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Tech, Regulatory Arbitrage, and Limits

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For helpful conversations and comments, thanks to Jordan Barry, Vic Fleischer, Kristelia García, Christine Riefa, Arad Reisberg, and the participants of the Third Annual Oxford Business Law Blog Conference at the University of Oxford. Special thanks to Luca Enriques for excellent discussion and suggestions.

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Abstract

Regulatory arbitrage refers to structuring activity to take advantage of gaps or differences in regulations or laws. Examples include Facebook modifying its terms and conditions to reduce the exposure of its user data to strict European privacy laws, and Uber and other platform companies organizing their affairs to categorize workers as nonemployees. This essay explores the constraints and limits on regulatory arbitrage through the lens of the technology industry, known for its adaptiveness and access to strategic resources. Specifically, the essay explores social license and the bundling of laws and resources as constraining forces on regulatory arbitrage, and the legal mismatch that can arise from new business models and innovations as a key area in which the limits of regulatory arbitrage can be observed.

Keywords: Regulatory arbitrage, technology, innovation, regulation, competition, social license, social contract, social responsibility, bundling, innovation cluster, regulatory entrepreneurship

JEL Classifications: K2, K4, L5

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Tech, Regulatory Arbitrage, and Limits

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"Your legal concepts of property, expression, identity, movement, and context do not apply to us. They are all based on matter, and there is no matter here."

– Cyber-philosopher John Perry Barlow (1996)[1]

1. Introduction

Legal strategy or gamesmanship known as "regulatory arbitrage" has been defined in various ways, such as "transactions designed specifically to reduce costs or capture profit opportunities created by different regulations or laws."[2] Regulatory arbitrage "occurs when parties take advantage of a gap between the economics of a deal and its regulatory treatment."[3] With examples ranging from financial maneuvers such as tax shelters and shadow banking, to strategic choices such as offshoring business or assets, the discourse on regulatory arbitrage often revolves around how to solve it.[4]

As opportunity for regulatory arbitrage is created by gaps or differences in regulations or laws, the prevailing wisdom is that regulatory arbitrage can be counteracted by harmonization.[5] But, recognizing that efforts at uniformity are contentious and difficult, other scholars suggest alternative solutions such as coordinating different legal regimes through conflicts-of-law rules.[6] Another approach to regulatory

[1] Barlow JP (1996) *A declaration of the independence of cyberspace*. Electronic Frontier Foundation, https://www.eff.org/cyberspace-independence.

[2] Partnoy (1997), p 227. For additional discussion of the definition of regulatory arbitrage, see Part 2.1.

[3] Fleischer (2010), p 227.

[4] Regulatory arbitrage is generally perceived as a problem. See García (2019), p 207 ("[A]t its core, regulatory arbitrage is distortionary behavior that can thwart regulatory intent and disadvantage actors who play by the rules."); Fleischer (2010), p 230 ("[A] more precise understanding of when and how gamesmanship occurs allows us to address the problem in a targeted fashion that avoids sweeping, overbroad reforms that do more harm than good.").

[5] See, e.g., Weadon (2012) (discussing lack of international harmonization in OTC derivatives regulation).

[6] Riles (2014); see also Freeman and Rossi (2012) (discussing interagency coordination as a mechanism to reduce regulatory arbitrage).

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arbitrage simply emphasizes the need to improve the drafting of laws and to use anti-avoidance regimes.[7] On the whole, a reader of the regulatory arbitrage literature is left with the impression that the problem could be fixed or at least significantly reduced if only we had harmonized laws, coordinated laws, or well-drafted laws.

A deeper look at the thin line between strategic legal planning and abusive conduct reveals a great number of related concepts to regulatory arbitrage. Discussion of these concepts reflect a similar stance of seeking solutions but also accepting some level of inevitability, whether it is through the language of loopholes, circumvention, avoidance, evasion, avoision, or regulatory cat-and-mouse.[8] The law is riddled with loopholes to fill and well-resourced market participants will find a way to exploit patchy regulatory landscapes.[9] Companies have the freedom to establish and structure their activities in ways that may be socially productive or may ultimately harm the public interest—policing this problem is both necessary and imperfect.

