

The TNC Business Model May Be Unconstitutional!

Implications of Illinois Federal Court Ruling Citing Equal Protection Violation Concerns about Chicago's TNC Law

By Matthew W. Daus, Esq.

Partner and Chairman, Windels Marx Transportation Practice Group
President, International Association of Transportation Regulators
Distinguished Lecturer, University Transportation Research Center
(City University of New York/City College)

and

Jasmine K. Le Veaux

Associate, Windels Marx Lane & Mittendorf, LLP

We have been talking a lot in recent months about the litigation against Transportation Network Companies (“TNCs”), and the onslaught of lawsuits (now nearing fifty cases within the United States alone), which are revealing the weaknesses of the TNC business model. Among them are worker classification issues, inadequate driver vetting and unfair competition. Just last month, a ruling in the federal lawsuit *Illinois Transportation Trade Association v. the City of Chicago*, arising out of the United States District Court for the Northern District of Illinois, has redirected the TNC debate away from TNCs themselves, and towards the TNC regulations which create a bifurcated, yet unbalanced, regulatory scheme for two similarly situated transportation providers.

Last year, an Illinois Transportation Trade Association and other taxi industry parties, including medallion owners, operators and taxi companies (collectively, the “Plaintiffs”) filed a lawsuit against the City of Chicago after it enacted its TNC ordinance on May 28, 2014.^[1] The plaintiffs, in *Illinois Transportation Trade Association et al., v. City of Chicago*, Case No. 1:14-cv-00827, allege that the City of Chicago violated the 5th Amendment of the United States Constitution by allowing TNCs to operate in the City under less stringent licensing standards while providing the same on-demand car services as taxicabs. Plaintiffs argue that allowing TNCs to encroach upon the on-demand for-hire market, without adhering to the same costly regulations as other on-demand operators, depreciates medallion values to the extent that it leaves no reasonable economically viable use of the property.

Specifically, Plaintiffs argue that prior Illinois legal precedent recognizes individual medallions as a property right and holds that the relationship between the City and medallion holders is contractual, not merely regulatory. A few years ago, medallions in Chicago sold for between \$325,000 and \$375,000. On September 13, 2013, the City announced that it would auction 50 medallions at a minimum price of \$360,000. However, Plaintiffs allege that this attempt to auction medallions ended on October 18, 2013, unsuccessfully.

Plaintiffs argue that the City’s decision not to apply its Taxi Ordinance in any meaningful way to the unlawful operations of TNCs has disrupted long-settled expectations and imposed very serious adverse consequences, including the devaluation of the more than 6,800 taxi medallions currently in use in Chicago, which have had a market value of at least \$2.38 billion (6,800 x \$350,000). Plaintiffs alleged that lenders who hold a security interest in medallions will see a substantial loss in substantial value of the collateral; the drop in value and related uncertainty threatens to cause the credit market that supports financing medallions to freeze, thereby causing a spiral in which medallion values plummet even further.

The Plaintiffs filed a seven count lawsuit, in February 2014, alleging, *inter alia*, equal protection

violations under the 5th and 14th amendments to the U.S. Constitution, state common law contractual causes of action for breach of contract and equitable causes of action for promissory estoppel. The gist of Plaintiff's arguments are that the new TNC Ordinance creates different, less stringent licensing standards for new TNCs for insurance, driver qualifications, background checks, vehicle qualifications, fares and in other areas than those required of taxis.^[2] Some examples include:

- Taxis must go through background checks conducted by the Chicago Police Department, while TNCs do their own background checks;
- The City inspects taxis for safety and maintenance, while TNCs can be inspected without a City-defined standard;
- Taxis must maintain liability insurance of a minimum of \$350,000 per occurrence and workers compensation insurance costing over \$4,000 per year, while TNCs are required to maintain insurance, but not through an insurance company authorized to conduct business in Illinois (instead of primary insurance required of taxicabs, TNCs can obtain excess coverage on top of a lesser primary minimum of \$20,000 while awaiting dispatch, and \$1 million while providing a ride, with no workers compensation required).

