salini* was known as the party-defined approach, utilized in *Biwater Gauff (Tanzania) Ltd.*<sup>111</sup> and *Malaysian Historical Salvors, SDN, BHD.*<sup>112</sup> This approach is more preferable as the parties' understanding and their intention to the disputes will outweigh the four factors discussed in the double key-hold approach.<sup>113</sup> It is therefore, better applied when considering what the law and the international circumstances were at the time when the BIT between America and Argentina was actually signed.<sup>114</sup> As such, it is unreasonable for the Argentine government to retrospectively rescind the rights of Uber as a foreign investor when it has already entered Argentina based on its reasonable belief and legitimate expectation that it would fairly be allowed to compete with the domestic transportation industry.

#### 5.6. purchased assets reside within the territory of the host state

For the final element of determining whether the assets are "in the territory" of the host state, *Abaclat v Argentina*, has established that the invested fund needs to have ultimately been made available to the host state and that it must have supported economic development.<sup>115</sup> As

such, this reference could potentially be raised by the opposing counsel because although Uber has essentially stimulated Argentina's economy, it has not made the invested fund available to the host state. Still, this can be reconciled in two ways, the first being that *Albacat* decreed that different types of investments should adhere to different standards.<sup>116</sup> Specifically, the investments made by the claimant in *Albacat* could be scrutinized because they were bonds, assets of a purely monetary nature.<sup>117</sup> Those made by Uber in Argentina however, may potentially not be subject to the same considerations because they were in the form of business operations relying on manpower and property. The contribution may be one of a long term, and its effect may not be that obvious when compared to other types of investments.

#### 5.7. has there been expropriation

Expropriation is defined as an instance in which the government takes privately owned property, to be used for purposes designed perpetuate overall public benefit.<sup>118</sup> In establishing this element, the first step is to define whether any form of direct or indirect expropriation has, in fact occurred, and second, if it has, whether it is lawful or unlawful.

In response to the first element, direct expropriation pertains to an event where both an investor's legal and equitable ownership over assets are transferred to the state.<sup>119</sup> However, direct expropriation is relatively rare because states are reluctant to jeopardize their investment climate and attract negative publicity which will ultimately damage the state's reputation as a venue for foreign investments.<sup>120</sup> In the present case, although police raided Uber's headquarters, they had not directly confiscated any assets owned by Uber.

As such, Uber stands a better chance of claiming on grounds of indirect expropriation. By doing so, where state measures have the effect of substantially depriving a foreign investor of the value of their investment, but without transferring the title of the property to the

<sup>108</sup> *Ibid.*

<sup>109</sup> *Ibid.*

<sup>110</sup> *Ibid.*

<sup>111</sup> *Tanzania Ltd. v United Republic of Tanzania*, ICSID Case No. ARB/05/22 2008.

<sup>112</sup> *Malaysian Historical Salvors v Malaysia*, ICSID Case No. ARB/05/10 2007.

<sup>113</sup> *Ibid.*

<sup>114</sup> United States Department of State: United States Bilateral Investment Treaties <https://www.state.gov/e/eb/ift/bit/117402.htm>, (Last visited July 5, 2017).

<sup>115</sup> *Abaclat v Argentina*, ICSID Case No. ARB/07/5 2011.

<sup>116</sup> *Ibid.*

<sup>117</sup> *Ibid.*

<sup>118</sup> K.N.Schefer, *International Investment Law: Text Cases and Materials* Edward Elgar Publishing, 2016.<sup>2</sup>

<sup>119</sup> Law Teacher, Disputes On Direct Expropriation, <https://www.lawteacher.net/free-law-essays/property-trusts/disputes-on-direct-expropriation.php> (Last visited June 28, 2017).

<sup>120</sup> *Ibid.*

state without any form of prompt, adequate<sup>121</sup> or effective compensation. Another form of indirect expropriation is referred to as creeping expropriation in which a series of subtle, separate acts, leads to the substantial deprivation of value of an investor's assets.<sup>122</sup> According to *Siemens AG v the Argentina Republic* "creeping expropriation refers to a process, to steps that eventually have the effect of an expropriation. If the process stops before it reaches that point, then expropriation would not occur."<sup>123</sup> This does not necessarily mean that no adverse effects would have occurred. Obviously, each step must have an adverse effect but by itself may not be significant or considered as an illegal act. The last step in a creeping expropriation that tilts the balance is similar to the straw that breaks the camel's back. The preceding straws may not have had a perceptible effect but are part of the process that led to the break."<sup>124</sup>

However, in the present case, there is no instance of creeping expropriation as the host state government had already been adamant about expelling Uber from the onset of their entry into Argentina.<sup>125</sup> As such, Uber can argue that the decision of Buenos Aires Officials to cut off credit card payments to their platform amounts to expropriation in that it devalued their company by inconveniencing customers by limiting their payment options.<sup>126</sup> Furthermore, there was also the fact that Uber's drivers were being arrested prior to the deliberation of a court proceeding which found that contrary to city officials' beliefs, Uber was indeed a legal service.<sup>127</sup> This too has caused significant damage to Uber's reputation and will now make it harder for the company to expand its workforces to reach broader customer bases in the future. It may also trigger other countries to issue similar order to expel Uber, resulting in a severe blow to Uber's worldwide

business. In conjunction with this, the recent office raid conducted by Buenos Aires police forces, could also be said to have the adverse effect of frightening Uber's office staff, therein potentially causing a number of them to quit and thereby causing Uber take on additional costs for hiring and training a replacement workforce. Finally, and most importantly, Uber can argue that the arrest of its executives in Argentina has done irreparable damage as its operations were left without leadership for an extended period of time. Furthermore, now that Uber's operations in Argentina have been forcefully suspended, all of the investments it has made in business infrastructure, including its headquarters, are now no longer of any use.

### 5.8. is this expropriation justifiable?

Assuming that the Argentine government may have indirectly expropriated Uber's assets, the question then, is whether they are able to justify them as legitimate regulatory measures.<sup>128</sup> Unlike unlawful expropriation, lawful expropriation serves a public purpose, is non-discriminatory, was enacted only after due diligence and due process has been respected and has prompted, adequate and effective compensation.<sup>129</sup>

From Argentina's perspective, Uber poses a public health hazard in that unqualified drivers without adequate insurance plans, i.e. third-party insurance and perhaps even those with criminal pasts could be present on the Uber platform.<sup>130</sup> In addition to public health, Argentina could also cite the non-existence of tax payments made by Uber to Argentina.<sup>131</sup> Furthermore, Uber's innovation is also economically disruptive and unfair to taxi drivers who, must pay more overhead expenses in the form of membership fees, do not have access to the same superior technologies utilized by Uber drivers, and are subsequently forced to charge higher prices to recoup their costs.<sup>132</sup> In addition to all of this, Uber was ordered to exit

121 Adequate compensation is equivalent to the market value of the expropriated investment.

122 Dolzer and C. Schreuer, *Principles of International Investment Law*, 2nd ed. Oxford University Press, 2012.

123 *Siemens AG v Argentina*, ICSID Case No. ARB/02/8 2007.

124 *Ibid*, 127.

125 Astro Awani, Argentine capital's government says Uber illegal, will be penalized <http://english.astroawani.com/world-news/argentine-capitals-government-says-uber-illegal-will-be-penalised-102407>, (April 14, 2016).

126 Selena Larson, CNN, Uber ordered to stop service in Argentina <http://money.cnn.com/2017/01/30/technology/uber-blocked-argentina/index.html>, (January 30, 2017).

127 Valentina Iricibar, The Bubble, What's The Deal With The Buenos Aires Court Ruling That Uber Is Legal? <http://www.thebubble.com/whats-the-deal-with-the-buenos-aires-court-ruling-that-uber-is-legal/>, (October 25, 2016).

128 Dolzer and C. Schreuer, *Principles of International Investment Law*, 2nd ed. Oxford University Press, 2012.

129 David Collins, *An Introduction To International Investment Law*, Cambridge, 2016.

130 Gabriel Samuels, Independent, Uber drivers accused of 32 rapes and sex attacks on London passengers over the past year <http://www.independent.co.uk/news/uk/uber-drivers-accused-of-32-rapes-and-sex-attacks-on-london-passengers-a7037926.html>, (May 19, 2016).

131 Christopher Woody, Business Insider, A court in Argentina has ordered a crackdown on Uber's operations <http://uk.businessinsider.com/argentina-crackdown-on-uber-2016-4>, (April 2016).

132 Michael Horn, Forbes, Uber, Disruptive Innovation And Regulated Markets <https://www.forbes.com/sites/mi>

the country a day after its inception, but instead of complying or attempting to obtain necessary licenses it instead chose to ignore orders of foreclosure and continue its operations. Though all of these arguments are legitimate and have a strong chance of succeeding before a tribunal, Uber has several counters it can potentially utilize to defend its interests.

In responding to the first claim, Uber can first attempt to mandate that it is an independent coordination platform, and as such, its drivers are the ones who should be responsible for obtaining their own licenses should any be needed.<sup>133</sup> Uber can also argue that it does not even need licenses to begin with, because, in reality, it is actually a much safer option than taxis – here's why. While the purpose of a taxi licenses in regards to public safety, inter alia, is to ensure that drivers are reputable and responsible persons, the city of Buenos Aires still manages to have an average of 99 cases of sexual assault reported to police every single month.<sup>134</sup> One such case involved a taxi driver stabbing a woman to death and eventually being declared immune from prosecution by "pleading insanity."<sup>135</sup> Furthermore, given that the number of such cases has been increasing exponentially over the past ten years, it is easy to see that government authorities are simply incapable of remedying this problem.<sup>136</sup>

Uber on the other hand, conducts its own background checks as well.<sup>137</sup> Of course, opponents will cite that there have also been instances of Uber drivers assaulting passengers in other countries and argue that background checks should be left to the states rather than private conglomerates. However, after having operated for an entire year, there have been absolutely no reports of Uber drivers causing harm to passengers in the city of Buenos Aires, only those of Uber drivers being hunted by belligerent cab drivers.<sup>138</sup> The key difference lies in Uber's review

system which allows users to know who exactly will be driving them through passenger reviews, and receive extensive information on the route that they will be taking, before deciding whether or not to hire them. Furthermore, should an Uber driver misbehave, the review system ensures that the entire Uber, online community will know about it. Conversely, taxis offer no such options and safety features and have no efficient way of providing information to passengers on the past history of their drivers. In addition to all of this, Uber could also argue on the basis of freedom of contract and that as long as customers are aware of the risks, they have a right to consent to them. Nonetheless, the weakness of this argument lies in that Uber is not a government body and therefore has no right to make decisions regarding public health. Also, even if Uber could promote public well-being, there is always a chance that user review systems can be falsified and that driver accounts can be hacked.

Another, very interesting point of contention pressed against Uber, lies in the realm of tax where officials have accused Uber of operating illegally by failing to register as a company with Argentina and file for tax returns.<sup>139</sup> Although investment policy between America and Argentina does say that foreign companies do not need to register with the host state before investing, the Argentine government still retains the right to subject them to tax laws once their operations have commenced.<sup>140</sup> As such, corporate tax rules in Argentina dictate that taxes must be paid on a monthly basis.

Admittedly, Uber has paid no taxes whatsoever since entering Argentina. However, as a member of their legal counsel, one would argue that there are several justifications for this. First, just like in the case of public safety, Uber could counter that it is simply a platform which coordinates the transactions between its users and as such, its drivers should be responsible for paying their own taxes.<sup>141</sup> However, raising such an argument would be unwise for Uber because it could potentially distort their reputation. It can also potentially fail because Uber still has infrastructure present in Argentina which garners profits for their company meaning that Argentina would in fact have a right to charge them if they so choose.

chaelhorn/2016/06/20/uber-disruptive-innovation-and-regulated-markets/#4d57652037fb, (June 20, 2016).

133 Rick Glofcheski, *Employment Law and Practice in Hong Kong* Sweet & Maxwell Asia, 2016.

134 Meaghan Beatley, Motherboard, Why Women Could Be the Key to Uber's Success in Argentina [https://motherboard.vice.com/en\\_us/article/8q8kyk/why-women-could-be-the-key-to-ubers-success-in-argentina](https://motherboard.vice.com/en_us/article/8q8kyk/why-women-could-be-the-key-to-ubers-success-in-argentina), (November 11, 2016).

135 *Ibid.*

136 *Ibid.*

137 B. Thermidor, Uber, What Does It Take to Pass Uber's Background Check <http://rideordriveuber.com/what-does-it-take-to-pass-uber-background-check/>, (November 12, 2016).

138 Valentina Iricibar, The Bubble, A Buenos Aires Judge Has Finally Ruled That Uber is Legal <http://www.thebubble.com/a-buenos-aires-court-has-finally-ruled-that-uber-is-legal/>, (October 24, 2016).

139 Christopher Woody, Business Insider, A court in Argentina has ordered a crackdown on Uber's operations <http://uk.businessinsider.com/argentina-crackdown-on-uber-2016-4>, (April 2016).

140 Patrick Archer, Invest BA, The Argentina Investment Report for April 20, 2016 <http://investba.com/2016/04/argentina-investment-report-april-20-2016>, (April 19, 2017).

141 R.Glofcheski,, *Employment Law and Practice in Hong Kong*, Sweet and Maxwell Asia, (2016).



However, there is a much more effective way for Uber to mitigate its tax problems. The first is by proclaiming that if Argentina was truly looking to collect on taxes from Uber, there would have been no reason to cut off its credit card transaction, which are, by their very operation, one of the best ways to keep track of a company's earnings. Secondly, bitcoin, though legal to use in Argentina, is not recognized as an actual legal currency by its local government which raises two issues. The first is whether these transactions are taxable to begin with. Even if they weren't, Uber could still claim the benefits of protection under the BIT because the money they have invested into their infrastructure under Article 1 is still legally recognized. Furthermore, the money they are receiving back at their headquarters in America, also holds value because it can be exchanged into different currencies.<sup>142</sup> The beauty of this argument is that while Uber can associate bitcoin with value, the Argentine government's legislation prevents them from doing so. Secondly,, if Argentina wishes to reconcile this, they would either need to outlaw bitcoins all together, or begin regulating them. Should they choose to adopt the prior policy, it would mean that once again, that the government is making it impossible for Uber to properly keep tally of their transaction and subsequently harder for them to file the correct amount of taxes. In adopting the latter, there would be an even more complex set of regulation issues for the Argentine government to address.<sup>143</sup> For example, the government would potentially have to struggle with how much value to prescribe to the bitcoin transaction and integrate it with its currency exchange.<sup>144</sup> Thus even if Argentina did require Uber to pay taxes on these transactions, how can it incriminate them without having first ascertained how much is actually owed?

Nonetheless, this argument also has a good chance of failing because bitcoin is still seen as a medium of exchange and transactions which utilize it are still of a business nature, meaning that typically, the government should have a right to subject it to taxation.<sup>145</sup> However, even

if credit card transactions were cut off, Uber still has algorithms and app functions in place to help it to keep track of how much money it has been earning. In following this, Uber could also argue that there was no legislation in place to say to forbid them from using crypto currencies to continue operating and that even if the Argentine government were to invoke sovereign immunity and begin taxing these transactions, they would be more than willing to oblige.<sup>146</sup> The reason for this is that it is unlikely Argentina would attempt to retrospectively tax Uber's previous bitcoin transactions because they would be extremely difficult to retrace and calculate. Doing so would, once again, violate rule of law and make foreign investors, which Argentina so desperately needs, hesitant to invest, effectively checkmating them.

Aside from citing the government's role in making it exceedingly difficult for it to calculate its finances, Uber could also claim that it owes no taxes if it sustained a loss in Argentina during the past fiscal year. Considering the heavy investments, it has made, in conjunction with all of the anti-Uber sentiment being perpetuated by the government, this is a likely possibility. However, this still would not explain why Uber failed to submit monthly reports to the government to reflect those losses.

Another option is for Uber to use time as its defense. That is, according to Argentine corporate tax regulations, "The due date for filing the profits and the minimum notional income tax return is during the second week of the fifth month after the fiscal year-end. Tax returns are filed electronically."<sup>147</sup> Thus, if taxes are due on the second week of May, and Uber was ordered by the judiciary to stop service in January, how then would it have been possible for them to file their tax return and cooperate with tax authorities?<sup>148</sup>

Furthermore, in addressing due diligence, Uber can argue that it is unreasonable for Argentina to require them to obtain taxi licenses, especially after proclaiming that companies would not need to register or obtain license prior

142 The Law Library of Congress, Global Legal Research Center, Regulation of Bitcoin in Selected Jurisdictions <http://www.loc.gov/law/help/bitcoin-survey/>, (April 29, 2015).

143 Nathaniel Popper, The New York Times, Can Bitcoin Conquer Argentina? <https://www.nytimes.com/2015/05/03/magazine/how-bitcoin-is-disrupting-argentinas-economy.html>, (April 29, 2015).

144 *Ibid*.

145 Daniel Krawisz, Satoshi Nakamoto Institute, Bitcoin as a Store of Value, Unit of Account, and Medium of Exchange (January 12, 2015).

146 Demian Bio, The Bubble, Argentina Is Taking Fight Against Uber to A Whole New Level of Ridiculousness <http://www.thebubble.com/argentina-is-taking-its-fight-against-uber-to-a-whole-new-ridiculous-level/>, (September 9, 2016).

147 Argentine Corporate Tax Administration, <http://taxsummaries.pwc.com/ID/Argentina-Corporate-Tax-administration> (Last visited June 30, 2017).

148 Tylar Durden, Zero Hedge, Argentine Judge Orders Arrest of Local Uber Executives, Shut Down of Uber Mobile App <http://www.zerohedge.com/news/2017-01-30/argentine-judge-orders-arrest-local-uber-executives-shut-down-uber-mobile-app>, (January 30, 2017).



to investment.<sup>149</sup> It is even more unreasonable for them to have arrested Uber's drivers and executives without at least having allotted a court hearing to properly classify the nature of its company before forcing it to overhaul its entire business model and potentially take on such substantial expenses. In responding to this, the Argentine government may argue that it has in fact given due diligence by alerting Uber of its violations for months before it finally decided to suspend its services.

Finally, in addressing the notion of Uber's disruptive innovation, why should Uber be forced to relieve itself of the inherent advantages it has afforded itself through better preparation than its competitors? Do we force competitors in a golf tournament to throw away their custom golf clubs simply because they have opponents who are using older equipment?