But what does not get much scholarly attention is a separate but related question—why don't we see more regulatory arbitrage? What constrains it? Regulatory arbitrage takes advantage of gaps or differences in laws—these are in abundant supply around the world.

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[7] See, e.g., Barry (2011), p 73 ("[R]egulatory arbitrage can be eliminated by crafting legal rules that accurately track the economic substance of transactions. . . If there is no gap to take advantage of, there is no risk of regulatory arbitrage. When seen in this light, regulatory arbitrage is a phenomenon that follows from having regulations that fail to take economic reality into account.").

[8] See Katz (1996), p 4 (coining the term "avoision" to refer to cases in which it is unclear whether conduct should be considered lawful avoidance or illegal evasion); Wu (2017); Burk (2016).

[9] See Wu (2018) (describing the economic and political power of large technology companies); Fleischer (2017), p 230 ("[T]he rich, sophisticated, well-advised, and politically connected avoid regulatory burdens the rest of us comply with.").

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We might be especially concerned about large and potentially even growing amounts of regulatory arbitrage in the tech industry because it is highly adaptive by its nature in the digital era. Entrepreneurship has always represented the pursuit of new and better ways of doing things and the potential for "creative destruction."[10] And, in an era of digital technology ranging from cryptocurrency to platforms, innovation has a global reach that appears untethered to physical presence. Tech companies are particularly well-positioned to create new products and services that don't quite fit existing categorizations and to flexibly move vast intangible wealth across jurisdictions. The tech industry is notorious for design that pushes the regulatory envelope and aggressively uses rhetoric to defy legal norms and shape legal classifications.[11]

Furthermore, some of the largest and most powerful companies in the world are in the tech industry.[12] Many of the tech behemoths have engaged in notable regulatory arbitrage that has captured news headlines. Apple Corporation, for instance, famously escaped tax liability by figuring out a way to put billions of profits in subsidiaries that exploited differences in U.S. and Irish laws.[13] Once Irish officials cracked down on the tax structure, Apple moved its strategy to Jersey in the Channel Islands.[14]

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[10] Schumpeter (1942).

[11] Pollman (forthcoming) (discussing tech culture and permissionless innovation); Stemler (2017) (discussing rhetorical devices and techniques used by sharing economy companies to avoid legal rules and obligations).

[12] See Cohen (2017), p 199 ("Although such [platform] corporations are nominally headquartered in particular countries and have physical assets in many other countries that are amenable to control in varying degrees, their great economic power translates into correspondingly powerful capacity for regulatory arbitrage.").

[13] Marian (2017), p 7 n 44.

[14] Drucker J, Bowers S (2017) *After a tax crackdown, Apple found a new shelter for its profits*. NY Times, https://www.nytimes.com/2017/11/06/world/apple-taxes-jersey.html.

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Other tech giants similarly garnered attention for their strategies. Amazon's controversial avoidance of sales tax for the first fifteen years of its existence gave it an 8-10% price advantage over local retailers.[15] In advance of the EU's General Data Protection Regulation (GDPR), Facebook modified its terms and conditions so that data from 1.5 billion of its users, previously managed from its European office in Ireland to benefit from low corporate tax rates, would instead be handled by its U.S. headquarters which falls under less strict privacy laws.[16] Google and other companies with digital business models may soon be subject to a new tax on revenues from the European Commission and the U.K. Treasury, which aims to rectify previous characterizations of technology products and services such as digital advertising as lacking a physical presence for tax purposes.[17]

Understanding the constraints and limits on regulatory arbitrage has become increasingly important. This essay explores this topic through the lens of the technology industry, known for its adaptiveness and access to strategic resources. Some applications of regulatory arbitrage such as aggressive tax planning are generalizable to a variety of businesses but the ability to use technology to design around regulation and to take advantage of legal categorizations also enables different expressions of regulatory arbitrage, which make the tech industry a particularly rich area of scholarly focus.[18]

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[15] Khan (2017), n 204.

