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Is Uber Unconstitutional?

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For decades, the taxi industry in the United States has been heavily regulated.[1] In most U.S. cities, the provision of taxi services is organized under the medallion system, which requires that a taxi driver either own a medallion—a license to operate a taxi in the city—or rent one from a medallion holder.[2] Local authorities limit the number of medallions and, consequently, the number of taxis that may operate in a given geographical area. Those authorities also prescribe rules that govern the provision of taxi services, such as mandatory enrollment of drivers in driver-training courses, vehicle-maintenance requirements, and rate control.[3] The ostensible purpose of these regulations is to correct alleged market failures that exist in the taxi industry.[4] The expressed concern is that, in an unregulated market, the high costs of executing a transaction would lead to such maladies as the undersupply or oversupply of taxi services, traffic congestion, poor quality of service, and the exploitation of passengers.[5]

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[1] *See, e.g.*, U.S. FEDERAL TRADE COMMISSION, AN ECONOMIC ANALYSIS OF TAXICAB REGULATION (1984) [hereinafter FTC TAXICAB REGULATION ANALYSIS], https://www.ftc.gov/sites/default/files/documents/reports/economic-analysis-taxicab-regulation/233832.pdf; Paul Stephen Dempsey, *Taxi Industry Regulation, Deregulation & Reregulation: the Paradox of Market Failure*, 24 TRANSP. L.J. 73 (1996).

[2] *See, e.g.*, Josh Barro, *Under Pressure from Uber, Taxi Medallion Prices Are Plummeting*, N.Y. TIMES (Nov. 27, 2014), http://www.nytimes.com/2014/11/28/upshot/under-pressure-from-uber-taxi-medallion-prices-are-plummeting.html?_r=0.

[3] *See, e.g.*, Dempsey, *supra* note 1, at 76–85.

[4] For skeptical analyses of the market-failure justifications for regulating the taxi industry, see FTC TAXICAB REGULATION ANALYSIS, *supra* note 1, at 2–6; Edmund W. Kitch, Marc Isaacson & Daniel Kasper, *The Regulation of Taxicabs in Chicago*, 14 J.L. & ECON. 285, 302, 310 (1971); Robert D. Cairns & Catherine Liston-Heyes, *Competition and Regulation in the Taxi Industry*, 59 J. PUB. ECON. 1, 1 (1996).

[5] *See, e.g.*, Dempsey, *supra* note 1, at 91–97.

In the resulting regulated environment, taxi medallions had been considered for several decades to be a profitable investment.[6] For example, the value of a medallion in New York City quadrupled from $240,000 in 2003 to $1 million in 2013.[7] Similarly, in Chicago, the price of a taxi medallion increased by more than 80 percent in the five years leading up to 2014, from a maximum price of $202,000 in 2009 to a maximum price of $370,000 in 2014.[8] However, investments in medallions became less profitable after Uber Technologies Inc. and other companies started offering online mobile platforms over which passengers can connect with drivers to arrange a ride. By providing a user-friendly mobile application, convenient service, and lower rates, Uber introduced an attractive alternative to traditional taxi services for both passengers and drivers. The increased competition from Uber caused medallions to lose their high valuations. For example, in January 2015, the *New York Times* reported that the value of a medallion in New York City had fallen from approximately $1 million in 2013 to $805,000.[9] In Chicago, prices fell from $370,000 in 2014 to $60,000 in 2016.[10]

Medallion holders have challenged the emerging competition from Uber through a variety of legal claims. In Chicago and Newark, for example, medallion holders have sued the local authorities that regulate the provision of taxi services.[11] They have argued, among other things, that the local authorities' failure to impose on Uber drivers the same requirements that apply to taxi drivers—in particular, the requirement to obtain a taxi medallion—violates

[6] Emily Badger, *Taxi Medallions Have Been the Best Investment in America for Years. Now Uber May Be Changing That*, Wash. Post (June 20, 2014), https://www.washingtonpost.com/news/wonk/wp/2014/06/20/taxi-medallions-have-been-the-best-investment-in-america-for-years-now-uber-may-be-changing-that/.

[7] New York City Taxi & Limousine Commission, 2003 Annual Report to the New York City Council 14 (2004), http://www.nyc.gov/html/tlc/downloads/pdf/2003_annual_report.pdf ("An individual taxicab medallion is valued . . . at about $240,000."); New York City Taxi & Limousine Commission, 2013 Annual Report 8, http://www.nyc.gov/html/tlc/downloads/pdf/annual_report_2013.pdf ("[T]he highest independently owned medallion sale of $1,051,000.00 was recorded in June[] 2013."); *see also* Jason Snead, *Taxicab Medallion Systems: Time for a Change*, Heritage (Dec. 10, 2015), http://www.heritage.org/research/reports/2015/12/taxicab-medallion-systems-time-for-a-change; Josh Barro, *New York City Taxi Medallion Prices Fall Again*, N.Y. Times (Dec. 2, 2014), http://www.nytimes.com/2014/12/03/upshot/new-york-taxi-medallion-prices-fall-again.html.

[8] City of Chicago, Business Affairs and Consumer Protection, 2014 Medallion Transfer Prices (2015), http://www.cityofchicago.org/content/dam/city/depts/bacp/publicvehicleinfo/medallionowners/taxicabmedalliontransferprices122014.pdf; *see also* Badger, *supra* note 6; *Chicago Medallion Prices*, Chicago Dispatcher, Jan. 2010, at 8–9, http://chicagodispatcher.com/clients/chicagodispatcher/medallionpricesdec09.pdf (showing that, in 2009, medallions were sold for a maximum price of $202,000).

[9] Josh Barro, *New York Taxi Medallion Prices Keep Falling, Now Down About 25 Percent*, N.Y. Times (Jan. 7, 2015), http://www.nytimes.com/2015/01/08/upshot/new-york-city-taxi-medallion-prices-keep-falling-now-down-about-25-percent.html.