Essentially, Uber's actions should not have warranted such an aggressive and excessive response from the Argentine government and additionally, there has been no compensation paid by Argentina as of yet, to rectify the expropriation of its assets. On another note, the government has now decided to start its own Taxi app which follows a blueprint similar to Uber's. What's more is that taxi drivers are also expressing resentment towards this app in the same way they had towards Uber, thereby making it highly suspicious as to whether or not the government truly has their best interest in mind. Furthermore, as previously mentioned, the press has presented that a "mystery Uber driver" was arrested for two days and had his driver's license suspended for two months.<sup>150</sup> However, the legitimacy of this story is questionable, because if such an even truly transpired, why has the government not released more details as to who the driver is, so as to deter others from joining the ranks of Uber? Of course, one possible response to this may be that the government wishes to protect the driver's identity so that he or she will not be attacked by protestors. However, the fact remains that protestors can already identify Uber drivers, for the platform itself, provides data on all of its drivers to the public. As such, the tribunal must discern if Argentina, in reality, has taken these actions with the hidden intention of intimidating and forcing Uber out of its market so that it can profit from inserting its own substitute.

149 Bureau of Economic and Business Affairs, 2015 Investment Climate Statement – Argentina <https://www.state.gov/e/eb/rls/othr/ics/2015/241462.htm> (Last visited July 2, 2017).

150 Katie McCay, The Bubble, Bad News For Uber: First Buenos Aires Driver Convicted <http://www.thebubble.com/bad-news-for-uber-first-buenos-aires-driver-convicted/>, (April 18, 2017).

## 6. The Buenos Aires government's actions are unconstitutional

In response to all of these claims, Argentina will always reserve the ability to invoke its right to sovereign immunity, however, not only would this be a violation of rule of law, it would also be unconstitutional under three provisions of Argentina's own constitution.<sup>151</sup> That is, according to Article 17 of Argentina's Constitution, amended as of 1994, "Property is inviolable and [cannot] be deprived thereof except by virtue of a judgment supported by law."<sup>152</sup> Under Article 20 "Foreigners enjoy in the territory of the Nation all the civil rights of a citizen; they may engage in their industry, trade or profession, own, purchase or transfer real property... They are not obligated to assume citizenship, or to pay extraordinary compulsory taxes."<sup>153</sup> Article 29 further reinforces these provisions by stating "Congress may not confer on the National Executive, nor Provincial Legislatures on the Provincial Governors, extraordinary powers, or the whole of the public authority, nor grant them acts of submission or supremacy whereby the lives, the honor or the property of Argentines will be at the mercy of governments or any person whatsoever. Acts of this nature shall be utterly void, and shall render those who formulate, consent to or sign them liable to be called to account and punished as infamous traitors to the country."<sup>154</sup>

Further to this, although an argument can be raised that such rights will only be allotted to "true Argentines", principles of national treatment forbid states from treating foreign investors differently from their own citizens.<sup>155</sup> This will be covered in greater detail in the following section.

## 7. Fair and equitable treatment and relative standards of protection

Under the American/Argentine BIT, it is specifically mentioned "A specific tenet reflected in this treaty, is that US investment abroad and foreign investment in the United States should receive fair, equitable, and nondiscriminatory treatment."<sup>156</sup> In addition to this, Article 2(1)

151 Argentina's Constitution of 1853, Reinstated in 1983 With Amendments through 1994, [https://www.constituteproject.org/constitution/Argentina\\_1994.pdf?lang=en](https://www.constituteproject.org/constitution/Argentina_1994.pdf?lang=en) (Last visited June 26, 2017).

152 *Ibid.*

153 *Ibid.*

154 *Ibid.*, 155.

155 Dolzer and C. Schreuer, *Principles of International Investment Law*, 2nd ed., Oxford University Press, 2012.

156 United States Department of State: United States Bilateral Investment Treaties. <https://www.state.gov/e/eb/ift/bit/117402.htm> (Last visited July 5, 2017).

states, “each Party shall permit and treat investment, and activities associated therewith, on a basis no less favorable than that accorded in like situations to investment or associated activities of its own nationals or companies, or of nationals or companies of any third country.”<sup>157</sup>

Such a clause is meant to guarantee that treatment of foreign investors is as favorable as that which is offered to the state and its citizens. According to *Técnicas Medioambientales Tecmed, S.A. (2003)*, FET is interpreted according to its ordinary meaning, international law and the principles of good faith.<sup>158</sup> The test for FET consists of six factors as follows:

- 1) Legitimate expectation (Overlaps with indirect Expropriation).
- 2) Transparency and consistency.
- 3) Compliance with contractual obligations.
- 4) Good faith and freedom from coercion.
- 5) Proportionality
- 6) Due Process

As previously mentioned in this submission, Uber can argue that its legitimate expectation of having a fair opportunity to compete in the Argentina has been violated by the respondent government due to sudden, detrimental acts of expropriation. In addition to this, these policy changes for tax and licensing remained unclarified after the conclusion of the original between the claimant and the respondent, proving that Argentina’s legislation is unpredictable, inconsistent, and predatory towards foreign competitors.

In *SPP v Egypt*, it was emphasized that an investor is entitled to rely on the official representations of the government.<sup>159</sup> Also, as per *Metalclad Corporation*, it was held that an agreement can only be regarded as transparent if its legal requirements are capable of being readily known to all affected investors of another Party.<sup>160</sup> It should also be noted that once the authorities of the central government of any party become aware of any scope for misunderstanding or confusion, it is their duty to ensure that the correct position is promptly determined and clearly stated so that investors can proceed with all appropriate expeditions in the confident belief that they are acting in accordance with all

relevant laws. The government failed to take any such measures, and as a result, the claimant was unable to adjust its market position after having already entered into the Argentine market.

At the same time, it can also be argued that as per *Consortium RFCC v Morocco*, such actions taken by the Argentine government are demonstrative of a blatant disregard to comply with the express provisions of the American/Argentine BIT in relation to Uber.<sup>161</sup> Aside from failing to recognize Uber’s investments which clearly fell under the definition provided in Article 1, the Argentine government also neglected to pay compensation for causing Uber to suffer damages and a loss in market value as per Articles 4(1), 4(2), 5(1), and 7(7).<sup>162</sup> Although Argentina could counter that violent protests necessitated such actions which resulted in the expropriation of the claimant’s assets, there is still no explanation as to why they had not taken other mitigating measures first. Such measures would include the deployment of police to quash protests and punish aggressors for hunting down Uber drivers.

Another contention against the Argentine government is that of the lack of transparency and the inconsistency of its policies, regarding the requirement for special commercial drivers’ licenses, towards Uber and another American company, Carpool World. In this way, Uber, in following *UPSD v Canada*, could also create a powerful case against Argentina claiming that it has violated relative standards of protection if it can prove 1) there is a basis for comparison; 2) differential treatment has been shown and 3) there is an absence of justification for the differential treatment.<sup>163</sup>

As per the case of *Marvin Roy Feldman Karpa v United Mexican States*, a basis for comparison certainly exists in that the companies are fundamentally similar in their operations as both provide coordination services between drivers and passengers in exchange for monetary payments.<sup>164</sup> Although *Marvin Roy Feldman Karpa*, highlighted the need for companies to be almost identical in nature for this element to be satisfied, it can be further argued simply that no two companies are alike.<sup>165</sup> Thus, although

161 *Consortium RFCC v Morocco*, ICSID Case No. ARB/00/6 (2005).

162 United States Department of State: United States Bilateral Investment Treaties <https://www.state.gov/e/eb/ift/bit/117402.htm> (Last visited July 5, 2017).

163 *United Parcel Service of America Inc v Canada*, ICSID Case No. UNCT/02/1 2002.

164 *Marvin Roy Feldman Karpa v The United Mexican States*, ICSID Case No. ARB(AF)/99/12003.

165 *Ibid.*

157 *Ibid.*

158 *Técnicas Medioambientales Tecmed, S.A. v The United Mexican States*, ICSID case no. ARB(AF)/00/2 2003.

159 *Southern Pacific Properties Limited v Arab Republic of Egypt*, ICSID Case No. ARB/84/3, 1992.

160 *Metalclad Corporation v The United Mexican States*, ICSID Case No ARB(AF)/97/1 2001.

their business tactics and methods of customer procurement may differ, the material service provided by both companies are exactly the same. Regarding the second factor, a significant difference in treatment has been shown in that Uber was aggressively forced out of Argentina while Carpool continues to operate without having to worry about excessive government intervention.

Finally, for the third factor, as Carpool World's Argentine website allows for drivers to sign up without any discussion concerning taxi licenses of government registrations, it can be assumed that Carpool has engaged in the same types of "violations" as Uber.<sup>166</sup> As such, there is no justification for such differential treatment.

According to *SD Myers v Canada* even if there is an inconsistency in treatment, there is still a need to take into account, circumstances that would justify government regulations that treat them differently.<sup>167</sup> Although the government claims one of its reasons for expelling Uber is that of protecting the cab industry, it is extremely contradictory of them to be introducing their own taxi app, despite cab drivers' protests towards its introduction. If the Argentine government was truly looking to protect their domestic market, why then are they partaking in the same exact type of business activity which they were originally trying to forbid? According to *UPSD v Canada* this is also a basis to claim unfair and inequitable treatment because Uber is being treated less favorably than both the local government and another foreign investor.<sup>168</sup> Still, the Argentine government can argue that due to a lack of regulation and non-compliance, Uber poses both a legitimate physical and economic threat to its citizenry.

In establishing these facts, we can thus conclude that even if the respondent was to claim it was aiming to exercise good faith, Uber y claim that this was not the case. That is, Uber could claim that Argentina allowed for rioters to influence its decisions and purposefully coerced the claimant into submitting to unfair regulations by hijacking the claimant's assets and threatening the operation of the company. (Note: *Compañía de Aguas del Aconquija S.A. and Vivendi Universal S.A.*<sup>169</sup> & *Waste Management, Inc v United Mexican*

*States*<sup>170</sup>) Furthermore, an argument could be made that the Argentine government's failure to actively investigate the acts of rioters could also amount to a denial of justice.<sup>171</sup>

However, Argentina may claim proportionality as a defense in that they were trying to balance regulation on foreign investment with public interests. Still Uber could argue that the imposition of arrests against drivers and Uber executives was excessive and, as found in the related court hearing, unwarranted.<sup>172</sup> Thus, as per *Occidental Petroleum Corporation and Occidental Exploration and Production Company v The Republic of Ecuador* (2012), even if the respondent's actions could be seen as a legitimate gain for public purpose because it is so heavily proportioned against and aimed at destroying the investor's business.<sup>173</sup> In addressing the principal of denial of justice, once again, as presented in *Tokios Tokeles v Ukraine*, the claimant should also have the right to an appropriate decision at the end of the process and its enforcement.<sup>174</sup> Here, when it comes to procedural propriety and due process, the manifest injustice of Uber's suspension in Argentina, can be further substantiated by the fact that although the claimant was given a trial, the hearing took place in a domestic Buenos Aires court rather than an international one.<sup>175</sup> The legitimacy of Argentina's decision to outlaw Uber is therefore questionable and cannot stand.

In all Uber can argue that there has been no justification offered by the Argentine government for its violation of the doctrine of fair and equitable treatment other than it wishes to protect its domestic market from foreign competition and expel Uber for acting outside the reign of their regulations. However, because they are engaging in the same practices which they deemed, endangered the taxi industry and because they had already given Uber a reasonable belief that it was abiding by pre-existing legislation, this malicious application of the law will only serve to portray Argentina in a xenophobic and hypocritical light.

170 *Waste Management Inc v The United Mexican States*, ICSID Case No. ARB(AF)/00/3 2004.

171 Dolzer and C. Schreuer, *Principles of International Investment Law*, 2nd ed. (Oxford University Press, 2012)

172 Valentina Iricibar, *The Bubble, What's The Deal With The Buenos Aires Court Ruling That Uber Is Legal?* <http://www.thebubble.com/whats-the-deal-with-the-buenos-aires-court-ruling-that-uber-is-legal/>, (October 25, 2016).

173 *Occidental Petroleum Corporation and Occidental Exploration and Production Company v The Republic of Ecuador*, ICSID Case No. ARB/06/1 2012.

174 *Tokios Tokeles v Ukraine*, ICSID Case No. ARB/02/18 2004.

175 Dolzer and C. Schreuer, *Principles of International Investment Law*, 2nd ed. (Oxford University Press, 2012).

166 Carpool Argentina, Official Website, [https://www.carpoolworld.com/carpool\\_ARGENTINA\\_favorites.html](https://www.carpoolworld.com/carpool_ARGENTINA_favorites.html) accessed June 11, 2017.

167 *SD Myers v Canada* 7 ICSID 148 2002.

168 *United Parcel Service of America Inc v Canada*, ICSID Case No. UNCT/02/1 2002

169 *Compañía de Aguas del Aconquija S.A. and Vivendi Universal S.A. v The United Mexican States*, ICSID Case No. ARB/97/3, 2000.



## 8. Remedies

Under customary international law, there is always an obligation to make full reparation for any injuries or losses caused by internationally wrongful acts.<sup>176</sup> Now that a case has been developed for Uber to present to the tribunal, all that remains to be determined are the remedies. As such, deciding on which remedies to pursue will largely depend on the desires of one's client.

The first of such remedies is known as restitution and satisfaction, which pertains to damages claimed for an illegal act of expropriation. According to Article 37(1) of the International Law Commission's instrument on the Responsibility of States for Internationally Wrongful Acts, The state responsible for an internationally wrongful act is under an obligation to give satisfaction for the injury caused by that act insofar as it cannot be made by good restitution or compensation.<sup>177</sup> Article 37(2) adds to this in citing that satisfaction may come in the form of an acknowledgement of breach, an expression of regret, and a formal apology or another appropriate modality.<sup>178</sup> Article 37(3) further comments that satisfaction must be made in proportion to the injury or losses sustained and may not be demanded in such a form that will humiliate the responsible state.<sup>179</sup>

According to the case of *Chorzow Factory*, calculation of such damages must reflect the damage which has actually been suffered by the victim by comparing the victim's current situation with the one that would have prevailed had it not been committed.<sup>180</sup> When applying these types of damages in a subjective manner, any consequential damages are added together with any incidental benefits which arose as a consequence from the illegal act. As such, the case of *PSEG v Turkey* ruled that there is a need to include loss of profits when calculating damages so long as they are not speculative.<sup>181</sup> As such, Uber can facilitate this by showing their financial records to substantiate the amount of earning lost from the government's unjustified intervention. On the other hand, the tribunal may opt to look at the actual losses sustained by Uber by referencing the actual amount it has invested,

as well as the costs and expenses incurred by the investor. According to the case of *Metalclad v Mexico*, these losses will also account for the accumulation of interest.<sup>182</sup>

Aside from this, Uber could also pursue costs comprised of all legal expenses arising

from the arbitration process.<sup>183</sup> The case of *ADC v Hungary* was highly similar to that of the present one as it was found that the respondent, was not acting for public interest in accordance with its BIT agreement and was therefore required to foot all of the costs for bringing the case before arbitration.<sup>184</sup> As a result, the claimant should be entitled to redress to recover for the losses arising out of the respondent's breaches.

## 9. Conclusion

To reiterate the points covered in this thesis, upon entering the Argentine market, Uber was of the reasonable belief that it was a qualified foreign investor because the BIT expressly stated that its investments in property and its possession of shares in a local company would confer investment rights upon it. In turn, the Argentine government which was in dire need of foreign investments to inject funds into its dying economy, had retrospectively taken excessive measures to illegally expropriate Uber's assets without justification and purportedly with the view of hijacking its business model. In considering all of this, not only does Uber have a strong case to bring against Argentina, it can potentially apply the same concepts to protect its investments in dozens of other jurisdictions as well. From a broader perspective, investment law can also protect the global expansion of the sharing economy and the innovation it brings by ensuring fair investment practices. At the same time, because the mechanism of investment law itself possesses a dynamic set of considerations that are difficult to satisfy, host states can be protected from a potential onslaught of vexatious claims brought by illegitimate investors.

Subsequently, in protecting the expansion of the sharing economy, one can also say that global welfare is being promoted. In returning to the context of Argentina, taxi companies in the city of Buenos Aires have been notorious for poor service and aggressive behavior. However,

<sup>176</sup> *Ibid.*

<sup>177</sup> United Nations: Responsibility of States for Internationally Wrongful Acts. [http://legal.un.org/ilc/texts/instruments/english/draft\\_articles/9\\_6\\_2001.pdf](http://legal.un.org/ilc/texts/instruments/english/draft_articles/9_6_2001.pdf) (Last visited June 30, 2017).

<sup>178</sup> *Ibid.*

<sup>179</sup> *Ibid.*

<sup>180</sup> *Case of Chorzow Factory* No. 13, 1927, PCIJ Series A No. 17, p. 47.

<sup>181</sup> *PSEG v Turkey*, ICSID Case No ARB/02/5 2007.

<sup>182</sup> *Metaclad Corporation v The United Mexican States*, ICSID Case No. ARB(AF)/97/1 2000.

<sup>183</sup> Dolzer and C. Schreuer, *Principles of International Investment Law*, 2nd ed. (Oxford University Press, 2012).

<sup>184</sup> *ADC Affiliate Limited and ADC & ADMC Management Limited v The Republic of Hungary*, ICSID Case No. ARB/03/1 2006.



Uber is able to generate positive change under this circumstance through its review system which effectively holds drivers responsible for any misdemeanors they commit. At the same time, it also helps to present its citizens with an opportunity to earn additional income on their spare time, and is more convenient than traditional taxi services, thereby improving quality of life for all of its users. Thirdly, there is also the notion of environmental protection. By providing users an alternative to driving their own cars, Uber's model will result in having fewer vehicles on the road, ultimately resulting in the reduction of pollution.

In accordance with this, Uber should also look to change its business strategy in order to accommodate investment law. At present, it is highly reliant on a first mover advantage because nothing about its business is proprietary, and as such, it must expand as quickly as possible in order to obtain footholds in foreign markets before others take its position. It is for this reason

that Uber often chooses to side step government regulations as a means of saving money to fund its widely spread operations. However, the problem with adopting such a strategy is that it ignores the importance of establishing good, solid, business infrastructure and leaves Uber susceptible to a plethora of legal issues. Furthermore, although one might say that it is better for Uber to apply with appropriate government agencies before it decides to commence operations in these countries, more than likely they will be rejected in favor of protecting domestic markets.

However, there is a way to reconcile Uber's need for stability with its desire to expand. That is, rather than simply investing in as many countries as possible, Uber should target those whose bilateral investment treaties with America are the most forgiving towards their endeavors. In this way, not only will their expansion be more efficient and sustainable, it will also provide more certainty for the drivers and passengers who rely on their app.

## EMPLOYMENT CLASSIFICATION IN THE SHARING ECONOMY

**Yeung Yat Hung Alan**

*The casual and fragmented nature of jobs in the sharing economy has challenged the traditional employment classification and its test. As a result, litigations and disputes are not uncommon, which has hindered the development of the sharing economy. This essay will analyse different proposed solutions and give recommendations in the context of Hong Kong. The discussion and debates here may also offer some inspiration for other jurisdictions in developing their laws in this respect.*

Keywords: Employee – Employment classification – Hong Kong – Independent Contractor – Sharing economy – Third category

### Introduction

With the advancement in technology, our way of life has changed dramatically. Information can be represented digitally, digital devices are more affordable and the programmability of software platforms is in a sustained increase.<sup>1</sup> This advancement in technology has created many new opportunities, with the rise of the sharing economy being one of the most significant.