[16] *Facebook to exclude billions from European privacy laws*, BBC (April 19, 2018), https://www.bbc.com/news/technology-43822184.

[17] See Cui (2018).

[18] See, e.g., Wu (2003) (discussing how code is used to avoid the law and seek legal advantage); Eler and Henrekson (2016) (discussing "profit-driven business activity in the market aimed at circumventing the existing institutional framework by using innovations to exploit contradictions in that framework").

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This essay offers new insight into limits on regulatory arbitrage. It begins with a brief look at definitions of regulatory arbitrage and related terms, as well as examples from the tech world. Next, it examines constraints and limits on regulatory arbitrage, starting from discussions in existing literature and then moving to new ground. Specifically, it explores social license and the bundling of laws and resources as constraining forces on regulatory arbitrage, and the legal mismatch that can arise from new business models and innovations as a key area in which the limits of regulatory arbitrage can be observed.

First, the discussion demonstrates that aggressive regulatory arbitrage can erode social license and create a more costly environment for sustainable operation.[19] Particularly when regulatory arbitrage creates social costs that are widely observed, social opprobrium from the public can affect whether, and the extent to which, such a strategy is a valuable course of action to pursue or continue.

Second, although a company might be able to arbitrage a particular law, the opportunity arises not in isolation but within a system of laws and in light of other needs and preferences such as investment capital, workforce talent, brand value, and personal benefits for executives that may constrain the decision. The more that laws can be discretely chosen, the greater potential for regulatory arbitrage. And conversely, the greater the extent to which a law is bundled, the less room there may be for regulatory arbitrage to function as a valuable strategy.

[19] Social license refers to the "social approval of those affected by a certain business activity." Melé and Armengou (2016); see also Sale (forthcoming 2020). The concept draws upon the notion of business as a social institution that requires legitimacy from stakeholders. For further discussion, see Part 3.1 infra.

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Third, in some instances, gaps or differences in laws exist but are part of a regulatory environment that is generally prohibitive for certain kinds of new business models or innovations to operate on a global scale, which gives rise to a need to change the laws rather than simply arbitrage them. Alternative strategies may offer more promising outcomes for new business models or innovations and highlight that the gains from regulatory arbitrage can be limited in these circumstances.

2. Regulatory Arbitrage

2.1. Definitions

Regulatory arbitrage has been variously defined, but the term consistently includes the notion of manipulation or strategic design of an activity to take advantage of specific legal or regulatory treatment. For example, as noted above, in writing about financial derivatives, Frank Partnoy defines regulatory arbitrage as: "transactions designed specifically to reduce costs or capture profit opportunities created by different regulations or laws."[20] He connects the term to the concept of arbitrage in modern finance generally, in which a party "may use a variety of different trading strategies in order to achieve the same economically-equivalent position."[21]

Similarly, Victor Fleischer defines regulatory arbitrage as "the manipulation of the structure of a deal to take advantage of a gap between the economic substance of a transaction and its regulatory treatment."[22] He provides the example of a company that

[20] Partnoy (1997), p 227.

[21] Ibid.; see also Riles (2014), p 69 ("[A]rbitrage is about exploiting formal differences, despite the functional similarity of products across different markets owing to the interrelationship of markets.").

[22] Fleischer (2010), p 230.

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would minimize agency costs by incorporating in Delaware but instead decides to save on taxes by incorporating in Bermuda.[23] At core, the economic substance of the company is the same, but it has exploited legal differences regarding taxation to its benefit. Fleischer notes, "[s]o long as the regulatory savings outweigh the increase in transaction costs, such planning is perfectly rational."[24] Regulatory costs are engineered, not fixed or exogenous—and the implications of this reality are significant for wide-ranging areas of law such as antitrust, banking, securities, and tax.[25]