[10] *Chicago Medallion Prices,* Chicago Dispatcher, May 2016, at 12, http://chicagodispatcher.com/clients/chicagodispatcher/May2016Medallion.pdf (showing that in April 2016, medallions were sold for a median price of $60,000); *see also* City of Chicago, Business Affairs and Consumer Protection, *supra* note 8.

[11] *See, e.g.*, Brief of Plaintiffs-Appellants at 11, Illinois Transp. Trade Ass'n v. City of Chicago, Nos. 16-2009 & 16-2077 (7th Cir. June 13, 2016) [hereinafter Brief of Plaintiffs-Appellant in Chicago Litigation]; Complaint at 1, Newark Cab Ass'n v. City of Newark, No. 2:16-cv-04681 (D.N.J. Aug. 2, 2016) [hereinafter Complaint in Newark Litigation]; *see also* Boston Taxi Owners Ass'n v. City of Boston, 84 F. Supp. 3d 72, 78 (D. Mass. 2015).

the Takings Clause of the Fifth Amendment to the U.S. Constitution,[12] which states that "private property [shall not] be taken for public use, without just compensation."[13] Medallion holders argued that, by allowing Uber drivers to offer *de facto* taxi services, local authorities "destroyed the core property right of medallion-holders" and caused an unconstitutional taking.[14]

In this article, I explain that, assuming for the sake of argument that a medallion is a property right,[15] a medallion holder has no plausible claim for just compensation under the Takings Clause.[16] The claims to just compensation that medallion holders have made recall the more sympathetic claims made two decades earlier, when state and federal legislation mandated open-access or network unbundling for public utilities.[17] On those previous occasions, courts found no taking when deregulation threatened to reduce or destroy, without any offsetting compensation, the value of private property in network industries. It is therefore inconceivable that the competitive

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[12] *See, e.g.*, Brief of Plaintiffs-Appellants in Chicago Litigation, *supra* note 11, at 11.

[13] U.S. Const. amend. V.

[14] Brief of Plaintiffs-Appellants in Chicago Litigation, *supra* note 11; *see also* Complaint in Newark Litigation, *supra* note 11.

[15] For a survey of the lower courts' decisions on whether medallions are a property right for purposes of the Takings Clause, see the thorough analysis in David K. Suska, *Regulatory Takings and Ridesharing: "Just Compensation" for Taxi Medallion Owners?*, 19 NYU J. Legis. & Pub. Pol'y 183, 198 (2016).

[16] Some of these issues have been identified, but not analyzed in depth. *See, e.g.*, Damien Geradin, *Should Uber Be Allowed to Compete in Europe? And If So How?*, Competition Pol'y Int'l (June 18, 2015), https://www.competitionpolicyinternational.com/should-uber-be-allowed-to-compete-in-europe-and-if-so-how/. For an analysis of Uber's business model from a labor law perspective, see Benjamin Means & Joseph A. Seiner, *Navigating the Uber Economy*, 49 U.C. Davis L. Rev. 1511 (2016); Jeremias Prassl & Martin Risak, *Uber, Taskrabbit, & Co: Platforms as Employers? Rethinking the Legal Analysis of Crowdwork*, 37 Comp. Lab. L. & Pol'y J. (forthcoming 2016); Ross Eisenbrey & Lawrence Mishel, *Uber Business Model Does Not Justify a New "Independent Worker" Category*, Econ. Pol'y Inst. (Mar. 17, 2016), http://www.epi.org/publication/uber-business-model-does-not-justify-a-new-independent-worker-category/; Orly Lobel, *The Law of the Platform*, 101 Minn. L. Rev. (forthcoming 2016); Jonathan V. Hall & Alan B. Krueger, *An Analysis of the Labor Market for Uber's Driver-Partners in the United States* (Princeton Univ. Indus. Rel. Sec., Working Paper No. 587, 2015), http://dataspace.princeton.edu/jspui/bitstream/88435/dsp010z708z67d/5/587.pdf. For a general discussion of the so-called sharing economy, see Stephen R. Miller, *First Principles for Regulating the Sharing Economy*, 53 Harv. J. on Legis. 147 (2016); John J. Horton & Richard J. Zeckhauser, *Owning, Using and Renting: Some Simple Economics of the "Sharing Economy"* (Nat'l Bureau of Econ. Research, Working Paper No. 22029, 2016); Christopher Koopman, Matthew Mitchell & Adam Thierer, *The Sharing Economy and Consumer Protection Regulation: The Case for Policy Change*, 8 J. Bus. Entrepreneurship & L. 529 (2015); Seth D. Harris & Alan B. Krueger, A Proposal for Modernizing Labor Laws for Twenty-First-Century Work: The "Independent Worker" (Hamilton Project 2015), http://www.hamiltonproject.org/assets/files/modernizing_labor_laws_for_twenty_first_century_work_krueger_harris.pdf; Donald N. Anderson, *"Not Just A Taxi"? For-Profit Ridesharing, Driver Strategies, and VMT*, 41 Transp. 1099 (2014); Boyd Cohen & Jan Kietzmann, *Ride On! Mobility Business Models for the Sharing Economy*, 27 Org. & Env't 279 (2014); Arvind Malhotra & Marshall Van Alstyne, *The Dark Side of the Sharing Economy . . . and How to Lighten It*, 57 Comm. ACM 24 (2014); Masabumi Furuhata, Maged Dessouky, Fernando Ordóñez, Marc-Etienne Brunet, Xiaoqing Wang & Sven Koenig, *Ridesharing: The State-of-the-Art and Future Directions*, 57 Transp. Res. Part B: Methodological 28 (2013); Nelson D. Chan & Susan A. Shaheen, *Ridesharing in North America: Past, Present, and Future*, 32 Transp. Revs. 93 (2012).

[17] *See, e.g.*, J. Gregory Sidak & Daniel F. Spulber, Deregulatory Takings and the Regulatory Contract: The Competitive Transformation of Network Industries in the United States (Cambridge Univ. Press 1997); Jerry A. Hausman & J. Gregory Sidak, *A Consumer-Welfare Approach to the Mandatory Unbundling of Telecommunications Networks*, 109 Yale L.J. 417 (1999).

pressure that Uber places on the taxi industry constitutes a taking, given that the provision of taxi services requires little or no irreversible investment.