The definition of sharing economy has been a topic for academic debates and there is no consensus as to what sharing economy is,<sup>2</sup> or even whether sharing economy itself is the correct term.<sup>3</sup> For instance, while some regard second-hand retail exchange platforms such as eBay as part of the sharing economy because they are making use of resources that are not in need,<sup>4</sup> others prefer a narrower definition which focuses on providing services (e.g., renting) instead of exchanging ownership.<sup>5</sup> Even so,

since the definition of sharing economy is not the main focus of this essay, a relatively short and comprehensive definition would suffice. Accordingly, for the purpose of this essay, the sharing economy refers to “the value in taking underutilised assets and making them accessible online to a community, leading to a reduced need for ownership of those assets.”<sup>6</sup>

The rise of the sharing economy has many benefits. For example, it has reduced transaction costs,<sup>7</sup> increased the efficiency of resource allocation,<sup>8</sup> built stronger communities<sup>9</sup> and created jobs.<sup>10</sup> However, it has also brought about some problems. Many laws and regulations failed to keep pace with the changing business environment.<sup>11</sup> An example is the classification of the status of workers participating in the sharing economy, whose job are often more contingent and casual in nature,<sup>12</sup> into one of the existing two categories, namely employees or independent contractors, using the current classification test.<sup>13</sup>

It is not the intention of this essay to provide an answer as to whether workers participating in the sharing economy should generally be classified as employees or independent contractors. In fact, it would be undesirable to classify all workers

1 A. Sundararajan, *The Sharing Economy: The End of Employment and the Rise of Crowd-Based Capitalism*, MIT Press, 2016, p. 52–53.

2 *Ibid.*, p. 27.

3 G. M. Eckhard, F. Bardhi, Harvard Business Review, The Sharing Economy Isn't About Sharing at All, <https://hbr.org/2015/01/the-sharing-economy-isnt-about-sharing-at-all>, last visited 9 July 2017.

4 Nealster, Seeking Alpha, eBay: The Original Sharing Economy Business Is A Great Value After PayPal Spinoff, <https://seekingalpha.com/article/3566266-ebay-original-sharing-economy-business-great-value-paypal-spinoff>, last visited 28 July 2017.

5 A. Sundararajan, *op.cit.*, p. 48–49.

6 A. Stephany, *The Business of Sharing: Making It in the New Sharing Economy*, Palgrave Macmillan 2015, p. 9.

7 Ernst & Young, The rise of the sharing economy, [http://www.ey.com/Publication/vwLUAssets/ey-the-rise-of-the-sharing-economy/\\$FILE/ey-the-rise-of-the-sharing-economy.pdf](http://www.ey.com/Publication/vwLUAssets/ey-the-rise-of-the-sharing-economy/$FILE/ey-the-rise-of-the-sharing-economy.pdf), last visited 9 July 2017.

8 *Ibid.*

9 A. Rudenko, Popsop, The collaborative consumption on the rise: why shared economy is winning over the capitalism of me, <http://popsop.com/2013/08/the-collaborative-consumption-sharing-wins-over-ownership/>, last visited 9 July 2017.

10 Ernst & Young

11 B. Donovan, P. Eberwine, J. Woodring, Inside Counsel, Are workers in the sharing economy independent contractors or employees? The answer is, ‘It depends’, <http://www.insidecounsel.com/2015/06/30/are-workers-in-the-sharing-economy-independent-con>, last visited 9 July 2017.

12 K. V. W. Stone, The Decline in the Standard Employment Contract: Evidence from Ten Advanced Industrial Countries, in C. V. W. Stone, H. Arthurs (eds), *After the Standard Contract of Employment: Innovations for Regulatory Design*, Russell Sage, 2013

13 See 2.1 below

participating in the sharing economy into one of the two categories as this would overlook the circumstances of each case and go against the common law rationale behind such distinction which is to protect true employees from their bargaining disadvantage they experience with their employers.<sup>14</sup> Rather, the purpose of this essay is to identify a better method to categorise the employment status so that it is easier to use and more socially and economically beneficial.

The first part of this essay describes the development of the employment categorisation and its test in Hong Kong, in which black letter analysis using case laws and statutes would mostly be used. The second part discusses whether the current employment categorisation and its test are adequate for the modern sharing economy. Here, academic journals and judgments are employed in order to illustrate the implementation of the classification test. The third part provides suggestions, in which suggestions from scholars, as well as experiences from other jurisdictions, provide valuable information from a comparative and practical point of view.

## 1. Development of the employment classification and its test in Hong Kong

### 1.1. Historical development

Hong Kong's employment law is based on the laws of England and Wales.<sup>15</sup> By the virtue of article 8 of the Basic Law, which provides for the continuation of the application of the common law in Hong Kong, large body of English common law principles are still applicable, including those of employment law.<sup>16</sup> One fundamental area of Hong Kong's employment law that is provided by common law is the determination of employment status.<sup>17</sup> Therefore, the historical development will mostly describe that of England and Wales.

The current binary classification of work relations into "employees" or "independent contractors" emerged in the mid-nineteenth century, which, at that time, was known as the masters and servants relationship.<sup>18</sup>

Traditionally, courts employed the control test as the only tool to differentiate between an employee and an independent contractor.<sup>19</sup> The control test provides that a worker is an employee if his employer has the right to control substantially the manner a job is performed.<sup>20</sup> The control test was more meaningful in the earlier years when the economies were dominated by agricultural and primitive industrial activities. Work was mostly done by labourers and craftsmen under the direction of their employers, who had similar or greater knowledge and would direct his employees as to the way to do their jobs.<sup>21</sup>

In the mid-twentieth century, industrialisation has dramatically changed the labour market. The employment relations was increasingly complex and the control test failed to cover new forms of work where the employer does not have the specialised professional skills and hence the skilled workers are granted greater autonomy in deciding the manner a job is done.<sup>22</sup> Therefore, courts have developed the enterprise or "integral part of the business" test, which looks into the extent and manner in which a person is an integral part of the business<sup>23</sup> by looking at factors such as whether employees owned their tools, whether they were paid a salary, etc.<sup>24</sup> However, this test has been criticised as being too vague as it does not define what "integral" means and can provide inconsistent results.<sup>25</sup>

In the late 1970–80s, the England and Wales courts have developed the "mutuality of obligations" test which asks whether the employer was under an obligation to provide work and whether the employee is obliged to perform that work.<sup>26</sup> The idea of "mutuality of obligations" was originally suggested in order to provide a better explanation as to why there is a

[http://www.hamiltonproject.org/assets/files/modernizing\\_labor\\_laws\\_for\\_twenty\\_first\\_century\\_work\\_krueger\\_harris.pdf](http://www.hamiltonproject.org/assets/files/modernizing_labor_laws_for_twenty_first_century_work_krueger_harris.pdf), last visited 24 July 2017; R. R. Carlson, "Why the Law Still Can't Tell an Employee When It Sees One and How It Ought to Stop Trying", *Berkeley Journal of Employment and Labour Law* 22/2001, 295, 304.

19 C. Witting, *Street on Torts*, Oxford, 2015<sup>14</sup>, p. 625.

20 F. N. Lone, *Hong Kong Tort Law: Texts, Cases and Ordinances*, LexisNexis, 2014, para 12.33.

21 C. Witting, Op. cit., p. 625.

22 R. R. Carlson, Op. cit., p. 305.

23 *Stevenson Jordan & Harrison v MacDonald & Evan* [1952] 1 TLR 101 (CA) 111 (Denning LJ)

24 F. N. Lone, para 12.36.

25 LawTeacher, *Complex Law Surrounding Employment Status*, <https://www.lawteacher.net/free-law-essays/employment-law/complex-law-surrounding-employment-status-employment-law-essay.php>, last visited 24 July 2017.

26 F. N. Lone, para 12.43.

14 R. L. Redfearn III, "Sharing Economy Misclassification: Employees and Independent Contractors in Transportation Network Companies", *Berkeley Technology Law Journal* 31/2016, p. 1023.

15 R. Glofcheski, F. Aslam, *Employment Law and Practice in Hong Kong*, Sweet & Maxwell, 2010, para 1.006.

16 Hong Kong Basic Law Article 8.

17 R. Glofcheski, F. Aslam, op. cit., para 1.012.

18 S. D. Harris, A. B. Krueger, The Hamilton Project, Brookings Institute, A Proposal for Modernizing Labor Laws for Twenty-First-Century Workers: The 'Independent Worker',

cause of action for acts such as wrongful dismissal or wrongful departure of the employee.<sup>27</sup> It was first proposed when the standard employment relationship was increasingly stable and continuous, in order to explain why newly introduced protections such as statutory notice periods<sup>28</sup>, redundancy compensation<sup>29</sup> and unfair dismissal protections<sup>30</sup> can create a cause of action.<sup>31</sup> However, the courts have instead used “mutuality of obligations” as a test to determine whether a contract of employment exists at a time when the jobs were getting more fragmented and precarious.<sup>32</sup>

Another test that was developed at that time was the “economic reality” test, which looks at whether the worker was performing a task as a person on his own account and whether and to what extent there is a chance of profit or loss.<sup>33</sup> However, this test has been criticised as failing to provide a complete definition of service from a conjectural perspective and therefore is not helpful in borderline cases.<sup>34</sup>

Due to the increasingly complex employment relations, courts nowadays will not rely only on one single test/factor, but will consider a range of factors to create an overall impression<sup>35</sup>.

## 1.2. Current classification and its test to determine whether a worker is an employee or an independent contractor

In Hong Kong, workers are classified as “employees” or “independent contractors”. It is for the plaintiff to prove, on the balance of probability, whether the relationship is one of employer-employee or one of principal-independent contractor.<sup>36</sup>

An employer is a worker engaged in a “contract of service” whereas an independent contractor is engaged in a “contract for services”.<sup>37</sup>

According to section 2 of the Employment Ordinance, a “contract of service” is ‘any agreement, whether in writing or oral, express or implied, whereby one person agrees to employ another and that other agrees to serve his employer as an employee and also a contract of apprenticeship.’<sup>38</sup>

Also, it is stipulated in the Employees’ Compensation Ordinance that an employee is ‘any person who has, either before or after the commencement of this Ordinance, entered into or works under a contract of service or apprenticeship with an employer in any employment, whether by way of manual labour, clerical work, or otherwise, and whether the contract is expressed or implied, is oral or in writing.’<sup>39</sup>

There are certain statutory exceptions to the above definition. The Employees’ Compensation Ordinance provides that any person ‘whose employment is of a casual nature, and who is employed otherwise than for the purposes of the employer’s trade or business, not being a person employed for the purposes of any game or recreation and engaged or paid through a club and not being a part-time domestic helper’<sup>40</sup> or is ‘an outworker’<sup>41</sup> or is ‘a member of the employer’s family employed by such employer and who resides with the employer’<sup>42</sup> shall not be regarded as an employee.

However, it is often difficult to decide whether a person is an employee or an independent contractor if we rely only on the statutory definitions.<sup>43</sup> This is especially so if we consider some relatively more flexible forms of employment that exists, such as part-time or casual work, domestic work, work required on a need basis, self-employment, etc.<sup>44</sup>

Accordingly, courts will consider the circumstances of each case in deciding work relationship. In the Privy Council case of *Lee Ting Sang v Chung Chi Keung*,<sup>45</sup> Lord Griffiths stated that ‘whether or not a person is employed under a contract of service is often said in the authorities to be a mixed question of fact and law.’<sup>46</sup> This also

27 M R Freedland, *The Contract of Employment*, Clarendon, 1976, p. 20.

28 Contract of Employment Act 1963 (UK).

29 Redundancy Payments Act 1965 (UK).

30 Trade Union and Labour Relations Act 1974 (UK) Schedule 1.

31 N. Countouris, UCL Labour Rights Institute On-Line Working Papers 1/2014, Uses and Misuses of ‘Mutuality of Obligations’ and the Autonomy of Labour Law, <http://www.ucl.ac.uk/laws/lri/docs/Uses-misuses-of-mutuality-of-obligations.pdf>, last visited 20 July 2017.

32 *Ibid.*

33 F. N. Lone, para 12.47; *Market Investigations Ltd v Minister of Social Security* [1969] 2 QB 173.

34 LawTeacher

35 F. N. Lone, para 12.30.

36 *Ibid.*, para 12.23.

37 *Ibid.*, para 12.18.

38 Employment Ordinance (Cap 57)(HK) Section 2.

39 Employees’ Compensation Ordinance (Cap 282)(HK) Section 2 (1).

40 *Ibid.*, Section 2 (1) (b).

41 *Ibid.*, Section 2 (1) (c).

42 *Ibid.*, Section 2 (1) (d).

43 F. N. Lone, para 12.22.

44 K Horsey, E Rackley, *Tort Law*, Oxford University Press, 2011<sup>2</sup>, p. 328.

45 [1990] 2 AC 374 (PC).

46 *Ibid.*, 384.



means that the way parties describe themselves in the contract is not a decisive factor.<sup>47</sup>

In fact, there is no single test for determining the status of a worker. Instead, all features of the relationship are taken into account in determining the work status as a matter of overall impression.<sup>48</sup> Factors the court may consider include:

1. Whether the employer could control how a worker did the job (the control test)<sup>49</sup>
2. Whether the worker was an integrated part of the business (the integration test)<sup>50</sup>
3. Payment method<sup>51</sup>
4. Whether there is any obligation to work only for a particular employer<sup>52</sup>
5. Requirements or arrangements as to hours<sup>53</sup>, holiday, overtime<sup>54</sup>, etc.
6. Arrangements for payment of income tax<sup>55</sup>
7. The filing of statutory Form 2 by an employer if injury or death occurred due to work<sup>56</sup>
8. Whether the individual or employer may delegate work<sup>57</sup>
9. Whether the worker provides the tools and equipment<sup>58</sup>
10. Who makes the Mandatory Provident Fund payments<sup>59</sup>

47 See *Chan Kwok-kin v Mok Kwan-hing* [1991] 1 HKLR 631; *Chan Shui Man v Tsang Hing Shan (t/a Yick Luen Furniture Design)* [1991] 2 HKC 243, CA.

48 *Poon Chau Nam v Yim Siu Cheung* (2007) 10 HKCFAR 156.

49 See *Yuen Mei v Hop Sze Machine Shop (a firm)* [1961] HKDCLR 193, DC.

50 See *Cheng Yuen v The Royal Hong Kong Golf Club* [1996] 2 HKLR 302.

51 See *Lee Chi-fai v Sunrise Knitting Factory Ltd* [1973] HKDCLR; and *Cheung Hung-yuk v Chiu Chai* (unreported; A7600/1985).

52 See *Wong Chi Wo v Cheng Muk Yung (t/a Cheng Muk Yung Steel Binding Engineering)* (unreported, 19 January 1996; LTA No 55/1995).

53 See *Chan Shek Kiu v Hip Shing Printing Press* [1965] HKDCLR 93; *HKSAR v Chan Wai Sang* (unreported, 24 November 2000; HCMA 940/2000).

54 See *Leung Kam Fat v Johnathan's Fashion Manufacturing Ltd* (unreported; LTA 14/ 1988).

55 See *Chan Sau Ying v Yuk Luk Sauna* (unreported, 16 February 1995; HCLA 82/94).

56 See *Cheung Shuk Wah Jessica v Wong Kang Hung Darwin* [2009] 6 HKC 182, DC.

57 See *Lee Chi Fai v Sunrise Knitting Factory Ltd* [1973] HKDCLR 61, DC.

58 See *Chan Sau Ying v Yuk Lung Sauna* (unreported; 16 February 1995; HCLA 82/1994).

59 See *Helskens Jan Bert Julia v AXA International Ltd* (unreported, 29 August 2008; HCA 1348/2005), CFI.

11. Who bears the profit enjoyment and loss risk<sup>60</sup>

12. Nature of the work itself<sup>61</sup>

13. Whether there is sufficient mutuality of obligations to justify a finding that there was a contract of employment<sup>62</sup>

Generally speaking, an independent contractor is separated from the employer and thus the contractor can stand on his own and support himself by contracting his services for jobs. Employees, on the other hand, are much more dependent on their employer as they contract their labour instead of their service.<sup>63</sup>

### 1.3. Significance of the distinction between "Employees" and "Independent contractors"

The distinction between "employees" and "independent contractors" is significant as employee status triggers a range of employer obligations and employee entitlements.<sup>64</sup>

Employers owe a non-delegable<sup>65</sup> duty of reasonable care to its employees in relation to their safety at work.<sup>66</sup> This non-delegable duty is fourfold, namely the provision of competent co-workers,<sup>67</sup> the duty to provide a safe place of work,<sup>68</sup> the duty to provide safe plant and tools,<sup>69</sup> and the duty to provide safe system of work.<sup>70</sup> There are also statutory duties imposed on employers towards employees. For instance, there is a statutory duty to ensure the 'health and safety at work of all persons employed by him

60 See *Leung Chun Pong v Cheng Man Tung* (unreported, 16 June 2008; HCPI 296/2007), CFI per To J at para 19.

61 See *Cheng Yuen v The Royal Hong Kong Golf Club* (unreported; CACV No 146/1996).

62 See *O'Kelly v Trusthouse Forte plc* [1984] QB 90, [1983] ICR 728, CA (Eng).

63 Brown, "An Uberdilemma: Employees and Independent Contractors in the Sharing Economy", *Maryland Law Review* 75/2016, 15, 32.; *Lee Ting Sang v Chung Chi Keung* [1990] 1 HKLR 764, 766.

64 R. Glofcheski, F. Aslam, Op. cit., para 2.007.

65 *Kristan Boers Phillips v Initial Environmental Services Ltd* [1997] HKEC 755.

66 R. Glofcheski, F. Aslam, Op. cit., para 10.004.

67 See, e.g., *Lau Pai Yam v ai Tung Coffee Co Ltd* [2003] HKEC 1191; *Ha Kwok Ming v Boxton Ltd* [2009] HKEC 2005.

68 See, e.g., *Tam Kam Fai v Michael J Design Let* [2006] HKEC 1820; *Wong Wai Ming v Hospital Authority* [2001] 3 HKLRD 209.

69 See, e.g., *Chan Kwai Sum v Ultimate Engineering Ltd* [2004] HKEC 1226; *Fan Hung Shing v Hang Fung Shipping Co Ltd* [2000] HKEC 65; *Chan Kin Ka v Siu Tung Hung* [1999] HKEC 355.