Uber joined the proceedings shortly after the lawsuit was filed as a "non-party", but filed no substantive motions in connection to the claims asserted by Plaintiff. Several drivers of the TNCs, SideCar, Lyft and Uber, however, also joined the lawsuit as "intervenors" seeking to have the Plaintiffs' Complaint dismissed for failure to state a claim. In December 2014, the City moved to dismiss the Plaintiffs' Complaint for failure to state a claim, alleging that Plaintiff's causes of action were not supported by legal precedent. United States District Court Judge Sharon Johnson Coleman dismissed five of the counts, but upheld two of the counts. Namely, the Court's ruling that the Plaintiffs' equal protection argument had a legal basis and should proceed to trial, has caused waves throughout the nation.

In analyzing a Motion to Dismiss, the Court must consider the Federal Rules to determine whether Plaintiff has made well-pled factual allegations that, if accepted as true, would state a claim to relief that is plausible on its face.^[3] Facts alleged by non-movant are accepted to be true, and reasonable inferences are drawn in the non-movant's favor.

The Plaintiffs, in Counts II and III of the complaint, allege violations of the equal protection clause for disparate application of the taxi ordinance before the TNC ordinance under Count II, and after the enactment of the TNC ordinance under Count III. The City argued that plaintiffs could not show they were not similarly situated to TNCs and that Plaintiffs could not show that the City had no rational basis for not enforcing the taxi ordinance against the TNCs or creating the TNC ordinance. The City argued that taxis and TNCs are not similarly situated because of the way they are hailed and due to their fare structures. The Court held these are not material differences and that they are similarly situated.

Indeed, Judge Coleman's opinion made the following notable findings:

- Taxis and TNCs are similarly situated;
- There is no material difference between raising your arm to hail a cab and putting your location in an app with a request for immediate transport;
- Rides can be prearranged by taxis as well as TNCs; and
- A TNC driver is not any more "known" to the consumer than a taxi driver

(as each provides for-hire transportation with the City of Chicago, rides can be prearranged for a set time, hailed, or virtually-hailed through an app, consumers are contractually bound to pay for the services, and may do so by credit card).

The Court held the above aspects of TNC and taxi operations are not material differences, but rather,

the two modes of transportation are similarly situated. The Court also held that none of the alleged differences are rationally related to the difference in treatment in background checks, drug testing, vehicle age limits, maintenance and inspections, insurance, annual fees, and differences in fares. The Court found that the regulations for taxis were more onerous than for TNCs in all of these areas. The Court went on to state that while the “increasing availability and accessibility of cost-effective transportation and fostering diversity and consumer choice in the for-hire market is a legitimate interest for the City”, the purported differences between taxis and TNCs are not rationally related to this stated rationale, and these goals do not justify maintaining heavier burdens on taxis. Thus, because of the arbitrariness in the laws, the Plaintiffs’ Equal Protection claim was allowed to continue.

In light of the foregoing, the taxicab and limousine industries may begin to abandon attempts to attack TNCs and redirect its attention and litigation sights to challenge TNC legislation and regulations in every state. If it were to do so, the litigation would be easier to win, with possibly less expense and simple motion practice to obtain quicker results. The decision in *Illinois Trade Assoc.*, is already being cited by members of the Chicago City Council to urge Mayor Rahm Emanuel to revisit the City’s ordinances in order to level the playing field.^[4] The impact of the Court’s decision in *Illinois Trade Assoc.* is significant and may introduce a new wave of litigation that could dismantle the TNC regulatory scheme, as well as the TNC business model itself. This nuanced approach may nevertheless achieve the goals sought by industry players - not to impede innovation or to curb competition - but to promote fair competition amongst all players in the for-hire transportation industry.