The Uber litigation in Chicago exemplifies a symmetry in the constitutional analysis of rent seeking. The First Amendment's right to petition government exempts from antitrust liability those who sincerely pursue the enactment of laws suppressing competition in a given market.[18] However, if asset-specific investment by the incumbent is inessential to providing the public service, then the incumbent has no valid claim to just compensation under the Takings Clause if the state subsequently permits an entrant exploiting a technological innovation to circumvent the statutory restraint of trade. That symmetry is currently only implicit in the constitutional jurisprudence on rent seeking. Perhaps the Uber litigation will cause courts to recognize the symmetry explicitly.

In Part I of this article, I briefly explain Uber's business model. In Part II, using the well-briefed litigation in Chicago, I summarize the arguments by which medallion holders claim just compensation for an alleged taking of private property resulting from Uber's entry. In Part III, I show that, by allowing Uber to offer its service, the City of Chicago does not take the private property of taxi medallion holders.

I. Uber's Business Model

Uber acts as an intermediary between a passenger and a driver: it provides an online platform using global positioning system (GPS) technology by which a passenger can connect with a driver to arrange a ride.[19] Uber's free mobile app provides a convenient way for a passenger to request a ride by entering a pickup location and a destination in the app. The app sends the request to any driver in the passenger's vicinity who offers rides on Uber's platform and asks the driver to accept or decline that request. Upon the driver's acceptance, the passenger can track the driver's location and estimated arrival time and view the driver's first name, profile picture, vehicle type, and license plate number.[20] At the end of the trip, Uber automatically charges the passenger's selected payment method registered on file, obviating cash exchange.[21] The passenger can view her ride history and charges online.

Uber neither employs drivers nor owns any cars. It simply connects passengers with independently contracted drivers who supply and maintain their own vehicles, including the provision of fuel and insurance. Anyone

[18] *See* U.S. Const. amend. I ("Congress shall make no law . . . abridging . . . the right of the people . . . to petition the government for a redress of grievances."); United Mine Workers v. Pennington, 381 U.S. 657 (1965); Eastern R.R. Presidents Conf. v. Noerr Motor Freight, Inc., 365 U.S. 127 (1961).

[19] *Terms and Conditions*, Uber, https://www.uber.com/legal/terms/us/.

[20] *How Does Uber Work?*, Uber, https://help.uber.com/h/738d1ff7-5fe0-4383-b34c-4a2480efd71e.

[21] *Id.*

with a driver's license and a vehicle may apply to become an Uber driver and may provide service on a full-time or part-time basis upon successful completion of that application process.[22] Uber calculates fares on the basis of the trip's duration and the distance travelled. It charges a 20-percent to 30-percent commission on that fare, with the remainder going to the driver.[23] Uber seeks to discourage drivers from rejecting short, less profitable rides by (1) hiding the passenger's destination from the driver until commencement of the ride[24] and (2) requiring a driver to maintain a low cancellation rate—that is, the number of ride requests that the driver accepts but then cancels.[25] One difference between Uber drivers and taxi drivers is that Uber drivers typically cannot accept street hails.[26]

Uber uses a dynamic pricing model based on an internal algorithm to determine the price of each arranged ride.[27] During a high-demand period, such as a holiday or rush hour, Uber applies a "surge" price multiplier to its base fare to reflect the heightened demand.[28] Economists have long recognized the benefits of peak-load pricing.[29] By offering drivers higher compensation during periods of high demand, Uber's dynamic pricing encourages more drivers to offer rides, thereby increasing the quantity supplied to meet peak demand. Surge pricing also encourages passengers to reduce their demand, perhaps by shifting their travel to off-peak periods. Dynamic pricing thus addresses the potential for short-run disequilibrium in the market for rides. Despite its dynamic pricing model, Uber's fares are typically lower than those of taxis.[30]

Uber reduces the transaction costs between a passenger and a driver.[31] In the traditional taxi industry, both drivers and passengers incur significant search costs in the process of seeking a match between a customer and an empty cab. Uber reduces search costs by matching passengers with drivers

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[22] Juha-Pekka Nurvala, *'Uberisation' Is the Future of the Digitalized Labour Market*, 14 Eur. View 231, 233 (2015); *Details on Safety at Uber*, Uber, https://newsroom.uber.com/details-on-safety/.

[23] *See, e.g.*, Ellen Huet, *Uber Raises UberX Commission to 25 Percent in Five More Markets*, Forbes (Sept. 11, 2015), http://www.forbes.com/sites/ellenhuet/2015/09/11/uber-raises-uberx-commission-to-25-percent-in-five-more-markets/#15460ca064b5; *How Are Uber Fares Calculated?*, Uber, https://help.uber.com/h/6a11c805-a9ff-44b7-8e2f-4ae10e7f861b.

[24] *See, e.g.*, Press Release, Uber, Uber Raises the Bar For Safety & Quality (Dec. 18, 2015), https://newsroom.uber.com/us-pennsylvania/safety/.

[25] *Driver Deactivation Policy—US ONLY*, Uber, https://www.uber.com/legal/deactivation-policy/us/.

[26] *See, e.g.*, Brief of Plaintiffs-Appellants in Chicago Litigation, *supra* note 11, at 4.

[27] Bill Gurley, *A Deeper Look at Uber's Dynamic Pricing Model*, Above the Crowd (Mar. 11, 2014), http://abovethecrowd.com/2014/03/11/a-deeper-look-at-ubers-dynamic-pricing-model/.

[28] *Understanding Surge*, Uber, https://help.uber.com/h/19572af0-d494-4885-a1ef-1a0d54d0e68f.

[29] *See, e.g.*, Dennis W. Carlton & Jeffrey M. Perloff, Modern Industrial Organization (Prentice Hall 4th ed. 2004); Alfred E. Kahn, The Economics of Regulation: Principles and Institutions (MIT Press 1988).