70 See, e.g., *Cathay Pacific Airways v Wong Sau Lai* [2006] 9 HKCFAR 371.

at the industrial undertaking.<sup>71</sup> Also, employers have a statutory duty to ensure the safety and health of employees at work.<sup>72</sup>

Employees are entitled to basic protection in the Employment Ordinance, such as payment of wages,<sup>73</sup> restriction on wages deductions<sup>74</sup> and the granting of statutory holidays<sup>75</sup>. Also, employees are protected under the Minimum Wage Ordinance.<sup>76</sup> Protections under the Employees' Compensation Ordinance, including compensation for injury or death arising out of and in the course of employment<sup>77</sup>, compensation for occupational diseases<sup>78</sup> and compulsory insurance<sup>79</sup>, are available to employees too. Further, employees are protected under the Mandatory Provident Fund Schemes Ordinance, including employers' contribution<sup>80</sup>. However, independent contractors are not entitled to the above protections.

Another distinction is that employers are generally vicariously liable for the acts of their employees in the course of the employee's employment,<sup>81</sup> but generally not vicariously liable for the acts of independent contractors,<sup>82</sup> except in cases such as negligence of the employer in engaging an incompetent independent contractor<sup>83</sup> and cases involving employer's non-delegable duties.<sup>84</sup>

After looking at the historical background and the current classification and its test, we can now move on to see whether the current classification and its test is applicable in today's economy.

## 2. Evalutaion of the current employment classification and the current classification test

This part of the essay will first evaluate whether the current test is suitable for today's sharing economy from a judicial application perspective. Then, the applicability of the current binary employment classification in the sharing economy will be discussed from a socio-economical perspective.

### 2.1. Applicability of the current classification test in the modern sharing economy

With the increasingly complex hybrid working arrangements in the modern economy, the question of whether the current employment classification test is still suitable has led to debates.

#### 2.1.1. LACK OF LEGAL CERTAINTY

In fact, criticisms regarding the current test have been around for some time.<sup>85</sup> This is due to the fact that with the many factors in the current test are increasingly less relevant in today's economy and that they can be manipulated more easily.<sup>86</sup>

The main criticism is that the current test lacks legal certainty. There are many different factors that can be considered, but there are no rules regarding the weight given to any particular factor.<sup>87</sup> Also, some of the relevant factors involve an examination of objective facts, while others involve examining subjective factors or a combination of objective and subjective factors.<sup>88</sup> The combination of the above two reasons has led to situations where the classification is unclear.<sup>89</sup> In certain cases, instead of reaching the final decision by applying the test objectively, a judge may focus only on several factors that point towards a category in order to justify the judge's pre-determined outcome.<sup>90</sup>

71 Factories and Industrial Undertakings Ordinance (Cap 59)(HK) Section 6A .

72 Occupational Safety and Health Ordinance (Cap 509) Section 6.

73 Employment Ordinance (Cap 57)(HK) Part 5.

74 *Ibid.*, Section 32.

75 *Ibid.*, Part 8.

76 Minimum Wage Ordinance (Cap 608)(HK) Section 8(1).

77 Employees' Compensation Ordinance (Cap 282)(HK) Section 5, 6, 9, 10.

78 *Ibid.*, Section 32.

79 *Ibid.*, Section 40.

80 Mandatory Provident Fund Schemes Ordinance (Cap 485)(HK) Part 3.

81 N. Sarony, Vicarious Liability, in Bokhary PJ, N. Sarony, D. K. Srivastava (eds), *Tort Law and Practice in Hong Kong*, Sweet & Maxwell, 2011<sup>2</sup>, para 2.035.

82 *Ibid.*, para 2.064.

83 See *Luen Hing Fat Coating & Finishing Factory Ltd v Waan Cheung Ming* [2001] 2 HKLRD 223.

84 N. Sarony, Op. cit., para 2.067–2.097.

85 See, e.g., *NLRB v. Hearst Publ'ns, Inc.*, 322 U.S. 111, 121 (1944) per Justice Wiley Blount Rutledge

86 J. Pinsof, "A New Take On An Old Problem: Employee Misclassification in the Modern Gig-Economy" *Michigan Telecommunications and Technology Law Review* 22/2016, p. 340, p. 351. –missing first and last page of the article First page: p. 340; Last page: p. 373

87 S. D. Harris, A. B. Krueger, Op. cit., p. 6.

88 R. L. Redfearn, Op. cit., p. 1034.

89 P. Walsh, *Hong Kong Employment Law: A Practical Guide*, CCH, 2008<sup>2</sup>, p. 36.

90 S. D. Harris, A. B. Krueger, Op. cit., p. 6.

The problem of the current classification test has become even more apparent after the exponential growth of the sharing economy. This is due to the both the increase in the number of sharing economy jobs<sup>91</sup> as well as the “intrinsically contingent and casual nature” of those jobs.<sup>92</sup> Also, workers often deploy their own capital, may never meet their putative employers<sup>93</sup> and there is a reduction in the importance of the physical workplace.<sup>94</sup> Moreover, workers are increasingly managed by and through data and are, in a sense, indirectly controlled and monitored.<sup>95</sup> Work fragmentation (i.e. breaking down jobs into smaller time segments or looser contractual terms)<sup>96</sup> due to the “cloud-based nature”<sup>97</sup> of the jobs in the sharing economy, and the heavy reliance on new technology (thus certain platforms label themselves as technology companies that connects workers and consumers)<sup>98</sup> in those jobs has led to many disputes as to the employment status.

The problem of legal uncertainty resulting from the current classification test when applied in sharing economy cases can be illustrated using Uber Technologies, Inc. (“Uber”) as an example.

#### 2.1.1.1. The case of uber

Uber is a ride-sharing company that provides a medium through which drivers and passengers can connect<sup>99</sup> and it is one of the most successful

sharing economy companies.<sup>100</sup> A reason behind Uber’s success was that Uber treats its drivers as independent contractors, thus avoiding many additional costs (e.g., minimum wage, insurance, etc.)<sup>101</sup>. This practice, however, has led to many disputes across different jurisdictions.<sup>102</sup>

The numerous disputes are due to the fact that Uber is currently operating in a legal grey area. In fact, it was suggested that in deciding the employment status of on-demand drivers, applying the current test is like being ‘handed a square peg and asked to choose between two round holes’.<sup>103</sup>

Even though the standard contract between Uber and the driver explicitly states that Uber is merely a technology platform that connects drivers and passengers and that the drivers are not employees but are ‘independent third party contractors’,<sup>104</sup> the court still have to look at the features of the relationship before deciding their employment status.<sup>105</sup> Applying the current classification test to Uber’s case, several factors are uncertain and debatable.

Firstly, it is unclear whether Uber can control substantively the manner Uber drivers do their job.

While Uber drivers are not required to carry any type of Uber insignia or wear a uniform,<sup>106</sup> Uber provides “suggestions” in the Uber Driver Handbook.<sup>107</sup> Some of the suggestions include dressing professionally, keeping the radio on “soft jazz or NPR” and carrying umbrella for passengers,<sup>108</sup> which is addressing the manner a driver completes the job.<sup>109</sup> Although Uber

91 The Independent, *Sharing Economy: Growth of Part-Time, Flexible Jobs Offered by Companies such as Uber is a Double-Edged Sword*, <http://www.independent.co.uk/voices/sharing-economy-growth-of-part-time-flexible-jobs-offered-by-companies-such-as-uber-is-a-double-a6875926.html>, last visited 29 July 2017.

92 K. V. W. Stone, *The Decline in the Standard Employment Contract: Evidence from Ten Advanced Industrial Countries*, in C. V. W. Stone, H. Arthurs (eds), *After the Standard Contract of Employment: Innovations for Regulatory Design*, Russell Sage, 2013.

93 B. Means, J. A. Seiner, “Navigating the Uber Economy” *U.C. Davis Law Review* 49/2016, p. 1511, p. 1525.

94 *Ibid.*, 1525.

95 M. A. Cherry, “Beyond Misclassification: The Digital Transformation of Work”, *Comparative Labor Law & Policy Journal* 37/2016, 577, p. 596–597.

96 Research Office of the Legislative Council Secretariat, “Challenges of Manpower Adjustment in Hong Kong”, Research Brief Issue No. 4 2015–2016, p. 4.

97 A. Chen, *New Yorker*, *An Uber Labor Movement Born in a LaGuardia Parking Lot*, <http://www.newyorker.com/business/currency/an-uber-labor-movement-bom-in-a-laguardia-par king-lot>, last visited 25 July 2017.

98 G. B. White, *The Atlantic*, *In the Sharing Economy, No One’s an Employee*, <https://www.theatlantic.com/business/archive/2015/06/in-the-sharing-economy-no-ones-an-employee/395027/>, last visited 20 July 2017.

99 Uber, *Our Story*, <https://www.uber.com/en-HK/our-story/>, last visited 20 July 2017.

100 D. MacMillan, T. Demos, *Wall Street Journal*, *Uber Valued at More Than \$ 50 Billion*, <http://www.wsj.com/articles/uber-valued-at-more-than-50-billion-1438367457>, last visited 20 July 2017.

101 See 1.

102 See, e.g., *Aslam v Uber BV* [2017] I.R.L.R. 4 (UK); *O’Connor et al v. Uber Technologies, Inc.*, C.A. No. 13–03826-EMC (N.D. Cal.); *Berwick v Uber Technologies, Inc.*, No. 11–46739 EK, 2015 WL 4153765 (CA Dept. Lab. June 3, 2015), etc.

103 *Cotter v Lyft, Inc.*, 60F. Supp. 3d 1067, 1070 (N.D.Cal. 2015).

104 Uber, *Legal*, <https://www.uber.com/legal/terms/hk/>, last visited 23 July 2017; Uber, *Software License and Online Services Agreement*, <http://hostcarsla.com/Software%20License%20and%20Online%20Services%20Agreement.pdf>, last visited 20 July 2017.

105 See *Chan Kwok-kin v Mok Kwan-hing* [1991] 1 HKLR 631; *Chan Shui Man v Tsang Hing Shan (t/a Yick Luen Furniture Design)* [1991] 2 HKC 243, CA; *Poon Chau Nam v Yim Siu Cheung* (2007) 10 HKCFAR 156.

106 Uber, *Software License and Online Services Agreement*.

107 R. L. Redfearn, *Op. cit.*, p. 1044.

108 *O’Connor et al v. Uber Technologies, Inc.*, C.A. No. 13–03826-EMC (N.D. Cal.) at 1149.

109 R. L. Redfearn, *Op. cit.*, p. 1048.



maintains that those are only “suggestions”, when a driver’s average rating is below a certain level, Uber might terminate the Driver Contract.<sup>110</sup> This provides strong incentive for Uber drivers to strictly adhere to those “suggestions”.

Also, while Uber does not control the exact route its drivers take, Uber can arguably exert soft control over its drivers through its surge pricing practice.<sup>111</sup> The surge pricing practice refers to how Uber increases the fare, often multiple times, in areas where supply fails to meet demand.<sup>112</sup> In fact, Uber has admitted that it is to encourage its drivers to either start working or to move to an area where there is high demand to ensure a certain level of driver availability to the passengers.<sup>113</sup> However, Uber may argue that the surge pricing practice is simply a reflection of the market demand and that drivers remained free to decide whether to start driving in the price surge area.<sup>114</sup>

Hence, it is unclear whether Uber can control substantively the manner Uber drivers complete their job.

Secondly, it is hard to determine whether Uber drivers are integrated into the business of Uber. Although Uber maintains that it is merely a technology company that connect Uber drivers with passengers and is not a transportation provider,<sup>115</sup> it cannot exist without its drivers.<sup>116</sup> Also, it is unclear whether Uber drivers owned their own tools or whether the tools are provided by Uber.<sup>117</sup> Uber asserts that its drivers must ‘provide all necessary equipment, tools and other material, at their own expenses’.<sup>118</sup> Yet, whether the Uber application would be considered as a tool is debatable.<sup>119</sup> Hence, it is difficult to determine whether Uber drivers are integrated into the business of Uber.

Thirdly, it is unclear whether Uber driver is obliged to perform the work provided by Uber. Uber does not prohibit its drivers from engaging in other occupations or using other similar software.<sup>120</sup> In fact, most of the Uber drivers have another full-time or part-time job.<sup>121</sup> However, even though Uber does not dictate its drivers’ working schedule, drivers are required to drive at least once a month or risk being deactivated.<sup>122</sup> Also, once an Uber driver turns on the Uber application, the driver has to accept most of the ride requests to maintain a certain ride acceptance rate or else could be terminated.<sup>123</sup> Therefore, it is unclear whether there is a mutuality of obligations.

Fourthly, even though Uber drivers are not paid wages and has the profit enjoyment and loss risk, Uber has the right to control how fares are calculated.<sup>124</sup> It also has the sole discretion to determine the fee Uber receives based on “local market factors”.<sup>125</sup> Drivers cannot negotiate the fares with the passengers, unless they are negotiating for a lower fare.<sup>126</sup>

Hence, the current test does not provide a clear picture as to whether a Uber driver is an employee or an independent contractor. Many disputes and litigations across the world have resulted from such legal uncertainty, with different courts and agencies reaching conflicting results.<sup>127</sup> For example, the Florida Department of Economic Opportunity found that Uber drivers are independent contractors<sup>128</sup> whereas the California Labour Commission ruled that they are employees<sup>129</sup>. This shows that judges can make

120 R. L. Redfearn, Op. cit., p. 1052.

121 K. K. Tsui, HK01, Starting From the Hong Kong Uber Case, Sharing Litigation’s Politics and Economics (從香港Uber案談起 共享官司的政治經濟), <https://www.hk01.com/01%E5%8D%9A%E8%A9%95-%E6%94%BF%E7%B6%93%E7%A4%BE/59804/%E5%BE%9E%E9%A6%99%E6%B8%AFUber%E6%A1%88%E8%AB%87%E8%B5%B7-%E5%85%B1%E4%BA%AB%E5%AE%98%E5%8F%B8%E7%9A%84%E6%94%BF%E6%B2%BB%E7%B6%93%E6%BF%9F>, last visited 25 July 2017.

122 M. Akande, Uberkit, How to Reactivate Your Uber Driver Account, <https://www.uberkit.net/blog/how-to-reactivate-your-uber-driver-account/>, last visited 21 July 2017.

123 R. L. Redfearn, Op. cit., p. 1049.

124 Uber, Software License and Online Services Agreement, para 5.1.1.

125 *Ibid*, para 5.2.1.

126 *Ibid*, para 1.12.

127 Brown, Op. cit., p. 16, p. 27.

128 *Raiser, LLC v Department of Economic Opportunity*, No. 0026 2825 90–02 (Fla. Dep’t of Econ. Opportunity Sept. 30, 2015).

129 *Berwick v. Uber Technologies, Inc.*, No. 11–46739 EK, 2015 WL 4153765 (CA. Dept. Lab. June 3, 2015).

110 J. Cook, Business Insider, Uber’s Internal Charts Show How its Driver-Rating System Actually Works, <http://uk.businessinsider.com/leaked-charts-show-how-ubers-driver-rating-system-works-2015-2>, last visited 24 July 2017.

111 R. L. Redfearn, Op. cit., p. 1051.

112 J. Hall, C. Kendrick, Uber Newsroom, The Effects of Uber’s Surge Pricing, <https://newsroom.uber.com/the-effects-of-ubers-surge-pricing/>, last visited 25 July 2017.

113 M. B. Quirk, Consumerist, How Do Uber and Lyft Work And Why Should I Even Care?, <https://consumerist.com/2014/09/18/how-do-uber-and-lyft-work-and-why-should-i-even-care/>, last visited 25 July 2017.

114 B. Means, J. A. Seiner, Op. cit., p. 1543.

115 Uber, Legal; M. Macmurdo, “Comment, Hold the Phone! “Peer-To-Peer” Ridesharing Services, Regulation, and Liability”, *Louisiana Law Review* 76/2015, p. 307, p. 310. – missing first and last page of the article\* First page: p. 307; Last page: p. 353

116 See *Aslam v Uber* 2202551/2015

117 A. Sundararajan, Op. cit., p. 186.

118 Uber, Software License and Online Services Agreement.

119 A. Sundararajan, Op. cit., p. 186.



use of the legal uncertainty in the classification test as illustrated above and weigh factors differently, even arbitrarily, leading to different results in similar cases.<sup>130</sup>

The above has illustrated how the sharing economy has pushed the current employment classification test to the limit and promoted legal uncertainty. This essay will now describe the consequences of such legal uncertainty.

### 2.1.2. CONSEQUENCES OF THE LEGAL UNCERTAINTY

From workers' perspective, the legal uncertainty means that it would be difficult for workers to know what benefits they are qualified for.<sup>131</sup> In theory, if there is ambiguity, workers can always seek clarification by the court. However, due to the "cloud-based nature"<sup>132</sup> and the fragmentation of jobs in the sharing economy,<sup>133</sup> individual workers they have less resources available as they are not supported by unions and thus have less incentive to initiate legal action. Most individual workers simply do not want to invest so much of their own money and resources to fight a legal battle that is likely to be long and complex, but the chances of succeeding is uncertain. As a result, most of the workers would rather relinquish the right to claim those benefits or to clarify the work status. This has encouraged companies to misclassify employees.<sup>134</sup>

Another unintended consequence of the current classification test is that it discouraged sharing economy companies from providing more support (e.g., offering training or additional insurance) to the workers, as it may turn the relationship into one of employer-employee.<sup>135</sup> This means that it is more difficult for companies to standardise quality, for workers to be better equipped and supported to do their job, and for consumers to enjoy better services, creating an all-lose situation. By observing the practice in other jurisdictions, such as the United States, which has the largest sharing economy in the world,<sup>136</sup> applying the common law employment

test has led to many long legal battles. This is not advantageous for both the workers and the company as litigation process can be very expensive and stressful. The numerous long legal battles may also have adverse effect to the development of the sharing economy. For example, the home services platform Homejoy, ceased operation in 2015 because it was involved in four lawsuits concerning the employment classification of its workers and could not attract funding.<sup>137</sup>

### 2.1.3. WHETHER THE CURRENT CLASSIFICATION TEST IS ALREADY ADEQUATE FOR HONG KONG

Despite the adverse consequences brought about by the current employment classification test, some may argue that the test is already adequate for Hong Kong.

This is because 'imprecise tests are common in law'<sup>138</sup>. For example, the "reasonable person" test, which is widely used in different areas of private, criminal and public law, has also been criticised as being too imprecise as there can be widely diverging views as to how the hypothetical reasonable person would act in a certain situation.<sup>139</sup> In other words, the exact nature of the objective and subjective characteristics of the hypothetical reasonable person is unclear.<sup>140</sup> Nevertheless, it is sometimes accepted that such uncertainty is necessary in order to provide greater flexibility to the courts to cope with the uniqueness of each case.<sup>141</sup> Nonetheless, it does not mean that such uncertainty is preferable if there are ways which can provide greater certainty.<sup>142</sup>

It is often said that the current classification test is already adequate because in Hong Kong, there has been relatively little enthusiasm as to whether the current classification test is suitable for the sharing economy. In fact, there has not

*mediatechnologyandtelecoms/11882122/Mapped-how-the-sharing-economy-is-sweeping-the-world.html*, last visited 25 July 2017.