Our predictions, early and often, have been consistent (unlike the TNC model) that in addition to labor violations and actions, the biggest risk for TNCs in terms of their business model involves basic constitutionality. The Equal Protection Clause of the United States Constitution is often cited with respect to discrimination, where persons in a protected class (i.e., race, gender, religion, etc...) subjected to laws drawing classifications that impact them disproportionately, or treating them differently without any compelling reason, are subject to strict scrutiny and have an easier chance of being declared unconstitutional, either by its disparate impact (in its application to persons) or on its face (by the very basic terms of reading the law). Every other law not involving those protected persons, such as TNC laws, involve a lower level of judicial constitutional, where simply a “rational basis” for the law must be established to uphold the law. Under basic Equal Protection scrutiny, either in its impact or on its face, the law must not be arbitrary or unfairly applied without a reason. Any reason - not even one which most people would agree with - can be relied on to uphold the law. The decision in *Illinois Trade Assoc.*, strongly raised concerns that TNC laws would not survive such a challenge, questioning how there is any difference in the manner, mode or operation of a taxicab, limousine or TNC when it came to establishing public safety and customer service licensing standards. In addition to the U.S. Constitution, many State Constitutions and state statutes have similar provisions that allow laws and regulations to be challenged and declared invalid or unconstitutional if they are arbitrary, capricious and/or irrational (what is also called a mandamus proceeding). We have been saying in published articles, speeches and media for a long time that TNC laws are unconstitutional violations of the Equal Protection Clause and the TNC debate will be decided in the courts. It appears this prediction is about to come true.

So, in terms of what happens next, we have predicted many times that TNCs and elected officials, in the wake of an adverse ruling, would go back to the drawing board and revise TNC laws to finally level the playing field between taxicabs, limousines and TNCs. It is highly likely this will happen, but not yet. There has been too much money and resources devoted to the current TNC business model and strategy for the TNCs not to appeal or tie such rulings up in the courts for a while longer. Ultimately, should the Illinois decision or another court with similar causes of action pending issue a final ruling on Equal Protection grounds, that means that basically almost every one of the laws promulgated over the last few years around the U.S. will potentially be invalidated in whole or in part. That would be a huge blow to the TNCs and a game changer to push the momentum back in the other direction in favor of the incumbent industry. But after many tens of millions of dollars of TNC money having been spent on developing TNC laws through political donations, lobbyists, media strategists and lawyers, the TNCs will seek to amend the laws. However, there are two basic options: (1) less regulation for all; or (2)

more regulation for all.

The TNC laws may have been a temporary stop-gap measure to legitimize quasi unlicensed operation to gather market share and accelerate an industry takeover, which it has basically done. There was always an hourglass or ticking clock that TNCs knew that this temporary model would be flattened. It may have been part of the strategy that there would be a loss in the courts eventually, due to the slow wheels of justice; but the TNCs knew full well it may have been too late for the industry to recover. Well, the TNCs' best defense was a good offense; but not the playbook will need to be re-written, and the big issue is will policymakers and legislators opt to bring the TNCs into full licensing compliance required of taxicabs and limousines (like New York City), or completely deregulate the market as was attempted in the 1980s; with little or no regulations or licensing standards for TNCs, limos and taxicabs, and with complete open market entry with no caps or restrictions on the number of vehicles on the road. It is more likely that we will end up somewhere in between where TNCs and taxis/limos are, maybe something similar to the Maryland or Houston models, where many licensing restrictions are removed except for the basic controversial ones such as biometric criminal background checks. It is highly probable that the taxi and limousine industry may agree to insurance requirements that the TNCs have, but that policymakers may meet all industries half way with either full government administered biometric fingerprints and vehicle inspections. Another possibility is a compromise where biometric prints (not name checks) and vehicle inspections are required, but that all industry businesses (TNCs, limos and taxicabs) can self-regulate or "do-it-themselves" - subject to government audit. It is hard to predict for sure, as there as so many daily and weekly twists and turns in this ever evolving battle, but these are the likely outcomes.

[1] The Memorandum Opinion and Order refers to these TNCs as "Transportation Network Providers" or "TNPs."

[2] Codified as Municipal Code of Chicago Chapter 9-115.

[3] Federal Rules of Procedure 12(b)(6).

[4] <http://www.chicagotribune.com/news/local/politics/ct-alderman-says-court-ruling-could-upend-emanuel-rideshare-taxi-fee-plan-20150928-story.html>