[30] *See, e.g.*, Sara Silverstein, *These Animated Charts Tell You Everything About Uber Prices in 21 Cities*, Bus. Insider (Oct. 16, 2014), http://www.businessinsider.com/uber-vs-taxi-pricing-by-city-2014-10.

[31] *See, e.g.*, Deloitte, Economic Effects of Ridesharing in Australia 2 (2016), https://www2.deloitte.com/content/dam/Deloitte/au/Documents/Economics/deloitte-au-economic-effects-ridesharing-australia-010216.pdf.

instantly over its online platform.[32] In addition, Uber offers in its app an optional rating system by which the driver and the passenger can rate each other, which decreases the asymmetry of information regarding the quality of both the driver and the passenger. Uber also acts as an adjudicator in disputes between the passenger and the driver, such as when a passenger complains about an "inefficient" route.[33] Thus, Uber addresses many of the market failures that traditionally have been invoked to justify taxi regulation.

Uber has experienced enormous success. In less than 7 years, Uber has expanded its operations to more than 500 cities across 60 countries and, as of August 2016, was valued at $62.5 billion.[34]

II. The Takings Litigation in Chicago

In 2014, medallion holders sued the City of Chicago in the U.S. District Court for the Northern District of Illinois arguing, among other things, that the City's actions (or inactions) that allowed Uber drivers to offer unregulated *de facto* taxi services so impaired the medallion holders' property as to constitute a compensable taking.[35] The district court dismissed the takings claim.[36] The medallion holders appealed that decision,[37] and, as of August 2016, the U.S. Court of Appeals for the Seventh Circuit had not yet rendered its opinion. For reasons that should be obvious, it is likely that, whatever its outcome in the Seventh Circuit, the case will be appealed to the Supreme Court. The novelty and commercial significance of the technology and the legal question presented make a grant of certiorari more likely than in a typical takings case.

A. Deregulatory Takings

The prototypical takings case involves a physical invasion of land. For example, the state needs a piece of private land to build a highway and commences an eminent domain proceeding to condemn the land and pay

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[32] *See, e.g.*, Uber, Chicago: An Uber Case Study 16 (2015), https://uber-static.s3. amazonaws.com/web-fresh/legal/Uber_Chicago_CaseStudy.pdf ("Whereas taxi drivers in Chicago complete 1.68 trips per hour, uberX driver-partners average roughly 15% more, or approximately two rides per hour."); Judd Cramer & Alan B. Krueger, *Disruptive Change in the Taxi Business: The Case of Uber*, 106 Am. Econ. Rev. 177 (2016).

[33] *My Driver Took a Poor Route*, Uber, https://help.uber.com/h/0487f360-dc56-4904-b5c9-9d3f04810fa9.

[34] *Find a City*, Uber, https://www.uber.com/cities/; Leslie Hook, *Uber Hitches a Ride With Car Finance Schemes*, Fin. Times (Aug. 11, 2016), http://www.ft.com/cms/s/0/921289f6-5dd1-11e6-bb77-a121aa8abd95.html#axzz4H3fLDBH6. For a detailed analysis of the development of Uber's services in U.S. cities, see Andrew T. Bond, *An App for That: Local Governments and the Rise of the Sharing Economy*, 90 Notre Dame L. Rev. 77, 86–93 (2015).

[35] Illinois Transp. Trade Ass'n v. City of Chicago, 134 F. Supp. 3d 1108, 1111–12 (N.D. Ill. 2015).

[36] Illinois Transp. Trade Ass'n v. City of Chicago, No. 14 cv 827, 2016 WL 1623206, at *1 (N.D. Ill. Apr. 25, 2016); *see also Illinois Transp. Trade Ass'n*, 134 F. Supp. 3d at 1112.

[37] Brief of Plaintiffs-Appellants in Chicago Litigation, *supra* note 11, at 11.

just compensation to its owner.[38] The dramatic growth of the regulatory state has produced a second category of takings cases—the regulatory taking—in which the owner of a private property is not forced to sell the property to the government pursuant to a condemnation action, but rather is allowed to keep his property subject to significant constraints on its use that are issued in the name of the state's police power.[39] In 1922, Justice Oliver Wendell Holmes introduced this theory when he observed, in *Pennsylvania Coal Co. v. Mahon*, that a law making it "commercially impracticable to mine certain coal" on one's property has "very nearly the same effect for constitutional purposes as appropriating or destroying it."[40] In determining whether regulation went "too far" in limiting the property right, courts apply the three-pronged test developed in *Penn Central Transportation Co. v. New York City*, which examines (1) "[t]he economic impact of the regulation," (2) "the extent to which the regulation has interfered with distinct investment-backed expectations," and (3) "the character of the governmental action."[41]

By the late 1980s, courts (and regulatory commissions) faced a third category of takings cases—what Daniel Spulber and I would subsequently term "deregulatory takings"—which arose during the competitive transformation of network industries served by public utilities long presumed to be natural monopolies, subject to price regulation and "incumbent burdens."[42] The takings issue arose because those utilities had assumed "obligations to serve"—including the obligation to comply with maximum rate regulation and to establish service requirements through universal service, carrier-of-last-resort, and other rules—in return for the regulator's assurance that the utilities would have the reasonable opportunity to earn a competitive return on invested capital and compensation for the full cost of providing service. Such an arrangement between the regulator and the service provider is called the regulatory contract.[43] When the state eases entry restrictions while simultaneously maintaining incumbent burdens, the incumbent utility might encounter costly competitive disadvantages that so jeopardize its financial solvency as to constitute a taking.

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[38] A taking is categorical if it results in a "complete elimination of value or a total loss," but a taking can also be partial. Tahoe-Sierra Pres. Council, Inc. v. Tahoe Reg'l Planning Agency, 535 U.S. 302, 330 (2002).

[39] *See, e.g.*, Yee v. City of Escondido, 503 U.S. 519, 522 (1992).

[40] 260 U.S. 393, 414 (1922).