137 C. Deamicis, Recode, Homejoy Shuts Down After Battling Worker Classification Lawsuits, <https://www.recode.net/2015/7/17/11614814/cleaning-services-startup-homejoy-shuts-down-after-battling-worker>, last visited 20 July 2017.

138 Brown, Op. cit., p. 39.

139 See, BBC, What is the Ghosh test for dishonesty?, <http://news.bbc.co.uk/1/hi/magazine/8242050.stm>, last visited 25 July 2017.

140 M. Moran, "The Reasonable Person: A Conceptual Biography in Comparative Perspective", *Lewis & Clark Law Review* 14/2013, p. 1233, p. 1235.

141 R. R. Carlson, Op. cit., p. 322.

142 *Ibid*, p. 322.

130 Brown, Op. cit., p. 30.

131 S. D. Harris, A. B. Krueger, Op. cit., p. 6.

132 A. Chen, New Yorker, An Uber Labor Movement Born in a LaGuardia Parking Lot, <http://www.newyorker.com/business/currency/an-uber-labor-movement-bom-in-a-laguardia-par-king-lot>, last visited 25 July 2017.

133 Research Office of the Legislative Council Secretariat, p. 4.

134 J. Pinsof, Op. cit., p. 343.

135 S. D. Harris, A. B. Krueger, Op. cit., p. 5.

136 L. Davidson, The Telegraph, Mapped: How the Sharing Economy is Sweeping the World, <http://www.telegraph.co.uk/finance/newsbysector/>

been any court case concerning the employment classification of workers participating in the sharing economy in Hong Kong. There is also relatively little academic research on this topic in Hong Kong compared to other jurisdictions. The lack of dispute provides strong evidence that the current classification test is already adequate for Hong Kong.

However, this essay argues that the lack of dispute or litigation in Hong Kong in this regard does not necessarily mean the current classification test is adequate. A possible reason why there is yet any litigation in sharing economy cases is due to the lack of incentive to spend so much time, money and resources<sup>143</sup> to fight for the relatively limited employment benefits currently available in Hong Kong. Another reason is that sharing economy is relatively less developed in Hong Kong compared to other jurisdictions, hence there is relatively few sharing economy workers.<sup>144</sup> However, as more people participate in the sharing economy, combined with the recent trend in Hong Kong of providing more statutory employment benefits<sup>145</sup> (e.g., the enactment of the Minimum Wage Ordinance in 2010, the proposed minimum working hour<sup>146</sup>), it is foreseeable that the number of litigations in this regard is likely to increase.

As a matter of fact, there have always been disputes and litigations due to the lack of legal certainty caused by the current employment classification test in Hong Kong, although not in relation to the sharing economy. Some may argue that courts can develop case laws in order to provide greater legal certainty and clarify the distinction.<sup>147</sup> Case law also enables courts to have greater flexibility to deal with each individual case. However, this is not an easy task. In fact, in *Wong Ki v Shun Tak Electrical Mechanical and Air Conditioning Engineering (Hong Kong) Co Ltd*<sup>148</sup>, Judge Chan stated:

*'The parties in this case, as laymen, have expressed confusion and bewilderment over the question of when a worker is, in law, an employee, and when he is an independent contractor. They may get some comfort from the fact that often, lawyers are just as confused, and that the question cannot be easily answered by the courts.'*<sup>149</sup>

When even judges and lawyers are confused about the question of employment classification, the argument that case law provides a useful guidance does not seem to be valid.

Therefore, the current classification test is inadequate for Hong Kong, especially after the emergence of the sharing economy.

## 2.2. Applicability of the current Binary classification in the sharing economy

Classifying workers into either one of the employment classification might not be ideal for consumers, workers and companies participating in the sharing economy.

### 2.2.1. CLASSIFYING A PARTICULAR WORKER AS AN EMPLOYEE

From the worker's perspective, an advantage of being classified as an employee is that the worker will be entitled to employee protection and entitlements. However, the downside is that this could mean less flexibility for the workers. This is significant as one of the main reasons why workers participate in the sharing economy is its flexibility (43% of the sharing economy workers say they prefer the flexibility of sharing economy jobs even at the expense of job security and benefits)<sup>150</sup>.

From the employer's perspective, classifying workers participating in the sharing economy as employees will increase cost significantly as they have to provide employment benefits. For instance, if Uber drivers are considered as employees, it will cost Uber \$4.1 billion USD a year.<sup>151</sup> It has been suggested that many sharing economy companies are not financially equipped to cover such cost.<sup>152</sup>

143 See above at 2.1.2

144 C. Yau and N. Sun, SCMP, Why won't Hong Kong embrace sharing economy?, <http://www.scmp.com/news/hong-kong/economy/article/2102418/why-wont-hong-kong-embrace-shared-economy>, last visited 30 July 2017.

145 Hong Kong Judiciary, Report of the Working Party on the Review of the Labour Tribunal, [http://www.judiciary.hk/en/publications/lt\\_review\\_report-final.pdf](http://www.judiciary.hk/en/publications/lt_review_report-final.pdf), last visited 30 July 2017.

146 H. Singh, SCMP, Hong Kong government working hours plan slammed in Legislative Council, <http://www.scmp.com/news/hong-kong/politics/article/2099240/hong-kong-government-working-hours-plan-slammed-legislative>, last visited 30 July 2017.

147 S. D. Harris, A. B. Krueger, Op. cit., p. 15.

148 [2009] HKEC 595

149 *Ibid.*, [7] (Chan J); See also *Poon Chau Nam v Yim Siu Cheung* [2007] 1 HKLRD 951, 957 (Ribeiro PJ).

150 A. Griswold, Quartz, The verdict on the "sharing" economy, from the 20% of Americans who've worked in it, <https://qz.com/587737/the-verdict-on-the-sharing-economy-from-the-20-of-americans-whove-worked-in-it/>, last visited 30 July 2017.

151 S. Gandel, Fortune, Uber-nomics: Here's what it would cost Uber to pay its drivers as employees, <http://fortune.com/2015/09/17/ubernomics/>, last visited 30 July 2017.

152 K. J. Marton, Jaburg Wilk, The Death of the Individual Independent Contractor: A Growing Trend Points to An Uncertain Future, <http://www.jaburgwilk.com/news-publications/the-death-of-the-individual-independent->

### 2.2.2. CLASSIFYING A PARTICULAR WORKER AS AN INDEPENDENT

From the worker's perspective, they will gain flexibility but will not be entitled to employment benefits and protection.

From the employer's perspective, although cost can be reduced due to the fact that the employer does not have to provide employment benefits, the employer cannot exert control over the manner the worker completes his job and cannot provide additional support such as training, or else risk being classified as an employer-employee relationship. This means that it can be difficult for the employer to control the quality of the service. From the consumer's perspective, classifying a particular worker as an independent contractor means that there will not be as much protection against tortious acts because the employer, who usually has greater financial capability, is generally not vicariously liable for the acts of independent contractors.

Therefore, the current binary classification is not ideal for the sharing economy.

## 3. Solution

The current classification and its test are inadequate in the sharing economy. Accordingly, this part of the essay will analyze some proposed solutions and provide recommendations.

### 3.1. Changing or modifying the classification test

It has been suggested that the problem of the lack of legal certainty can be mitigated by changing or modifying the classification test. Below are some suggestions raised by scholars.

#### 3.1.1. LIMITING THE NUMBER OF FACTORS TO BE CONSIDERED IN THE CLASSIFICATION TEST

It has been proposed that since confusion, subjectivity and over-mechanical application are likely to be the result of a legal test with too many different factors, the classification test should eliminate out-dated and manipulable factors, such as method of payment,<sup>153</sup> and instead be limited to three to four core factors that is more relevant to the modern economy and the sharing economy,<sup>154</sup> such as the control test and the entrepreneurial opportunity for gain or loss.

*contractor-a-growing-trend-points-to-an-uncertain-future*, last visited 22 July 2017.

153 J. Pinsof, Op. cit., p. 368.

154 B. Beebe, "An Empirical Study of the Multifactor Tests for Trademark Infringement", *California Law Review* 94/2006, 1581, 1646.

The reason behind such proposal is that by reducing the number of factors, the test can be clearer and more concise, hence can be applied more easily and reduce misclassification.<sup>155</sup>

However, this proposal seems to overlook the fact that the current multi-factored classification test has been developed in order to provide a more flexible and pragmatic approach in classifying the employment status of workers in the modern economy.<sup>156</sup> In fact, courts have repeatedly stated that there should not be a rigid rule or consideration in determining the employment status of a worker.<sup>157</sup> In the case of *Market Investigations Ltd v Minister of Social Security*,<sup>158</sup> Justice Cook stated:

*'No exhaustive list has been compiled and perhaps no exhaustive list can be compiled of the considerations which are relevant in determining that question, nor can strict rules be laid down as to the relative weight which the various considerations should carry in particular cases'*<sup>159</sup>

In other words, by only looking at three to four core factors, it would be extremely difficult for the court to have a complete picture of the relationship, thus providing an inaccurate outcome that cannot reflect the true relationship.

#### 3.1.1.1. Employing only objective standards

In order to mitigate the problem of subjective balancing inherent in the current classification test, it is recommended that classification should be based on objective standards, such as hours worked or the proportion of the total income that is derived from a particular job.<sup>160</sup> This way, the employment status of a worker can be absolutely clear for the worker, the employer and the court.

However, by looking at just the objective standards, the results might not present a complete picture of the employment relationship. There is a risk that casual and part-time workers who work for the employer's trade and business will no longer be treated as employees and hence loses all the employee protections and entitlements currently available to them.<sup>161</sup>

155 J. Pinsof, Op. cit., p. 368.

156 R. Glofcheski, *Tort Law in Hong Kong*, Sweet & Maxwell 2002, 351.

157 See, e.g., *Montreal v Montreal Locomotive Works Ltd* [1947] 1 DLR 161; *Ready Mixed Concrete (South East) Ltd v Ministry of Pensions and National Insurance* [1968] 2 QB 497; *Tsang Kar Lee & Ors v Rich Long Transaction Limited & Anor* [2000] HKCU 1005; See also above at 1.

158 [1969] 2 QB 173

159 *Ibid.*, p. 184.

160 R. L. Redfearn, Op. cit., p. 1055–1056.

161 See *Lee Ting Sang v Chung Chi Keung* [1990] 1 HKLR 764.

There is also a risk that workers and employers can manipulate the classification test by changing their work arrangements in order to fit into a particular classification, resulting in inaccurate classification.<sup>162</sup>

Hence, the recommendation of employing only objective standards does not seem to be viable.

#### 4. Focusing on flexibility

This method is advocated by Professor Benjamin Means and Professor Joseph Seiner. They argue that the main problem of the current classification test is that the range of factors which the court can take into account do not all point to the same direction.<sup>163</sup> This causes legal uncertainty, increases expenses of litigating parties and wastes judicial resources as a result.<sup>164</sup> What is missing in the current classification test is a 'higher-level conceptual analysis' in order to help courts to classify different work relations, including those in the sharing economy, into the existing classification consistently.<sup>165</sup>

Research indicates that workers in the sharing economy value flexibility a lot. In a survey done by Uber drivers, 55.8% of the drivers believe that the most important thing for a sharing economy worker is flexibility.<sup>166</sup> Accordingly, Professor Means and Professor Seiner proposed that while applying the factors in the current classification test, the higher-level conceptual guideline should be the level of flexibility the worker has in the work relationship.<sup>167</sup> This means that a worker should not be classified as an independent contractor if the worker does not enjoy meaningful flexibility<sup>168</sup> (i.e., the ability to freely choose the time, price, place, frequency and manner of work<sup>169</sup>).

An advantage of focusing on flexibility is that it is in accordance with the preference of workers participating in the sharing economy.<sup>170</sup> It has also been argued that the focus on flexibility is in line with the 'intuitive judgments about fairness',<sup>171</sup> as it is fair to classify workers as independent contractors, and thus do not have

the employee protections and entitlements, if they have the power to decide when, what, how and whether to perform a particular task.<sup>172</sup> Furthermore, the focus on flexibility can utilise the different factors in the current classification test, thus enable the court take into consideration of the unique characteristics of each case.<sup>173</sup>

Despite the numerous benefits of the focus on flexibility approach, there are some fatal drawbacks. A problem is that it is often difficult to determine whether there is meaningful flexibility. For instance, this approach cannot answer clearly whether the soft control exerted by Uber on its drivers<sup>174</sup> would mean that Uber drivers do not have meaningful flexibility. In fact, meaningful flexibility, as defined above, is likely to be already implied and take into account when judges apply the current classification test to generate an overall impression of the work relationship. In other words, the focus on flexibility approach is simply a different way of describing how judges reach a decision using the current classification test and is not providing any additional guidance.

Therefore, the focus on flexibility approach is not helpful in improving the current classification test.

##### 4.1. Shifting the burden of proof to the employer

Shifting the burden of proof to the employer means that it is for the employer to prove on the balance of probability that a worker belongs to a particular category.

By shifting the burden of proof to the employer, it would increase the difficulty and discourage employers to misclassify workers.<sup>175</sup> Also, the number of workers entitled to employee entitlement and employee benefits by default will increase.<sup>176</sup> It is also fairer to place the burden of proof on the employer, who is the party with more resources available and typically has greater legal knowledge, than on the workers.<sup>177</sup> In fact, this method has been adopted in several jurisdictions such as the Netherlands,<sup>178</sup> Portugal<sup>179</sup> and Hungary<sup>180</sup> with satisfactory outcome.<sup>181</sup>

162 R. L. Redfearn, Op. cit., p. 1055.

163 B. Means, J. A. Seiner, Op. cit., p. 1532.

164 *Ibid*, p. 1532

165 *Ibid*, p. 1527.

166 H. Campbell, The Rideshare Guy, 2016 Survey Results: How Satisfied Are Uber Drivers Really?, <http://therideshareguy.com/2016-survey-results-how-satisfied-are-uber-drivers-really/>, last visited 29 July 2017.

167 B. Means, J. A. Seiner, p. 1535.

168 *Ibid.*, p. 1517.

169 *Ibid.*, p. 1545.

170 *Ibid.*, p. 1538.

171 *Ibid.*, p. 1539.

172 *Ibid.*, p. 1539.

173 *Ibid.*, p. 1539.

174 See above at 2.1.1

175 J. Pinsof, Op. cit., p. 367.

176 *Ibid.*, 367.

177 *Ibid.*, 368.

178 See *Groen/Schoevers* (HR 14 November 1997, NJ 1998, 149, JAR 1997, 263)(The Netherlands); See also Flexibility and Security Act 1998 (The Netherlands)

179 Labour Code (Portugal) Article 12.

180 Act LXXV of 1996 (Hungary) Section 1 (5).

181 Governance and Tripartism Department of the International Labour Office Geneva, "Regulating



However, it can be argued that shifting the burden of proof does not actually reduce the difficulty in applying and the lack of legal certainty associated with the current classification test. Also, there is the opinion that this might not be the most efficient way to solve disputes due to the fact that no work relationship is the same and courts would still have to look at the circumstances of each case when deciding the employment classification.<sup>182</sup>

While agreeing that shifting the burden of proof to the employer does not make the current classification test easier to use and does not provide greater legal certainty, this essay contends that this would reduce the inequalities between employers and workers in terms of resource available and legal knowledge, hence facilitating workers with meritorious cases to be effectively litigated.<sup>183</sup> In other words, since the workers do not have the burden of proof, they would have fewer obstacles and therefore workers who are unsure of their employment status will have greater incentive to seek clarification by the court.

Hence, shifting the burden of proof to the employer can mitigate the adverse consequence caused by the lack of legal certainty in the current classification test.

This essay recommends that the current classification test, which takes into account of a range of factors and determine the classification based on the overall impression, should be retained. This is because none of the proposed modification to the classification test can provide a more comprehensive and accurate picture of the true substance of a particular work relationship than the current multi-factored overall impression approach. However, this essay is of the view that the burden of proof should be transferred to the employer because it reduces the adverse effect of the legal uncertainty of the current classification test.

#### 4.2. introducing a third category

Due to the insufficiencies of the current binary classification and its test,<sup>184</sup> as well as the failure to provide a better test than the current multi-factor overall impression approach classification

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*the Employment Relationship in Europe: A Guide to Recommendation No. 198"*

182 A. L. Crank, "O'Connor v. Uber Technologies, Inc.: The Dispute Lingers-Are Workers in the On-Demand Economy Employees or Independent Contractors?", *American Journal of Trial Advocacy* 39/2016, p. 609, p. 630.

183 J. Pinsof, *Op. cit.*, p. 368.

184 See above at 2.

test,<sup>185</sup> this essay will now explore the possibility of introducing a third category.

It would not be suitable to group those which can have completely different work relationships into one single third category just because they are all jobs in the sharing economy without acknowledging their differences.<sup>186</sup> Besides, the problem with the current classification is not confined to the sharing economy and definition of sharing economy is still subject to many debates.<sup>187</sup> Hence, the third category should not be a category specifically for jobs in the sharing economy. Instead, in view of the fact that many jobs in the sharing economy and the modern economy often lies in the grey area in the sense that they share some characteristics of an employer-employee relationship and some characteristics of a principal-independent contractor relationship,<sup>188</sup> this essay is of the view that the third category should act as the middle ground between two extremes.

##### 4.2.1. DISCUSSION AS TO WHETHER A THIRD CATEGORY SHOULD BE CREATED

The main reason of having a third category to govern the workers in the grey area is to increase legal certainty.<sup>189</sup> Another important reason is that a third category can mitigate some problems of the current binary classification system. For example, it is possible to design the content of the third category so as to grant additional protection and benefits to the workers in the third category while maintaining flexibility.<sup>190</sup> This is fair and proportional in the sense that only some labour protection and rights are offered to workers who only present some characteristics of employees.<sup>191</sup>

However, there are scepticisms as to whether the creation of a third category would solve the classification problem. It has been criticised that a

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185 See above at 3.1

186 V. De Stefano, "The Rise of the "Just-In-Time Workforce": On-Demand Work, Crowdfund, and Labor Protection in the "Gig-Economy", *Comparative Labor Law & Policy Journal* 37/2016, 498–499, p. 471.

187 *Ibid.*, p. 498–499.

188 S. D. Harris, A. B. Krueger, *Op. cit.*, p. 6.

189 M. A. Cherry, "Dependent Contractors" In the Gig Economy: A Comparative Approach", *American University Law Review* 66/2017, 635, 646.

190 *Ibid.*, p. 646.

191 G. Davidov, M. Freedland, N. Kountouris, Hebrew University of Jerusalem Legal Studies Research Paper Series No. 15–15, The Subjects of Labor Law: "Employees" and Other Workers, [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2561752](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2561752), last visited 30 July 2017.

third category would in fact bring more confusion and complicate the matter.<sup>192</sup> This is not only because of the fact that a choice between three categories is deemed to be more complicated and uncertain than a choice between two, but more importantly, because it is extremely difficult to define and provide a test for the third category.<sup>193</sup> Some jurisdictions, in classifying the third category, the applicable test is to look at the percentage of the total income derived from the principal/employer.<sup>194</sup> This test, however, is extremely difficult to apply, especially in an age where casualised employment with workers working for several employers with flexible pay, it would be difficult and burdensome for workers and businesses to determine the percentage of their total earning a worker is making in a particular job.

Another criticism of the creation of a third category is that it can cause workers who are originally employees to be misclassified as part of the third category, leading to reduced employee protection and benefits. An example is Italy, which introduced a third intermediate category of worker known as *lavoratore parasubordinato* (quasi-subordinate). They are defined as workers 'when the provision of the service presents itself as characterized, in practice, by a predominantly personal activity of continuous and coordinated collaboration'.<sup>195</sup> This relatively vague definition of the *lavoratore parasubordinato*,<sup>196</sup> combined with the fact that there was no substantive right granted to *lavoratore parasubordinato*,<sup>197</sup> have caused businesses to misclassify what would originally be employees as *lavoratore parasubordinato*.<sup>198</sup>

This essay, however, argues that as long as the definition of the third category is carefully tailored by the legislature, the problem of legal certainty and misclassification can be resolved.

Even though the introduction of a third category might increase uncertainty in the short run when there is a lack of understanding of the definition of the third category, as case law develops, legal certainty will increase. Also, there will be greater certainty as the new categories can more closely resemble the actual status of the workers in the grey area.<sup>199</sup> As a result, it would be easier to reach a common conclusion.

An example we can refer to is the case of the United Kingdom. Due to the rapid growth of 'marginal' forms of employment in the UK in the 1990s, a third category known as the 'worker' was created.<sup>200</sup> Section 230 of the Employment Rights Act 1996 provides that a "worker" is 'an individual who has entered into or works under (a) a contract of employment or (b) any other contract, whether express or implied and (if it is express) whether oral or in writing, whereby the individual undertakes to do or perform personally any work or services for another party to the contract whose status is not by virtue of the contract that of a client or customer of any profession or business undertaking carried on by the individual'.

Although this might look confusing at first, as case law develops, legal certainty has increased.

For instance, the Employment Tribunal has ruled in all four cases involving workers in the sharing economy that they should be classified as 'workers'.<sup>201</sup> As case law continues to develop, the classification will become more predictable.

Also, the point that introducing a third category would encourage employers to misclassify the employment status of workers would not be valid if this essay's recommendation on shifting the burden of proof to the employer is adopted. This is because it would incentivise workers who suspect that they have been misclassified to seek for clarification in court, thus reducing the number of misclassification.<sup>202</sup>

Therefore, a third category should be introduced in order to remove the problems of the current employment classification test.

192 V. De Stefano, Op. cit., p. 495.

193 B. Rogers, Temple University Legal Studies Research Paper No. 2015-33, Employment Rights in the Platform Economy: Getting Back to Basics, [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2641305](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2641305), last visited 30 July 2017.

194 See, e.g., Labour Relations Act 1995 (Ontario); Estatuto del Trabajador Autónomo Article 11 (B.O.E. 2007, 20) (Spain).

195 Legge 11 agosto 1973, n.533 (Italy).

196 S. Liebman, ILO National Studies-Italy, Employment Situations and Workers' Protection, [http://www.ilo.org/wcmsp5/groups/public/---ed\\_dialogue/---dialogue/documents/genericdocument/wcms\\_205366.pdf](http://www.ilo.org/wcmsp5/groups/public/---ed_dialogue/---dialogue/documents/genericdocument/wcms_205366.pdf), last visited 30 July 2017.

197 Cherry, Op. cit., p. 611.

198 V. De Stefano, Op. cit., p. 496.

199 S. D. Harris, A. B. Krueger, Op. cit., p. 25.

200 M. Freedland, J. Prassl, University of Oxford Legal Research Paper No 19/2017, Employees, Workers and the 'Sharing Economy': Changing Practices and Changing Concepts in the United Kingdom, <https://ssrn.com/abstract=2932757>, last visited 30 July 2017.

201 *Aslam v Uber* 2202551/2015; *Pimlico Plumbers Ltd v Smith* [2017] EWCA Civ 51; *Dewhurst v CitySprint UK Ltd* 2202512/2016; *Boxer v Excel Group Services Ltd* 3200365/2016.

202 See 3.1 iv

#### 4.2.2. THE PROPOSED THIRD CATEGORY

After establishing that there is a need for a third category to be introduced, this essay will now suggest some details of the third category.

##### 4.2.2.1. Name

The name of the third category varies in different jurisdictions. For example, they are called “dependent contractors” in Canada<sup>203</sup> and “workers” in the United Kingdom.<sup>204</sup> However, those names run the risk of encouraging misclassification. For instance, “dependent contractor” implies that the individual is a contractor with more dependency, but ultimately still a contractor. Also, one of the literal meanings of “worker” is ‘a person who is employed in a company or industry’.<sup>205</sup> The ambiguity in the name may lead to intentional or unintentional misclassification, especially when used by laymen who might be confused by the literal meaning.

This essay recommends that in order to promote neutrality and highlight that the third category does not shift towards either ends of the spectrum, a name that does not hint employee or contractor shall be adopted. A viable suggestion of the name is “collaborator”, which is neutral and offers a more accurate description of jobs in the third category (not controlled by the employer like employees yet receives more assistance from the employers than independent contractors).

##### 4.2.2.2. Definition

The definition of the third category directly affects the success of the classification. Accordingly, this essay recognises that the definition should be drawn carefully, keeping in mind that the definition should be flexible to use, able to provide clear guidance and avoids over-expanding the scope of the third category.

This essay proposes to adopt the second limb of the definition of “worker” in the UK as the definition of the third category. The second limb provides that a “worker” is ‘an individual who has entered into or works under any other contract, whether express or implied and (if it is express) whether oral or in writing, whereby the individual undertakes to do or perform personally any work or services for another party to the contract whose status is not by virtue of

the contract that of a client or customer of any profession or business undertaking carried on by the individual’.<sup>206</sup>

This definition points out accurately and precisely the scope of the third category (i.e., the area outside the boundaries of employee and independent contractors). Also, this definition provides sufficient flexibility for courts to take into account of the specificity of each case using the current multi-factor overall impression approach. This would enable case law to develop in response to changes in the employment structure, thus developing the law and providing general principles for new situations.<sup>207</sup> Moreover, this definition has been successfully implemented in the UK, as shown by the fact that the “worker” status is actively used by the courts in dealing with cases in the grey area and the fact that there has not been a significant rise in the misclassification of employees as workers or independent contractors.<sup>208</sup>

Therefore, this essay recommends the second limb of “worker” should be adopted as the definition of the third category.

##### 4.2.2.3. Application of the third category in cases

The court should determine whether an individual fits in the third category only after the court has decided that the individual does not satisfy the test for an employer-employee relationship.

This essay suggests that there shouldn’t be a special classification test for the third category. It would be better for courts to develop case law and general principles instead of listing out an exhaustive list of factors equating an individual to the third category status. The overall impression is still an important factor when determining whether an individual falls into the third category so as to take into account of the specificity of each case.

## 5. Protection and benefits

Some have suggested that the safe harbour approach, which advocates for a hands-off approach and allow employers to provide support, such as training and benefits, without triggering a categorisation of these providers

203 H. W. Arthurs, “The Dependent Contractor: A Study of the Legal Problems of Countervailing Power”, *University of Toronto Law Journal* 16/1965, p. 89,

204 Employment Rights Act 1996 (UK) Section 230.

205 Oxford Learner’s Dictionaries, Worker, <http://www.oxfordlearnersdictionaries.com/definition/english/worker?q=worker>, last visited 30 July 2017.

206 Employment Rights Act 1996 (UK) Section 230 (b).

207 S. H. C. Lo, W. H. Chui, *The Hong Kong Legal System*, McGraw Hill, 2012, p. 128–129; See also 3.2.1

208 M. Taylor *et al.*, The Taylor Review of Modern Working Practices, [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/627671/good-work-taylor-review-modern-working-practices-rg.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/627671/good-work-taylor-review-modern-working-practices-rg.pdf), last visited 30 July 2017.

as employees, should be adopted.<sup>209</sup> However, this would be hard to apply as there is inherent conflict with the classification test. Also, the safe harbour approach might incentivise the misclassification of workers by employees. Accordingly, this essay argues that the traditional regulation approach, which lists out all the rights and duties, should be used. Some rights relating to basic protection, such as wage payment protection and<sup>210</sup> protection against anti-union discrimination,<sup>211</sup> should be available to the third category. In contrast, benefits associated with having a long and stable relationship with a particular employer should not be available, such as long service payments,<sup>212</sup> annual leave with pay<sup>213</sup> and maternal<sup>214</sup> and paternal<sup>215</sup> leave. This is fair in the sense that jobs in the third category are usually more contingent and casual<sup>216</sup> and should only receive some employer benefits due to the fact that they only share some of the characteristics of an employee.<sup>217</sup>

There are suggestions that protections involving calculation of the working hours cannot be granted to an individual in the third category due to the 'immeasurability of work hours' as one or more sharing economy software can be turned on at the same time, so it is hard to determine who the employer is.<sup>218</sup> However,

this essay argues that the individual can only respond to one software at once (e.g., cannot practically accept two rides at the same time on two ride-sharing platforms). In fact, the use of technology has actually enabled more accurate time-keeping. Therefore, protection such as the minimum wage<sup>219</sup> may also be available.

Also, to enable better consumer protection, it is recommended that the employer should be vicariously liable for the tortious acts of individuals of the third category. This is because employers usually have greater financial capability,<sup>220</sup> thus can compensate the victim more adequately.

## 6. Legislative action

The definition of the third category should be added to the interpretation section of the relevant ordinances and the third category should be added to the relevant sections offering the relevant protections and benefits.

## 7. Conclusion

The sharing economy has brought many opportunities, but it has also challenged many areas of the modern society. This essay has described the current classification and its test, the discussed the applicability of the current classification and its test and analysed different solutions suggested by scholars. This essay recommends retaining the current multi-factor classification test but shifting the burden of proof to the employer and the creation of a third category. The name of the third category should be neutral but representative, such as "collaborator". The definition of the third category is similar to "worker" in the UK and only certain the employer obligation and employee benefit will be available to the third category. Hopefully, the recommendations made by this essay can better equip Hong Kong for the sharing economy.

209 A. Sundararajan, Op. cit., p. 185.

210 Employment Ordinance (Cap 57)(HK) Part 5.

211 *Ibid.*, pt 4A.

212 *Ibid.*, pt 5B.

213 *Ibid.*, pt 8A.

214 *Ibid.*, pt 3.

215 *Ibid.*, pt 3A.

216 K. V. W. Stone, The Decline in the Standard Employment Contract: Evidence from Ten Advanced Industrial Countries, in C. V. W. Stone, H. Arthurs (eds), *After the Standard Contract of Employment: Innovations for Regulatory Design*, Russell Sage, 2013

217 G. Davidov, M. Freedland, N. Kountouris, Hebrew University of Jerusalem Legal Studies Research Paper Series No. 15–15, The Subjects of Labor Law: "Employees" and Other Workers, [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2561752](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2561752), last visited 30 July 2017.

218 S. D. Harris, A. B. Krueger, Op. cit., p. 13.

219 Minimum Wage Ordinance (Cap 608)(HK).

220 F. N. Lone, para 14.08.



## UBER HK DRIVERS – EMPLOYEES OR INDEPENDENT CONTRACTORS?

**Tsang Hei Man**

*This essay purports to discuss the case study of Uber in answering the question whether UberHK drivers are employees or independent contractors, as it would be an important decision that impacts the sustainability of the Uber business model under the sharing economy in the long run. The first part of the essay will discuss two landmark Uber cases in the UK and US, comparing their employment status classification test to that of Hong Kong, following to discuss the application and prediction of the employment status classification of UberHK drivers. The second part of this essay will cover the implications upon this determination of employment status on various stakeholders including consumers, drivers and the company.*

**Key Word:** *Uber, Sharing economy, employment law, independent contractors, employees*

### 1. Sharing economy

The sharing economy is a popular business model among companies nowadays. It itself challenges the notion of self-ownership and promotes peer-to-peer (P2P) activities as most of the legal issues are found there. Although the sharing economy has known to be popular among users with companies like Uber and Airbnb valuing tens of billion of dollars, there are no precise definitions of the sharing economy among scholars. However, it can be ascertain that one main focus of the sharing economy consists of 'P2P based activity of obtaining, giving, or sharing access to good and services'.<sup>1</sup>

Some scholars suggested that the sharing economy can be viewed as a marketplace that 'brings together distributed networks of individuals to share or exchange otherwise underutilized assets'.<sup>2</sup> Goods and services can be exchanged for both monetary or non-monetary returns.

1 J. Hamari, Sjöklint, M. and A. Ukkonen, *The sharing economy: Why people participate in collaborative consumption*, (2015), *J Assn Inf Sci Tec*, 67: 2047–2059, <http://onlinelibrary.wiley.com/doi/10.1002/asi.23552/epdf>, (25 August 2015).

2 Koopman, Christopher and Mitchell, Matthew D. and Thierer, Adam D., *The Sharing Economy and Consumer Protection Regulation: The Case for Policy Change*, *The Journal of Business, Entrepreneurship & the Law*, Vol. 8 Iss 2, (2015), [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2535345](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2535345), (25 August 2015).

### 2. Background

Uber is one of the biggest companies under the gig economy. It uses online platforms to connect users with their services. Uber claimed that their drivers are independent contractors, as they are just a digital platform instead of a transportation company.<sup>3</sup> The possible reason behind is that hiring workers as employees is usually far costlier than hiring them as independent contractors.<sup>4</sup>

There are several lawsuits all over the world that relate to the classification of driver status, as it directly impacts the employment benefits and protection of drivers, which many claim that they deserve to enjoy. The landmark ruling of the UK Employment Tribunal stirred up the debate whether the classification will be the same in other common law countries. In Hong Kong, there are various opinions concerning the drivers' status. Uber would claim that they provide drivers with autonomy to choose their working time so that they can work flexibly for their own business<sup>5</sup> and hence drivers are hired as independent contractors.

However, complaints were also found from drivers which tend to think that the job is risky as it fails to provide drivers with adequate security. For instance, drivers are not bound by contracts. Further, 'There is not even a responsible person from the firm that can answer our (drivers) inquiries. Any communication must be made through emails'.<sup>6</sup> Drivers feel unsafe working for Uber as they have to take all the risks and liabilities. One commented that the commission paid to the company is worse than that of a cleaning worker.<sup>7</sup> It is foreseeable that drivers would strive for more labor protections from Uber in future in Hong Kong.

3 J. Tomassetti, "Does Uber Redefine The Firm? The Postindustrial Corporation And Advanced Information Technology" (2016).

4 Ibid.

5 Uber, *Uber Needs Partners Like You*, [https://www.uber.com/a/join/?emsug=true&exp=70622\\_t](https://www.uber.com/a/join/?emsug=true&exp=70622_t).

6 Cannix Yau, *Too much risk and too little money deter Hong Kong Uber drivers*, *South China Morning Post*, <http://www.scmp.com/news/hong-kong/article/2011878/too-much-risk-and-too-little-money-deters-hong-kong-uber-drivers>, (31 August 2016).

7 Ibid.

Earlier in 2015, the Hong Kong police had arrested 5 Uber drivers and they were convicted of driving their vehicles for hire without permit and third-party insurance.<sup>8</sup> The drivers were fined HK\$10,000 and banned from driving. Uber had appealed against this conviction after the ruling.<sup>9</sup> Recently, 22 more Uber drivers were arrested in May 2017, also for not having third-party insurance and hire permit.<sup>10</sup> The legality of the company is being challenged heavily. Under the current Hong Kong law, Uber drivers are associated with a potential breach under s.52(3) of the Road Traffic Ordinance (Cap 374) for carriage of passengers in a motor vehicle for commercial purpose and s.4(1) of the Motor Vehicles Insurance (Third Party Risks) Ordinance (Cap 272) relating to carriage of valid third-party insurance policies in motor vehicles.<sup>11</sup> A permit allowing the carrying of passengers for profits has a current cap of 18,000 vehicles, according to Transport and Housing Bureau.<sup>12</sup> It is still unknown whether Uber can operate legally in Hong Kong using the current business model, especially with huge protest from taxi drivers who had obtained a legal permit from the HKSAR government. The classification from the court would be significant as to how Uber runs its business in Hong Kong or as reference for similar competitors that want to start a business under the sharing economy.

### 3. Significance

This essay aims to discuss the case study of Uber in answering the question whether UberHK drivers are employees or independent contractors. It involves legal complexities in the legal boundary between two employment status which the employment law has not yet caught up with the fast-evolving business model.<sup>13</sup> The determination of employment status of UberHK

drivers will have important implications as it touches several areas of laws which can affect all stakeholders under the sharing economy model. The debate of Uber HK employment status can affect to a large extent the success of companies that run a similar P2P business model under the sharing economy as they share similar concerns with Uber. In a broader sense, the lawsuit can determine if companies like Uber can serve to facilitate a market between users and transportation service by utilizing technology that can lower the cost of exchange by hiring workers as independent contractors.<sup>14</sup>

The essay is divided into two parts: the first part focuses on the debate whether UberHK drivers are employees or independent contractors. The second part of this essay will continue to discuss the implications upon the determination of employment status of UberHK drivers on Uber, drivers and users.

### 4. Uber – introduction

Uber Technologies Incorporated (Uber) was founded in March 2008. It is now available in over 626 cities worldwide and it was launched in Hong Kong in 2014.<sup>15</sup> Uber is a platform economy that uses the Uber application (Uber app) to provide on-demand transportation service. It is one of the fastest growing startup and has changed the market for transportation services in the world. Several companies have copied Uber's business model to provide ridesharing platforms and the trend has also been termed as Uberfication.<sup>16</sup>

The Uber model works when users request for a ride at their location in the minimum possible time. Uber then pairs available drivers, who supply their own private cars to carry the ride. Afterwards, Uber charges passengers from their credit cards automatically and pays the driver with a set portion of the fare. In the process, Uber does not cover maintenance cost of the vehicle. Uber certifies drivers who completed the hiring process with the vehicle inspection. Drivers will set their own working schedule to work and they can be available at any time to accept the ride requests. There is no minimum work hour required by Uber.