[41] 438 U.S. 104, 124 (1978); *see also* Horne v. Dep't of Agric., 135 S. Ct. 2419 (2015); Lingle v. Chevron U.S.A. Inc., 544 U.S. 528 (2005); Palazzolo v. Rhode Island, 533 U.S. 606 (2001).

[42] The term "incumbent burdens" was introduced in Paul W. MacAvoy, Daniel F. Spulber & Bruce E. Stangle, *Is Competitive Entry Free? Bypass and Partial Deregulation in Natural Gas Markets*, 6 Yale J. on Reg. 209, 210, 224–31 (1989). For an extended explanation of incumbent burdens, see Sidak & Spulber, *supra* note 17, at 30–31, 83–85, 417–19.

[43] Sidak & Spulber, *supra* note 17, at 4.

B. Takings and Uber

Relying in essence on the theory of deregulatory takings, incumbents in the taxi industry in Chicago allege that the City of Chicago violated the Takings Clause. The plaintiffs include individual owners of taxi medallions, firms that manage taxi operations, and issuers of loans secured by medallions—all of whom I will collectively call medallion holders for simplicity. They allege that, by imposing "burdensome and costly" regulation on taxi drivers while allowing Uber to operate without that regulation, Chicago violated the medallion holders' constitutional rights,[44] including the right to just compensation under the Takings Clause.[45] For ease of exposition, I will assume that all of the plaintiffs' factual allegations in the Chicago litigation are true.

Since the 1930s, Chicago has imposed "strict and costly regulation on taxis."[46] Among other things, Chicago "requires taxi owners to buy . . . 'medallion[s],'"[47] which confer the "exclusive right" to provide "for-hire transportation" in Chicago.[48] Chicago granted medallions for over 60 years and "fostered . . . the billion-dollar taxi industry that grew in reliance" on that system.[49] The medallions were "until recently sold for between $325,000 and $375,000."[50] They "were bought, sold and financed like homes and other property in an active market."[51] In 2012, the 6,800 medallions in Chicago were "worth over $2 billion ($360,000 each)" and "secur[ed] over $900 million in loans."[52]

Since 2012, Chicago has allowed Uber to provide *de facto* taxi services without requiring Uber drivers to obtain medallions or to comply with other requirements imposed on taxi drivers.[53] Those requirements include a background check, fingerprinting, and drug tests for each taxi driver, along with vehicle requirements, insurance requirements, and compliance with fare regulation.[54] The different regulatory treatment gives Uber a competitive advantage,[55] leading to a situation in which Uber is "flourishing and taxis and liveries are dying."[56] Such unequal treatment has caused the "collapse" of the medallion market and made medallions "virtually worthless."[57] In 2013,

[44] Brief of Plaintiffs-Appellants in Chicago Litigation, *supra* note 11. Although the plaintiffs target additional ride-sharing services, I will refer solely to Uber for simplicity.
[45] *Id.* at 1.
[46] *Id.* at 4.
[47] *Id.* at 5.
[48] *Id.* at 41.
[49] *Id.*
[50] *Id.* at 11.
[51] *Id.* at 5.
[52] *Id.*
[53] *Id.* at 2.
[54] *Id.* at 5–7.
[55] *Id.* at 6.
[56] *Id.* at 9.
[57] *Id.* at 4.

Chicago attempted to auction 50 medallions for $360,000 each but sold none.[58] "By May 2014, medallion liquidity disappeared," and "[l]enders exited the market."[59] Consequently, "[e]ach medallion owner has lost a six-figure investment," and "many are, or soon will be, in default on their loans."[60]

The medallion holders argue that, by allowing Uber to provide *de facto* taxi services without medallions, Chicago has caused a taking.[61] They say that medallions are property because they grant the owner an "'exclusive' right to provide for-hire individual transportation on a mileage-and-time basis."[62] By allowing Uber to provide taxi services, Chicago has "destroyed the core property right of medallion holders[,] . . . [taking] away the exclusive right" to provide taxi services.[63] "Without exclusivity, medallions have no value or purpose."[64] The medallion holders argue that Chicago may not eliminate the exclusivity that they previously purchased "without paying just compensation, when a billion-dollar industry is reasonably built in reliance on it."[65] The medallion holders emphasize that they "do not assert a property interest in the 'market value' of medallions."[66] In their view, "the loss of market value is relevant to calculating just compensation for the taking, but is not the taking itself," which instead resides in the loss of exclusivity.[67]

III. Did Chicago Cause a Taking By Allowing Uber to Enter the Market?

I apply here insights that Daniel Spulber and I developed two decades ago in our book, *Deregulatory Takings and the Regulatory Contract*, which analyzed how regulatory changes in network industries threatened to reduce or destroy the value of private property without any offsetting compensation. When assessing an allegation of a deregulatory taking, it is necessary to distinguish between (1) the case in which the firm has entered into a regulatory contract with the state and (2) the case in which the firm has merely benefited from regulation that enabled the firm to earn economic rents without delivering any corresponding *quid pro quo*. In the former case, the overriding purpose of the regulatory contract is to induce the incumbent company to make irreversible investments that are necessary to provide the regulated service.[68]

58 *Id.* at 5.
59 *Id.*
60 *Id.* at 34.
61 *Id.* at 16, 39, 46.
62 *Id.* at 16, 39, 41.
63 *Id.* at 39.
64 *Id.* at 50.
65 *Id.*
66 *Id.*
67 *Id.*
68 Sidak & Spulber, *supra* note 17, at 226.

Price regulation seeks to prevent monopoly pricing yet give the incumbent company a reasonable opportunity to recover its investment and to earn a competitive risk-adjusted return on that investment.[69] When the state eliminates a regulatory entry barrier, the incumbent company confronts a material impediment to its ability to recover the costs of its investment, such that the state should ease the company's incumbent burdens and offer just compensation for its remaining loss from any stranded investment—which consists of "expenditures . . . that reflect outlays required by regulators that firms cannot recoup in the presence of competitive entry."[70] The absence of such cost-reduction and cost-recovery mechanisms could cause an unconstitutional taking. However, the state's obligation to counterbalance the firm's loss from deregulation of the market is absent when, as in the case of taxi medallion holders, the provision of the public service in question does not require the firm to make a significant irreversible investment in infrastructure.