[www.lexology.com/library/detail.aspx?g=8d141ed6-38f9-4fcd-9576-b745e616a21a](http://www.lexology.com/library/detail.aspx?g=8d141ed6-38f9-4fcd-9576-b745e616a21a), (Lexology, 13 January 2017).

14 Ibid (n3).

15 Uber, Our Story <https://www.uber.com/en-HK/our-story/>, (2017),

16 Marsden, P, The Uberfication of Everything: Directory of Uber-Inspired Businesses. Digital Intelligence Today <http://digitalintelligencetoday.com/theuberfication-of-everything-master-list-ofuber-inspired-businesses/>, (11 August 2014).

8 Jasmine Siu, Five Hong Kong Uber drivers lodge appeals following conviction for driving without permit and third-party insurance, South China Morning Post <http://www.scmp.com/news/hong-kong/law-crime/article/2077719/five-uber-drivers-convicted-driving-without-permit-and>, (10 March 2017).

9 Ibid.

10 Clifford Lo & Cannix Yau, 22 Uber drivers arrested in undercover Hong Kong police operation, South China Morning Post <http://www.scmp.com/news/hong-kong/law-crime/article/2095336/21-uber-drivers-arrested-hong-kong-undercover-police>, (23 May 2017).

11 Ervin Lau, How to make Uber work in Hong Kong Hooray Industry Report, [http://www.hooraysec.com/public/upload/pdf/research\\_analysis/Hooray\\_Research\\_Report\\_Uber\\_AUG25.pdf](http://www.hooraysec.com/public/upload/pdf/research_analysis/Hooray_Research_Report_Uber_AUG25.pdf), (25 August 2015).

12 Ibid.

13 McCann FitzGerald, The UK Employment Tribunal Uber Ruling: What Does it Mean for the Gig Economy? <http://>

## 5. How Uber fits into sharing economy

There are certain characteristics of the sharing economy proposed by scholars which explain how sharing economy can create values.<sup>17</sup>

First, the sharing economy provides users with an opportunity to utilize assets or dead capital into productive use. Uber does this by utilizing people's private cars when they are not in use into accepting ride requests for productive use.

Second, it helps to bring together multiple buyers and sellers in a market with natural supply and demand principles. Uber fits into it by bringing together customers a new transportation service and matching them with drivers who can supply the vehicle and offer the ride.

Third, the sharing economy helps to cut down transaction costs and expand the scope of trade by lowering the cost of matching traders and monitoring performance. In this aspect, Uber offers the technology to develop the app to achieve the matching.

Fourthly, by reviewing past users and matching them with new participants in the market, the model can help diminish the problem of asymmetric information between producers and consumers. Uber app functions when it allows riders to rate drivers so that other riders can view the ratings as a reference and to evaluate the drivers' performance.

However, the debate lies in whether Uber as a P2P platform is in fact, an employer. The determination will affect whether Uber can still survive under this business model or if it is responsible for paying the labor costs relating to its employees. Hence, the classification of driver status would impact greatly on their 'marketplace mindset' in running their business.<sup>18</sup>

## 6. Employment status In Hong Kong

In Hong Kong, the principal employment legislation is the Employment Ordinance (EO) and it protects an employee as long as he or she is shown to be under a continuous contract of employment. There is a distinction between an employee and an independent contractor, the difference is expressed between a worker engaging in a contract of service and a contract for service.

Apart from the protection under the EO, an employee is also protected by the Employees' Compensation Ordinance (ECO), which includes sick leave and compensation from work injuries. For the following discussion, it is worth noting that both the EO and ECO cover casual workers engaging in a contract of service. Casual workers refer to workers who are hired on a temporary, irregular or 'as required' basis. There is usually no mutuality of obligation in the provision of work.<sup>19</sup>

Some characteristics of an employee are that he or she receives remuneration at regular intervals, ready to take instructions from the employer and often receives contractual benefits apart from statutory protections.<sup>20</sup>

Some characteristics of an independent contractor are that he or she usually does not commit in full to the employer's supervision. The engagement may only last for a period of time so that the contractor can have an additional employment. Independent contractors are not entitled to statutory employment benefits and protections.<sup>21</sup> There is no true consensus whether the determination of employment status is a question of fact or law in the case law. The worker bears the burden of proof to prove a contract of employment on a balance of probabilities. It is commented that the matter is best characterised as one of mixed fact and law, and that 'the criteria to be applied are a matter of law, but the application of the criteria is a question of fact.'<sup>22</sup>

## 7. Employment status classification in Hong Kong

There is no legal distinction between an employee and an independent contractor nor a legal definition for an independent contractor. The distinction has to be made by reference to the common law. There is no conclusive test to distinguish between a contract of employment and a contract for service

In past, the control test was the major test adopted for a determination of employment status. This test looks at the degree of control exercised by the employer over the worker to find a contract of employment. The test has become inadequate in dealing with complicated cases of employment, such as *Poon Chau Nam v*

<sup>17</sup> Ibid (n1).

<sup>18</sup> O'Sullivan Whitney, Employee or Independent Contractor? Get it Right or Pay <http://www.shakelaw.com/blog/ics/>, (19 June 2015).

<sup>19</sup> Rick Glofcheski and others (ed), *Employment Law and Practice in Hong Kong* (Sweet & Maxwell Asia 2016).

<sup>20</sup> Ibid.

<sup>21</sup> Ibid (n19).

<sup>22</sup> Ibid (n19).

*Yim Siu Cheung*<sup>23</sup> and *Lee Ting Sang v Chung Chi Keung*<sup>24</sup>. The court in these 2 cases found the existence of an employment contract although there was almost a complete absence of control and supervision by the employer over the worker. The control test was widened to include indirect forms of control and more emphasis was put on the economic or commercial aspects of the relationship.<sup>25</sup>

The modern approach is to examine all the features of an employment relationship against the indicia developed in case-law. In *Lee*, the Privy Council reversed the lower court decision and found the applicant to be an employee. The court endorsed the approach in *Market Investigations v Minister of Social Security*<sup>26</sup> which explained that the test to apply is to ask whether 'the person who has engaged himself to perform these services performing them as a person in business on his own account'.<sup>27</sup> If the answer is affirmative, the contract is a contract for service whereas a no indicates a contract of service. There will not be an exhaustive list of factors for a mechanical exercise of classification.

In other words, the control test is no longer the only decisive factor and the court has to look at the overall picture and purpose to arrive at the conclusion and to rate all other relevant factors to check if the provision of service is a performance in business on their own account. The object is to 'paint a picture from the accumulation of detail' by 'standing back from the detailed picture which has been painted, by viewing it from a distance and by making an informed, considered, qualitative appreciation of the whole'.<sup>28</sup> It is especially noted by Riberiro PJ that 'not all details are equal weight or importance' and the details may also vary in importance from one situation to another.<sup>29</sup>

This essay seeks to determine the employment status of Uber drivers in Hong Kong by adopting the modern approach suggested in *Poon* by Riberiro PJ, i.e. to examine all features of an employment relationship with an open-ended list of factors, as employment status is a fact-sensitive inquiry. The control test used in the past has become less and less useful...

## 8. Two landmark cases

From the Hong Kong legal perspective, the classification of employment status is not identical to that of the UK and the US. The case is also not binding on Hong Kong courts. However, it is important to take note of the arguments raised by Uber and the reasoning of both courts to arrive at their conclusions that Uber drivers are employees before predicting the outcome in Hong Kong.

### 8.1. UK – *Aslam and others v Uber BV and others*

The classification was done in *Aslam and others v Uber BV and others*<sup>30</sup> in 2016 when the UK employment tribunal decided that 'Uber drivers are employees rather than independent contractors that the notion that Uber in London is a mosaic of 30,000 small businesses linked by a common platform is to our minds faintly ridiculous'.<sup>31</sup> The case involves 2 driver claimants who took Uber to court on behalf of a group 19 others to seek compensation for Uber's failure to pay minimum wage and paid leave. The case debates whether Uber drivers are 'workers' to be entitled of labor protection legislations. The tribunal found that Uber runs a transportation business in which drivers provide the skilled labor. The court also looked at multiples factors from the provision of tools, setting of route and fares, recruitment and interviews of drivers etc. to draw its conclusion.

The notion of hybrid workers does not exist in Hong Kong employment law.<sup>32</sup> In the UK, employees can be further classified as either an employee or a worker. A worker is entitled to basic employment rights while an employee is entitled to full range of protections.<sup>33</sup> For the purpose of our discussion, workers will be regarded as one category of employees in accordance to the definition given under the ECO, Hong Kong.

The definition of a worker, according to Employment Rights Act (ERA) s.230(3)<sup>34</sup> is similar to that of Hong Kong in the sense of finding a contract of service:

23 [2007] 1 HKLRD 951.

24 [1990] 1 HKLR 764.

25 *Poon* (n23).

26 [1969] 2 QB 173, [1969] 2 WLR 1, [1968] 3 All ER 732.

27 *Ibid* (Cooke J).

28 *Poon* (n19) (Ribeiro PJ).

29 *Ibid*.

30 [2017] I.R.L.R. 4.

31 *Aslam* (n33).

32 Oldham, Li & Nie Layers, Driving for the boss or driving as a boss?, <http://www.hk-lawyer.org/content/driving-boss-or-driving-boss>, Hong Kong Lawyer, December 2016.

33 Gov UK, Employment status (2017), <https://www.gov.uk/employment-status/worker>.

34 ERA s.230(3) (1996).



(3) In this Act “worker” means an individual who has entered into or works under (or, where the employment has ceased, worked under)–

(a) a contract of employment, or

(b) any other contract, whether express or implied and (if it is express) whether oral or in writing

Compared to the definition of employees in Hong Kong, according to s.2(1) of the ECO in Hong Kong, employees are:

“any person who has ... entered into or works under a contract of service ... with an employer in any employment, whether by way of manual labor, clerical work, or otherwise, and whether the contract is expressed or implied, is oral or in writing<sup>35</sup>”

In terms of implications of the classification in employment law, Uber drivers are workers in the UK which will be entitled to basic protections only, while in Hong Kong Uber drivers will be entitled to all kinds of protections under the EO once they are classified as employees under a contract of service. The cost of hiring employees thus will also be higher.

The UK Employment Tribunal ruled that Uber drivers are workers under the meaning of the Employment Rights Act (ERA). The court stated that drivers are ‘workers’ pursuant to the ERA at all times whenever they had the Uber app switched on, were within the territory in which they were authorised to work and were able to accept assignments.<sup>36</sup> Drivers provided their work under a contractual relationship. Uber cannot deny that they are in business as a supplier of transportation services.

The approach adopted by the Employment Tribunal is similar to the one used in Hong Kong, that the judge also weighed against various characteristics regarding all circumstances to arrive at the conclusion of the classification. The court has adopted 13 conditions to draw their analysis, such as recruitment of drivers, control in information, acceptance of trips, fixing of price. This is a highly useful reference for the Hong Kong court to consider since UberHK shares most operation characteristics with their office in London. Nevertheless, the case is not binding on Hong Kong courts.

The principal argument Uber held is that Uber drivers are not under any obligation to switch on the App or accept any driving assignment. The freedoms enjoyed by the drivers precludes the finding of any contract of service.

The judge commented that Uber attempted in ‘resorting in its documentation to fictions, twisted

language and even brand-new terminology’ for its false classification of driver status since drivers are employees once the app is switched on.<sup>37</sup> Uber has already applied for an appeal of this case.<sup>38</sup> It is not clear yet whether the judgment will apply to all other UK Uber employees apart from the 2 employees who succeeded their claim. However, since the Tribunal is adopting a similar approach as the modern approach, the case outcome serves as a useful reference.

## 8.2. US – *O’Connor, et al. v Uber technologies, inc.*

In 2013, there was a lawsuit filed against Uber on behalf of 385,000 Uber drivers in the Northern District of California, *O’Connor, et al. v Uber Technologies, Inc.*<sup>39</sup> A ruling against the company will be a disaster to Uber since it will mean a change in business model for them having to pay for the expenses for all its drivers.

In *O’Connor*, Uber argued that drivers ‘pay Defendant (Uber) for access to leads via the Uber app and to benefit from Defendant (Uber) marketing efforts and payment processing. Like passengers, Plaintiffs and other drivers are customers who receive a service from Defendant (Uber).’<sup>40</sup> Also, Uber argued that they only implemented an application that riders and drivers ‘find attractive to utilize their vehicles where they would otherwise be unutilized. It’s a benefit to them; it’s a service to them.’<sup>41</sup> Uber’s central claim was that drivers did not perform any services for them. Rather, Uber provides a service to drivers and thus receives their service fee in return from them. The court disagrees with the argument that Uber’s business is a technology rather than a transportation company.

The judge in *O’Connor* found that the work rules Uber imposes on drivers created standardized form of services which suggest that they act as sellers of ride services rather than market mediators.<sup>42</sup> For instance, Drivers must follow ‘suggestions’ which tend to create uniform ride service including clothing, music, pick up procedure and dos and don’ts. The aim of this rule is to create a branded service.<sup>43</sup> The judge responded to Uber’s argument that it was ‘fatally flawed in numerous aspects’ for

37 *Aslam* (n33).

38 Robert Booth, Uber granted right to appeal against ruling on UK drivers’ rights, *The Guardian* <https://www.theguardian.com/technology/2017/apr/19/uber-appeal-uk-employment-ruling-drivers-working-rights>, (19 April 2017).

39 82 F. Supp. 3d. (N.D. Cal. 2015) (No. CV 13–03826-EMC).

40 *O’Connor* (n43).

41 *Ibid.*

42 *Ibid* (n3).

43 *O’Connor* (n43).

35 ECO s.2(1) (1953).

36 *Aslam* (n33).

Uber to claim themselves as only a technology company.<sup>44</sup> Instead, Uber is involved in 'marketing its transportation services, qualifying and selecting drivers, regulating and monitoring their performances, disciplining those who fail to meet standards, and setting prices'.<sup>45</sup> Uber's definition of their position focuses on the mechanics of the platform instead of the substance of what Uber actually does.

In other words, Uber could not be "Everyone's Private Driver" as they claim without drivers performing a service for them. Uber's revenue is driven from the generation of rides by drivers but not from the distribution of software. The representation to the public from its logo does indicate that transportation is its business. For the court's test of employment status, it adopted the approach used in *S.G. Borello & Sons, Inc. v. Dep't of Indus*<sup>46</sup> that the 'most significant consideration' is the control test that looks at the employer's right to control work details.<sup>47</sup> The central question is to determine whether the entity keeps 'all necessary control over the worker's performance'.<sup>48</sup> The above approach for employment status classification is different from the modern approach adopted by Hong Kong.

The factors could be looked into by the Hong Kong court as well as a reference since the list is non-exhaustive. Although at first sight it seems that the approach is different than the one in Hong Kong, the Ninth Circuit stated in *Narayan v. EGL, Inc.*<sup>49</sup> that the fact-finder must 'assess and weigh all of the incidents of the relationship with the understanding that no one factor is decisive, and that it is the rare case where the various factors will point with unanimity in one direction or the other'.<sup>50</sup> It indirectly means that no one *Borello* factor will be decisive for the classification and this will be in line with the Hong Kong court's preference.

## 9. Application of classification test in Hong Kong

The following analysis will be based partly on the terms of Uber's Services Agreement between drivers and Raiser Operation B.V., the company which holds the legal rights to the Uber app. In order for a UberHK driver to use the Uber services, they must agree to the terms and conditions set forth in the agreement. The modern approach

will be adopted and the factors considered are reference from different jurisdictions.

## 10. Control exercised by Uber on drivers

### 10.1. Licensing checks and interviews

To become a driver, the required documents are HK Permanent ID, vehicle registration document, vehicle insurance and full driving license.<sup>51</sup> After signing up, every driver needs to undergo a background screening. Drivers are strongly encouraged to attend training before accepting ride requests. It hints towards a form of control exerted by the Uber company.

### 10.2. Tracking of drivers ride acceptance, cancellation rates and customer ratings

Drivers' ride acceptance rate, cancellation rate and customer ratings will be tracked to make disciplinary and termination decisions as well as for evaluation of their performance as stated under s.2.5 of the Driver Agreement.<sup>52</sup> This points towards an employee status since drivers' freedom to deal, that is the market process of voluntary exchange, is missing.<sup>53</sup>

Furthermore, Uber will not disclose a passenger's destination until after drivers accepted the request. They will not know how much the ride will cost beforehand. In other words, drivers accept the ride request to maintain their job in Uber, not in thinking that the transaction is a good bargain with the price signal. There is clearly a control in the form of information disclosed to drivers. Accounts who constantly receive low ratings or cancellation rates may also be deactivated after receiving multiple warnings which again hints towards an employee status:

*"If you do not increase your average rating above the Minimum Average Rating within the period allowed (if any), Company reserves the right to deactivate your access to the Driver app and the Uber Services."<sup>54</sup>*

### 10.3 Solicitation of clients

Solicitation of clients is not allowed. All ride requests are matched with the closest available driver by the app. This is a rather clear hint for an employer-employee relationship to show that drivers are not free to conduct business on their own.

44 Ibid.

45 Ibid.

46 48 Cal. 3d 341, 350 (1989)

47 Ibid.

48 Ibid.

49 616 F.3d 895, 900 (9th Cir. 2010).

50 Ibid.

51 Uber, Start driving with Uber, <https://www.uber.com/en-HK/drive/#>.

52 Raiser Operations B.V. Services Agreement s.2.5.

53 Ibid (n3).

54 Raiser Operations B.V. Services Agreement s.2.5.2.

## 10.4. Termination of employment

It is mentioned in the Uber's Services Agreement that drivers can choose to accept, decline or ignore a ride request. Nevertheless, Uber reserves the right to terminate drivers for any or no reason.<sup>55</sup>

## 10.5. Driver handbook

It is unclear whether drivers in Hong Kong are given such documents as in the case of US, which lists out some expectations written in the language of command in terms of dressing and music in car<sup>56</sup>.

## 10.6. Tracking of driver locations

The application uses GPS technology to track the locations of driver to ensure passenger safety during their rides. There is a function in which passengers can share their instant locations with friends and family for them to follow the route. GPS data is logged for every trip. This is also one form of control exercised by Uber which can limit drivers' freedom in the ride process.

## 11. Economic considerations

### 11.1. Prohibitions of price negotiation and setting of fare

Uber sets fare unilaterally and forbids negotiation of higher fare by drivers. The fare is calculated with a base fare for each type of Uber cars plus fixed distance rate and time rate.<sup>57</sup> The fare is calculated before passenger takes on the ride instead of after the ride ends. There will be times when a multiplier applies to the standard rate, also known as price surge.<sup>58</sup> Price surge applies when there is a high demand for Uber service in a specific area so as to encourage more drivers to be available on road. The surge will last until the demand goes down to a normal level.

### 11.2. Payment of salary

Payments are done on a weekly cycle.<sup>59</sup> However, it is to be proved in *Ng Siu Chau* that payment is not a concluding factor for a contract of employment.

## 12. Other factors

### 12.1. Setting of work schedule

As mentioned, drivers have no set work schedule. Drivers can accept requests whenever they are available and log into the app. The app permits drivers to also decline a ride request and cancel an accepted ride before completion.

Mutuality of obligation to work is not a requirement for a contract of service. It is not relevant to the ECO since the Ordinance includes casual workers who by definition have no mutuality of obligation in work. Ribeiro PJ further clarified in *Poon* that even under the EO, a continuous employment does not require mutuality of work.<sup>60</sup>

This factor pertaining to the function of the app may prima facie indicate a contract for service that the worker is engaged in work for his own account. However, it was the case in UK and US that Uber reserves complete discretion to terminate drivers at any time with no reasons or with reference to drivers' cancelling rate. There was evidence that drivers who declined 3 trips or cancelled an accepted ride will be forced to log off the app for 10 minutes.<sup>61</sup> Drivers are warned to achieve a set acceptance rate or to risk a suspension of account.<sup>62</sup> There is also no minimum or maximum work hours set for an employee to begin with. Hence, this factor does not indicate an independent contractor relationship if evidence of such is also found in Hong Kong.

### 12.2. Provision of tools and equipment

Drivers must provide their own cars. Drivers also have to supply their own smartphones and data plan to access to the Uber app. Those who do not have one have to hire one from Uber with a monthly price.<sup>63</sup> Uber drivers, however, are not required to wear uniforms or show any Uber logos in their cars while at work. This factor points towards a contract for service, but it is also not conclusive as seen in *Wong Wai Ming v FTE Logistics International Ltd.*<sup>64</sup> The Court found an express delivery worker who supplied his own motorcycle to be an employee of the company.

<sup>55</sup> Raiser Operations B.V. Services Agreement s.12.1.

<sup>56</sup> Ibid (n3).

<sup>57</sup> Ibid (n5).

<sup>58</sup> Ibid.

<sup>59</sup> Raiser Operations B.V. Services Agreement s.4.1.

<sup>60</sup> [2007] 1 HKLRD 951.

<sup>61</sup> *Aslam* (n33).

<sup>62</sup> *O'Connor* (n43).

<sup>63</sup> Raiser Operations B.V. Services Agreement s.2.6.

<sup>64</sup> [2008] HKEC 1441.

### 12.3. Tax and insurance

Drivers are obliged to pay for their own tax and insurance costs instead of them being covered by Uber.<sup>65</sup> There is an intention to treat the drivers as independent contractors. However, this is in no way determinative. Uber has admitted that they have covered third-party insurance for all drivers in Hong Kong.<sup>66</sup>

### 12.4. Maintenance fee

In cases of maintenance or accidents that the vehicle was made dirty by passenger's fault, drivers have to be responsible for their own cleaning or maintenance fee. Uber provides that they can assist drivers to claim for damage from passengers and offers discount for drivers to clean their vehicles at their official cleaning partner with prior reporting.<sup>67</sup> This factor is in no way determinative as to the classification of employment status.

### 12.5. Services agreement

To deal with the point that the Uber Services Agreement with driver uses the word 'independent contractors' to describe driver status,<sup>68</sup> usually the intention of parties in forming of relationship in a contract will be respected and be given considerable weight. Nonetheless, it will not be determinative of the worker's employment status.

Sham agreements are not recognised by the court. It means that the court will decide on the legal effect of any staffing arrangement, so it will not be determined by the express language used by one party. The court would look at the substance of the employment details to classify workers and it always enjoys the power to override the will of parties and to avoid labeling practice for employers. Facts will be viewed objectively, and indicia of employment will be applied.<sup>69</sup>

In *Young & Woods Ltd v West*<sup>70</sup>, the claimant has successfully sued for an unfair dismissal because there was an employment relationship when viewed objectively instead of what was freely opted as self-employment. Parties cannot

transfer a statute-imposed duty of care for safety of workers from an employer to the worker himself simply on the basis that there was a mutual agreement between both parties. It is also stated expressly in s.31(1) of the ECO that any similar agreement should be void.

### 12.6. Nature of employment activity

Indeed, there are scholars discussing Uber model's significance in the sharing economy. They claim that these sharing platforms can facilitate exchanges that can hardly occur due to the high transaction costs.<sup>71</sup> Currently, they make it possible for informal participants to operate with a minimal transaction cost with the emerging of a digital platform.

In my opinion, the nature of employment activity would be most controversial among all factors to be weighed by the court as it will be the strongest defence argument raised by Uber. One must not make assumptions to determine the legal status of Uber drivers in this novel area of employment law. We have looked at how US and UK courts view about this issue. The 2 court decisions both disagree the notion that Uber runs a platform that provides services to the drivers and found that Uber actually runs a transportation business and come to the conclusion that there is a contract of service between Uber and its drivers.

## 13. Prediction – employees

In Hong Kong, it is true that Uber drivers set their own working schedule. It is mentioned on Uber website that its drivers are independent contractors<sup>72</sup>. Drivers can choose when to drive, where to go and who to pick up. Additionally, Uber is working to offer women a chance to balance family and education, apart from having a job. Kenneth She, general manager of Uber Hong Kong said that their target is to have more than 1 million female drivers by 2020.<sup>73</sup> Drivers enjoy the accessibility and flexibility of this job. The phenomenon of moonlight is common for both lower-class working group and mothers in Hong Kong. All these may suggest to the public that the reality matches with the company claim.

However, it is difficult for all factors analyzed above to point towards a conclusion that drivers are running a business on their own account adoption the *Poon's* test. To weigh against

65 Raiser Operations B.V. Services Agreement s.4.8.

66 Gabriel Olano, Uber nets third-party insurance in its bid to be legal in Hong Kong *Insurance Business* <http://www.insurancebusinessmag.com/asia/news/breaking-news/uber-nets-thirdparty-insurance-in-its-bid-to-be-legal-in-hong-kong-61064.aspx>, (27 February 2017).

67 Uber, Cleaning/Maintenance Fee, <https://www.uber.com/zh-HK/drive/hong-kong/resources/cleaningfee/>.

68 Raiser Operations B.V. Services Agreement s.13.

69 Ibid (n19).

70 [1980] IRLR 201.

71 Ibid (n3)

72 Ibid (n5).

73 Uber Hong Kong gives 1,000 women flexible work opportunities, *Asia Times* <http://www.atimes.com/article/uber-hong-kong-gives-1000-women-flexible-work-opportunities/>, (8 March, 2017).



all the above factors, one can see that the control measures Uber exerts on drivers are relatively large in scale with rigid evidence. Although some factors like provision of tools and setting of work schedule from the drivers do not support a conclusion of an employee status, they are also proved to be non-conclusive to a classification of independent contractors.

Having a similar case with *Poon*, Uber drivers can be employed by the company on a casual basis. There is no doubt that the ECO covers casual employments under s.2(1)(b) which states that the meaning of employees includes 'any person whose employment is of a casual nature, and who is employed otherwise than for the purposes of the employer's trade or business...'<sup>74</sup> They will be covered as employees as long as the employment is for the purposes of the employer's trade or business. In *Perry v Wright*<sup>75</sup>, the claimant was successful to argue himself as an employee even when there was no obligation on him to work for the employer. Besides, it was ruled in *Poon* that a casual worker is in nature to 'take up work wherever it can be found, with one or more employers'.<sup>76</sup> Hence, Uber cannot raise this as an argument to show that drivers are self-employed because they can work whenever they want, and they are in control of their own business.

Uber may argue that for all 'control' measures it exercises on drivers from recruitment, tracking to termination are purely administrative in nature to ensure a fair and safe ride for drivers. In *Ng Siu Chau v HKSAR*<sup>77</sup>, the Court of Final Appeal had to determine whether apprentice jockeys are employees of Jockey Club. Ching PJ ruled that the control exercised by the Club over the apprentices which include the provision of training, payment of money provided in the indentures 'indicate nothing more than that the Club is exercising administrative powers' for purpose of administering horse-racing monopoly.<sup>78</sup>

In *O'Connor*, Uber also argued that the screening measures of drivers are important because 'Uber provides the best transportation service... and to keep it this way, we will be taking some major steps to improve both driver and vehicle quality on the Uber system'.<sup>79</sup> However, the Court will have to look at the role of Uber in Hong Kong in the provision of transportation service

in substance, not the form. As seen from the US and UK judgments, both courts agree that Uber's revenue is driven by the generation of rides by drivers but not by the distribution of software, as distinguished from *Ng*. It is hard for the court to conclude that Uber is not involved in the provision of on-demand transportation service.

Uber may claim that they have the need to adopt a set of measures with terms stated in the agreement to standardize drivers to ensure high-quality and safe rides, so it is a reliable one to attract users. However, it would be difficult for the court to consider these 'control' measures serve as a standardization purpose only in the high degree of control such as the prohibition of solicitation of clients and negotiation of price.

Uber may also argue that the money payable to drivers comes from the users of their platform, i.e. passengers. It is mentioned in *Ng* that 'payment by one person to another does not itself mean that the latter is an employee of the former'.<sup>80</sup> In *Ng*, the apprentice will be paid monthly by the Club. All earnings are also held by the Club and the Club has discretion as in how much to pay to the apprentice. The Court found that the riding fee and the prize money paid to the apprentice 'comes not from the Club but from the prize money won by the owner of the horse although, as a matter of administration, it is paid through the Club'.<sup>81</sup> Using the principle, Uber may argue that they only pay the salary to drivers for the users. Nonetheless, it is a different case with Uber. All the profits and losses of the business are on Uber's account. Drivers bear no financial risks and they are paid with set fares determined by Uber for each specific engagement of service, i.e. the ride. Drivers are not allowed to solicit clients and engage other workers to help. It is not likely for the court to view the payment of earnings as an administrative action and that drivers are engaging in business on their own account.

To further distinguish *Ng* with the current situation, the Court in *Ng* cannot find apprentices do anything for or on behalf of the Club. They ride races 'for the benefit of the owners or for the trainer, or both, but not for the Club'.<sup>82</sup> However, it is apparent that Uber relies on their driver's services as their main revenue and thus drivers are doing business on behalf of Uber for the benefits of the company. After balancing the substance of the relationship between Uber and drivers using the indicia of employment, legally speaking, the Court of Hong Kong is predicted to

74 ECO s.2(1)(b).

75 [1908] 1 KB 441.

76 Ibid (n23).

77 [2000] HKCU 19.

78 *Ng* (n89) (Ching PJ).

79 *O'Connor* (n43).

80 *Ng* (n89).

81 *Ng* (n89) (Ching PJ).

82 Ibid.

find Uber drivers in Hong Kong as employees by looking at the overall picture.

## 14. Change of business model

However, one must not forget the possibility that Uber may change its business model in Hong Kong, due to local government's pressure. The government's attitude towards such ride-sharing services can be reflected from the series of arrest of drivers by the police on issues of third-party insurance and hire car permit.

Secretary for Transport and Housing Professor Anthony Cheung Bing-leung commented in his report the long-term development of public transport on Uber that 'it can run its businesses like how existing taxi companies do now'.<sup>83</sup> Under the current law however, it is impossible for Uber to get hire car permits legally for the private cars of their drivers since they would not be able to provide the commissioner for transport with sufficient information which includes the extent to which area drivers operate is covered by public transport as well as the fact that Uber service is breaking conditions that restrict the use of private cars with a permit e.g.

Prohibition from operating by transmitting or receiving radio messages.<sup>84</sup>

## 15. Implications

### 15.1. Tort

If Uber drivers are viewed as employees, in cases of accidents, Uber passengers will have a claim against the company according to the vicarious liability doctrine. Uber will also have the responsibility to cover third-party insurance for the drivers. More details can be found in the insurance session discussed below.

### 15.2. Unionization

According to the Basic Law<sup>85</sup> and the EO<sup>86</sup>, drivers as employees have the right to form trade unions in accordance with the Trade Unions

Ordinance<sup>87</sup> to bargain for labor rights with Uber under the EO.

### 15.3. Employment benefits

If Uber drivers are found to be employees, the company will be responsible for their own safety, insurance, MPF and tax payments.

In terms of employment protection, an employee is entitled to all statutory protections under the EO. If an employee is engaged under a continuous contract, he or she is also entitled to enjoy employment benefits such as paid annual leave, statutory holiday pay, sickness allowance, severance payment or long service payment. Here, a continuous contract refers to an employee who has been employed continuously by the same employer for 4 weeks or more, with at least 18 work hours in each week.<sup>88</sup>

It should also be noted that employees will be protected from wrongful, unlawful and unreasonable dismissal by Uber company. As for wrongful dismissal, either party should terminate the contract with reasonable notice or payment in lieu of notice. Under unlawful dismissal, there is a list of circumstances which prohibits the employer to dismiss the employee including involvement in trade union activities. For unreasonable dismissal, it protects an employee against situations where the employer intends to extinguish any right or benefit conferred by the EO or to dismiss other than having a valid reason. In other words, drivers will be protected from being deactivated their account suddenly without notice or without proper reasons under the EO. Apart from the protection under the EO, an employee is also protected by the ECO, which includes sick leave and compensation from work injuries. An employee is entitled to protection by the Minimum Wage Ordinance pertaining to the statutory minimum wage. There will also be an employment protection under the Mandatory Provident Fund Ordinance with a part of the employer's contribution. It is foreseeable that once Uber drivers in Hong Kong are classified as employees, there will be an increase in the number of claims in relation to the EO and ECO.

### 15.4. Potential labour exploitation

Nevertheless, there will be potential exploitation of drivers by Uber who may exercise their discretion in making tactical contractual arrangement to avoid statutory benefits. In *Lui Lin Kam v Nice Creation Development Ltd*<sup>89</sup>, the employer arranged a 2-week break between an 18-month contract and thus broke the continuity

83 Phila Siu & Tony Cheung, Hong Kong puts brakes on Uber in its road map for the future, South China Morning Post <http://www.scmp.com/news/hong-kong/economy/article/2097342/uber-must-change-business-fit-hong-kong-taxi-model-transport>, (7 June, 2017).

84 Jasmine Siu, Hong Kong makes it impossible for Uber drivers to operate legally, says lawyer in landmark case, South China Morning Post <http://www.scmp.com/news/hong-kong/law-crime/article/2018717/hong-kong-law-infringes-job-rights-uber-drivers-court-hears>, (12 September, 2016).

85 Basic Law Art. 27.

86 EO s.21B.

87 Trade Union Ordinance (1962).

88 EO Schedule 1.

89 [2006] 3 HKLRD 655, [2006] HKEC 1258.

of employment for employees to be eligible for severance payment, which requires a continuous employment of 24 months under the EO. The Court of Appeal ruled that an employer is entitled to arrange its own affairs to take advantage of the provisions and 'there is nothing unreal about the break'.<sup>90</sup>

Furthermore, since Uber has to pay the appropriate tax and insurance for their drivers, they may become more selective in the recruitment of drivers and in the setting of the agreement terms such as setting of maximum work hours. There may be an increase in claims in relation to discrimination laws in Hong Kong for any employment discrimination.

### 15.5. insurance

From the perspective of insurance law, it is uncertain as for the scope of insurance coverage and the risks associated with the users of the sharing economy model. The case of Uber is a novel situation which awaits for more regulations and authorities to govern upon.

S.8 of the Uber's agreement mentions that insurance coverage is to be obtained by drivers at their sole cost and expense.<sup>91</sup> They should maintain an 'automobile liability insurance that provides protection against bodily injury and property damage to yourself, your passengers and third parties' and also 'workers' compensation insurance or other occupational accident injury insurance' as required by any applicable law in Hong Kong.<sup>92</sup> During the period of the legal trial, UberHK announced that they had signed a contract with AIG in October 2016 for third-party coverage worth up to HKD100 million for any ride-sharing in Hong Kong. The limit is per occurrence for bodily injury or death, which equals to that required of all vehicles under the law. Uber claimed that the insurance 'applies from the moment you book a trip [until] the last passenger exits the vehicle' The policy will begin coverage from October 17, 2016.<sup>93</sup>

### 15.6. Tax requirements

For tax requirements, if the conclusion is that Uber drivers are employees, Uber will need to bear the responsibility to keep payroll records of all drivers and to report to Inland Revenue

Department remuneration paid to them by submitting annual Employer's Return.<sup>94</sup> Drivers will be chargeable to Salaries Tax based on their income received from their driver job.

### 15.7. Antitrust

Originally, if Uber drivers are classified as independent contractors, Uber may have violated the anti-competition law by secretly conspiring with the drivers to fix price to charge the customers including the price surge scheme. It is commented that Uber constantly circumvents legal and financial burdens to enjoy an unfair competitive advantage over traditional taxi services from using an app-based car-for-hire platforms with minimum risks associated with their misclassification of drivers.<sup>95</sup> Yet, if Uber is employing drivers as employees, it itself, as a transportation company, will be free to compete with other companies with its own pricing scheme and suffers no violations of the competition law.<sup>96</sup>

## 16. Conclusion

As the US court has explained, the application of the traditional test of employment was evolved under an economic model that is different from the 'sharing economy model. Uber's business model has created significant challenges to the traditional multi-factor test. Until a new test is developed to cater this novel model, the test will yield the result that UberHK drivers are employees, with a similar conclusion to the 2 landmark cases in the UK and US, with the fact that Uber exerts a large amount of control on its drivers employed as casual workers.

However, it is likely that the HKSAR government will first determine the legality of Uber before there is a claim for benefits or compensation in relation to the ECO or EO together with the discussion of employment status classification.

90 Ibid.

91 Raiser Operations B.V. Services Agreement s.8.

92 Ibid.

93 Gabriel Olano, Uber nets third-party insurance in its bid to be legal in Hong Kong, Insurance Business <http://www.insurancebusinessmag.com/asia/news/breaking-news/uber-nets-thirdparty-insurance-in-its-bid-to-be-legal-in-hong-kong-61064.aspx>, (27 February 2017).

94 Inland Revenue Department, <http://www.ird.gov.hk/eng/tax/ere.htm#01>, (3 April 2017).

95 Elisa Mastroiello, Getting Taken for a Ride by Uber Technologies Incorporated (2016), Sociological Imagination: Western's Undergraduate Sociology Student Journal: Vol. 5: Iss. 1, Article 4, <http://ir.lib.uwo.ca/si/vol5/iss1/4>.

96 Zach Carter, The Legal Problem that Could Crash Uber Huffpost [http://www.huffingtonpost.com/entry/legal-problem-could-crash-uber\\_us\\_5718d485e4b0479c59d714f6](http://www.huffingtonpost.com/entry/legal-problem-could-crash-uber_us_5718d485e4b0479c59d714f6), 21 April 2016).

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