A. Irreversible Investment to Discharge the Obligation to Serve

Four economic conditions are necessary to support a takings claim by a regulated firm for the recovery of stranded investment: (1) the existence of a regulatory contract, (2) evidence of investment-backed expectations, (3) the elimination of a regulatory barrier to entry, and (4) a decline in the regulated firm's expected revenues.[71] The absence of any one of these conditions will defeat a firm's claim that it has suffered a deregulatory taking. For brevity, I will focus solely on evidence of investment-backed expectations.

The regulatory contract's overriding purpose is to induce the regulated firm to make substantial *irreversible* investment in facilities built to discharge its regulatory obligation to serve. Nobel laureate Oliver Williamson has defined the irreversibility of an investment in terms of its *asset specificity*. Asset-specific investments are "durable investments that are undertaken in support of particular transactions, the opportunity cost of which investments is much lower in best alternative uses or by alternative users should the original transaction be prematurely terminated."[72] Without the regulatory contract, the regulated firm would not be willing to incur capital costs to build the asset-specific facilities needed to satisfy its regulatory obligations. In the language of contract law, the basis for compensating stranded costs is *detrimental reliance*, which manifests itself as the firm's irreversible

[69] *Id.* at 104.
[70] *Id.* at 114
[71] *Id.* at 29; *see also id*. at 450. William J. Baumol & J. Gregory Sidak, *Stranded Costs*, 18 Harv. J.L. & Pub. Pol'y 835, 835 (1995), https://www.criterioneconomics.com/docs/stranded_costs1.pdf.
[72] Oliver E. Williamson, The Economic Institutions of Capitalism 55 (Free Press 1985). For an analysis of how a regulator might exploit asset-specific investment by the regulated firm to achieve illegitimate objectives, see J. Gregory Sidak, *An Economic Theory of Censorship*, 11 Sup. Ct. Econ. Rev. 81, 89 (2004).

investment to perform the contract. Without such objectively verifiable reliance on the part of the regulated firm, there can be no deregulatory taking. Conversely, if a firm simply produces a regulated service and can recover all its economic costs as they are incurred, then the firm cannot suffer a deregulatory taking if the state removes entry control.

One might argue that taxi companies have entered into a regulatory contract with Chicago: they received entry regulation in return for submitting to Chicago's rate regulation and the public service obligation of carrying any passenger to any neighborhood in Chicago, regardless of how inconvenient the trip might be. Even so, the provision of the taxi service required little if any *irreversible* investment. Taxicabs that currently bear medallions in Chicago are not irreversible investments. To the contrary, taxicabs are quintessentially mobile assets, redeployable for the same use in another city or for a different use in Chicago. Moreover, a fleet of taxicabs is divisible; it does not have the "lumpiness" of an integrated network that is used for the provision of electricity or local telephony services.[73] The same point regarding the reversibility of investment is true to only a slightly lesser extent for the taxicab company's investments in garage and radio communications assets.

In short, one can reach either of two conclusions that have the same economic and legal significance: (1) taxicab regulation in Chicago is not a regulatory contract because it does not exist to induce irreversible and asset-specific investment, or (2) such regulation does establish a regulatory contract, but one that can give rise to only negligible stranded costs in the face of competitive entry because most of the firm's invested capital can be thoroughly and immediately redeployed in alternative uses. Put differently, when the degree of asset specificity is low, the firm has a greater opportunity to mitigate its stranded costs. Consequently, a deregulatory taking becomes implausible.

B. Statutory Gratuities and Government-Managed Cartels

The regulation that has benefited medallion holders for Chicago taxicabs is closer to a government-managed cartel than a regulatory contract. The regulatory contract is a bargained-for exchange between the state and a private firm that is intended to benefit consumers as third-party beneficiaries. That relationship differs fundamentally from the relationship that frequently exists when—as in the notorious case of the California raisin cartel that the Supreme Court gave state-action immunity from federal antitrust law in

[73] *See* William J. Baumol & J. Gregory Sidak, *The Pig in the Python: Is Lumpy Capacity Investment Used and Useful?*, 23 Energy L.J. 383 (2002).

Parker v. Brown[74]—the government confers a statutory gratuity on a firm or permits (or even encourages) the government's use of its regulatory prerogatives to cartelize an industry.[75] Unlike a regulatory contract, a state-managed cartel harms, rather than benefits, consumers.

In 1991, the Supreme Court was asked to remove antitrust immunity from state-managed restraints of trade in cases in which the state action resulted from a conspiracy against consumers or competitors into which public officials and private actors had entered. The Court refused to apply the Sherman Act to such conduct:

> Few governmental actions are immune from the charge that they are "not in the public interest" or in some sense "corrupt." The California marketing scheme at issue in *Parker* itself, for example, can readily be viewed as the result of a "conspiracy" to put the "private" interest of the State's raisin growers above the "public" interest of the State's consumers. The fact is that virtually all regulation benefits some segments of the society and harms others; and that it is not universally considered contrary to the public good if the net economic loss to the losers exceeds the net economic gain to the winners.[76]

If federal antitrust law does not oblige the state to compensate losers when it restrains trade and reduces consumer welfare for the purpose of transferring wealth to a favored constituency, then surely the state need not compensate yesterday's winners when it subsequently reverses course and terminates their statutory gratuity or state-managed cartel.

To be sure, the private firms that benefited from the prior state of affairs will have lost an economic expectation. That expectation might have even led to some measure of irreversible investment. However, the expectation held by a member of a state-managed cartel is qualitatively different from the expectation of a regulated utility. The latter is rooted in the law of contract and property and predicated on the recovery of the cost of the transaction-specific investment that the utility needed to make to discharge its obligation to serve. Thus, a state's decision to terminate or impair the expectation of a formerly state-sanctioned cartel, even an *investment-backed* expectation, would not support a claim for a deregulatory taking.

"No person," wrote Justice Mahlon Pitney in 1917 in *New York Central Railroad v. White*, "has a vested interest in any rule of law entitling him

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74 317 U.S. 341 (1943).

75 *See, e.g.*, Bates v. State Bar of Ariz., 433 U.S. 350 (1977); Cal. Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc., 445 U.S. 97 (1980); Hoover v. Ronwin, 466 U.S. 558 (1984); S. Motor Carriers Rate Conf. v. United States, 471 U.S. 48 (1985); 324 Liquor Corp. v. Duffy, 479 U.S. 335 (1987); City of Columbia v. Omni Outdoor Advert., Inc., 499 U.S. 365 (1991); FTC v. Ticor Title Ins. Co., 504 U.S. 621 (1992). As noted earlier, the antitrust laws do not constrain the sincere (as opposed to sham) attempts of private actors to petition government to crush their competitors. *See supra* note 18 and accompanying text.

76 *Omni Outdoor*, 499 U.S. at 377.

to insist that it shall remain unchanged for his benefit."[77] The regulatory contract does not entitle the regulated utility to insist that the law remain unchanged for the firm's benefit. Rather, the regulatory contract—to paraphrase Justice Oliver Wendell Holmes's famous aphorism about contracts generally and damages for breach of contract in particular—merely entitles the regulated utility to compensation when the state breaches the regulatory contract.[78] As Judge Richard Posner has recognized, there is a fundamental symmetry between the logic underlying Justice Holmes's observation and the proposition that the government avoids a taking by paying just compensation for its changes in regulation:

> The essence . . . of a breach of contract is that it triggers a duty to pay damages for the reasonably foreseeable consequences of the breach. If the duty is unimpaired, the obligation of the contract cannot be said to have been impaired. In Holmes's vivid formulation, the obligation created by a contract is an obligation to perform or pay damages for nonperformance, and if the second alternative remains, then, since it is an alternative, the obligation created by the contract is not impaired. The analogy to the principle that government does not violate the takings clause if it stands ready to pay compensation for its takings should be evident.[79]

Judge Posner's insight applies directly to deregulatory takings and breach of the regulatory contract. It is the state's choice whether to exercise its police power in a manner that abrogates the regulatory contract, subject to the resulting obligation to compensate the utility for its lost expectation of cost recovery. The existence of a regulatory contract thus clarifies the distinction between the Takings Clause and the state's police power to impose or remove entry regulation.

The conclusion that the breach of a regulatory contract obligates the state to compensate the regulated firm is entirely congruent with the well-established principle in constitutional law that the termination of statutory gratuities, such as welfare or pension rights, is not compensable under the Takings Clause.[80] Such relationships between the state and private parties are not sufficiently significant to constitute a contract, even if those relationships induce detrimental reliance by private parties and might therefore sustain a claim based on promissory estoppel. No obvious consideration

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[77] 243 U.S. 188, 198 (1917).

[78] Oliver Wendell Holmes, *The Path of the Law*, 10 Harv. L. Rev. 457, 462 (1897) ("The duty to keep a contract at common law means a prediction that you must pay damages if you do not keep it—and nothing else.").

[79] Horwitz-Matthews, Inc. v. City of Chicago, 78 F.3d 1248, 1251 (7th Cir. 1996) (citing Ruckelshaus v. Monsanto Co., 467 U.S. 986, 1016 (1984); Coniston Corp. v. Village of Hoffman Estates, 844 F.2d 461, 463 (7th Cir. 1988) (citation to Holmes, *supra* note 78, omitted).

[80] United States v. Teller, 107 U.S. 64, 68 (1883); Lynch v. United States, 292 U.S. 571, 576–77 (1934); R.R. Retirement Bd. v. Fritz, 449 U.S. 166, 174 (1980); Bowen v. Gilliard, 483 U.S. 587, 604, 607 (1987); Hoffman v. City of Warwick, 909 F.2d 608, 616–17 (1st Cir. 1990).

flows from the recipient of such benefits to the state—as there does when a public utility accepts an obligation to serve all customers in its area at regulated rates. Deregulation of Chicago's taxi industry that permits circumvention of an entry barrier that gratuitously benefited medallion holders is not a deregulatory taking.

To identify the limits on stranded cost recovery, it is critical to comprehend the difference between a regulatory contract and the phenomenon of cartelization by regulation. In a comment on my writings with Daniel Spulber, Judge Stephen F. Williams of the U.S. Court of Appeals for the D.C. Circuit posed in 1996 the following questions concerning the potential recovery of stranded costs by a third party who had purchased a taxi franchise, which then experiences the elimination of entry regulation:

> [Sidak and Spulber] set forth the existence of a franchise as a limit to their proposal [to compensate deregulatory takings], but also seem ready to embrace franchises generally, *i.e.*, to see franchises as manifesting the sort of regulatory bargain that calls for their solution. What of taxi franchises, held now not by the original rent-seekers but by people who have bought their franchises at market rates, *i.e.*, rates that capitalized the value of the artificially created scarcity? Those purchases were transfer payments induced by regulation. Must the state provide compensation for losses in franchise value that will flow from any increase in the number of taxi franchises?[81]

Judge Williams then answered his questions this way:

> Perhaps compensation should be excluded . . . because the medallion owners' payments have been made *outside* the system, somewhat like the payments by which particular investors in a utility become stockholders, as opposed to the investments of the utility itself (just as, today, a firm purchasing a regulated utility does not get a stepped-up "rate base" merely by paying more than book value for the firm's assets). *Or perhaps compensation should be denied on the ground that such purchasers were obviously buying the capitalized value of prior rent-seeking, and thus, the argument would run, an asset that is not only self-evidently hazardous but one of questionable social utility*.[82]

Judge Williams' insight about the questionable social utility of buying the capitalized value of prior rent seeking meshes well with the distinguishing characteristic of the regulatory contract—namely, the *irreversible* deployment of capital necessary to discharge an obligation to serve the public. Hence,

[81] Stephen F. Williams, *Deregulatory Takings and Breach of the Regulatory Contract: A Comment*, 71 NYU L. Rev. 1000, 1004–05 (1996).

[82] *Id.* (emphasis added). These questions resemble the question of whether holders of spectrum licenses in the United States have any protected property interest in light of the fact that federal law expressly forbids the grant of ownership rights in spectrum. For an extensive discussion of how there evolved a legal regime of *faux* property, manifested in ornate procedural rights regarding the renewal, transfer, and revocation of licenses, see Sidak, *An Economic Theory of Censorship*, *supra* note 72, at 93–110.

it is straightforward to distinguish the case of taxi medallions from, say, the mandatory unbundling of the electricity and local telephony industries in the 1990s. To be eligible for just compensation in the event of deregulation, the irreversible investment of the property holder cannot consist solely of the right to receive supracompetitive returns. An investment in taxi medallions is not the kind of irreversible investment that deserves just compensation under the Takings Clause when competition reduces it value.

That qualification helps to distinguish the taxicab example from the regulatory contract in electric power and local telephony, which was formed in the late 1800s and early 1900s in response to the need of municipalities to induce private investors to make asset-specific investments in network infrastructure.[83] The regulation of taxicabs, in contrast, was directed at an industry with a far lower level of asset specificity.[84] The problem of inducing asset-specific investment and committing the regulator to refrain from acting opportunistically once the firm has made nonsalvageable investments does not exist to the same degree in the taxicab industry as in the electric power and local telephony industries.

True, a subsequent buyer of a taxi medallion cannot mitigate the loss in value of that franchise if the regulator permits Uber to expand aggregate supply in the market. But the specialized asset that this buyer acquires—the medallion in the secondary market—is an irreversible investment *only* because, as Judge Williams observes, it "obviously" embodies the naked demand that the law not change to the medallion holder's detriment.[85] That obvious political risk makes the taxi medallion "an asset that is . . . self-evidently hazardous."[86] It is a hazardous asset precisely because, as Justice Pitney observed, the medallion holder has no right to "to insist that" entry regulation "shall remain unchanged for his benefit."[87] A simple rule of thumb is that the government owes no compensation for deregulation that expands output and lowers price while preserving the incumbent firm's ability to recoup the costs of its irreversible investments in infrastructure required to provide a public service.

[83] *See* Sidak & Spulber, *supra* note 17, at 463–66.

[84] One can define the degree of asset specificity as "the fraction of [the asset's] value that would be lost if it were excluded from its major use." Paul Milgrom & John Roberts, Economics, Organization and Management 307 (Prentice Hall 1992). In 1930, for example, the Supreme Court of California affirmed the regulator's grant to an entrant of a certificate of public convenience and necessity to provide ferry service across San Diego Bay, notwithstanding the incumbent's recent purchase of an expensive, new ferryboat. San Diego & Coronado Ferry Co. v. R.R. Comm'n of Cal., 210 Cal. 504, 292 P. 640 (1930). That result implicitly recognizes that a ferryboat is inherently mobile. A firm that no longer needs a ferry in San Diego can readily redeploy the asset to San Francisco, Seattle, or Vancouver. Hence, the fraction of the ferry's value that would be lost if it were excluded from use in San Diego Bay is nil.

[85] Williams, *supra* note 81, at 1005.

[86] *Id.*

[87] N.Y. Cent. R.R. Co. v. White, 243 U.S. 188, 198 (1917).

IV. Conclusion

Uber's online platform enables passengers to find drivers to arrange a ride. Uber has introduced a convenient and often cheaper alternative to the traditional taxi service. The traditional taxi industry has challenged Uber's entrance into a market that previously had faced little competition due to regulatory barriers to entry. In the United States, the holder of a taxi medallion possesses the right to operate a taxi in the designated geographical area. Medallion holders have sued local regulators of taxi services, challenging their failure to impose on Uber obligations similar to those that taxis bear. Such lawsuits in Chicago and other cities have alleged that the regulator's failure to require Uber drivers to obtain medallions violates the Takings Clause of the Fifth Amendment to the U.S. Constitution. The medallion holders argue that, by allowing Uber to offer *de facto* taxi services without medallions, local authorities have so impaired the medallion holders' property as to cause a compensable taking of private property.

That conclusion is false as a matter of both economic analysis and constitutional law. As an economic matter, to establish a deregulatory taking, one must prove: (1) the existence of a regulatory contract, (2) the presence of investment-backed expectations based on irreversible investment, (3) the elimination of a regulatory barrier to entry, and (4) a decline in the regulated firm's expected revenues. Because the provision of taxi service requires little if any irreversible investment, for this reason alone the deregulation of the taxi industry cannot be a deregulatory taking. For many years, medallion holders benefited from a regulatory barrier to entry in the taxi industry enforced by the limited number of issued medallions. But with a business model based on an entirely new technology, Uber upended that equilibrium. As Justice Pitney said in 1917, no one has the right to insist that a law shall remain unchanged for his benefit. The claim that the City of Chicago has violated the Takings Clause by permitting Uber to operate in competition with taxicabs is baseless.

The Uber litigation over taxi medallions reifies a rough justice in the Constitution's treatment of rent seeking. On the one hand, the First Amendment's right to petition government immunizes from antitrust liability a person's sincere efforts to persuade the legislature to bar competitors from his market. On the other hand, if the statutory barrier to entry was never essential to eliciting the incumbent's asset-specific investment to provide a public service by enabling the incumbent to recover its quasi-rents—that is, if the incumbent has reaped pure economic rent from a naked restraint of trade that legislators created at his (or his predecessor's) behest—then the Takings Clause will not be read to entitle the incumbent to just compensation when a new technology evades that statutory barrier to entry

and competes away the economic rent that it created for incumbents. To my knowledge, this symmetry between the First and Fifth Amendments is currently only implicit in the constitutional jurisprudence on rent seeking. The current Uber litigation will give the Seventh Circuit or the Supreme Court the opportunity to declare that symmetry explicitly.