Scholars have also identified that distinct kinds of regulatory arbitrage exist. Jurisdictional arbitrage, as the name suggests, takes advantage of differences in laws from different jurisdictions.[26] By contrast, categorical arbitrage exploits a legal discrepancy between the treatment of two types of activity or products that are functionally similar.[27] This could occur within the same jurisdiction by structuring conduct so that it achieves the same substantive result but falls under law A instead of law B to save on regulatory costs. As Annelise Riles explains, arbitrage as a mode of thinking appreciates "both similarities and differences, all at once."[28] One can take advantage of a difference in

[23] Ibid. at p 231; Bruner (2016), pp 30-38 (discussing capital mobility and regulatory competition); cf. Talley, p 1653 (arguing that "[f]ederal law's creeping displacement of state law has consequently 'unbundled' domestic tax law from domestic corporate governance regulation" in the U.S.). For a discussion of "how offshore jurisdictions enable business entities to opt out of otherwise mandatory domestic regulatory laws," see Moon (2019), pp 1-2.

[24] Ibid.

[25] Ibid. at pp 232-234; see also Burk (2016), pp 6-7 ("[Exploitation of loopholes] happens routinely, in all areas of social activity, producing unexpected and often undesired outcomes as regulation changes behavior in unanticipated ways."); Wu (2003), pp 682-683 (describing code as a technological mechanism to minimize the burden of laws).

[26] Riles (2014), p 71.

[27] Ibid.

[28] Ibid., p 72.

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jurisdictions or legal categorization while functionally engaging in the same activity. In her words, "What distinguishes regulatory arbitrage is simply that all relevant differences are differences of law or regulatory practice."[29]

Others would slice regulatory arbitrage in different ways than by jurisdiction and legal categorization. Kristelia García suggests this dichotomy: "(1) ontological—i.e., the manipulation of a statutory definition so as to either avoid regulatory scrutiny, or to benefit from preferential statutory treatment; and (2) exploitative—i.e., the utilization of a regulation for purposes at odds with the statute's purported legislative intent."[30] She illustrates the first with Pandora's purchase of a terrestrial radio station in order to recategorize itself from a digital radio platform to a mixed-use company and lower its regulatory costs for public performance royalties.[31] The applicable statute does not expressly prohibit this conduct but it also doesn't contemplate internet radio stations doing this to manipulate their royalty rate. An example of the latter category, exploitative arbitrage, according to García, is a content owner's issuance of a baseless or inaccurate takedown notice of alleged infringement—misusing the mechanism under U.S. copyright law for purposes not envisioned, such as improperly forcing the removal of negative reviews about a company or product.[32]

A host of other terminology in the literature also adds color and depth to descriptions and reminds that technical definitions of regulatory arbitrage are perhaps of

[29] Ibid.

[30] García (2019), p 203; see also Burk, pp 15-16 (discussing technological and ontological avoision).

[31] García (2019), p 203.

[32] Ibid., pp 203, 237-238.

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less importance than the notions of circumvention and strategic legal avoidance more generally.[33] Whether an actor exploits a loophole or decides to order their affairs to avoid a particular law is arguably in the same general class of conduct and it is a contextual matter whether it is tolerable within the bounds of the law or poses a problem, for example by placing social or economic activity that impacts a jurisdiction beyond its regulatory reach.[34]

2.2. Examples

To inquire, as this essay does, into limits on regulatory arbitrage is not to underestimate or diminish the very substantial amount of this activity that is occurring. Examples in the realm of technology abound. To underscore this point, it is worth briefly considering a few.

Some regulatory arbitrage by tech companies is in the vein of the discussion above, such as a tax inversion in which a corporation relocates its legal domicile to a lower-tax country, while retaining material operations in higher-tax locations. Facebook's changing of its terms and conditions to shift the regulatory treatment of its users for purposes of privacy laws is a variant. But examples in technology also include

[33] See Katz (2010) (discussing circumvention of law and related other phrases such as evasion, avoidance, and loophole exploitation, as well as more context-specific examples such as tax shelters and bootstrapping, and forum-shopping); see also Moon (2019), n 7 ("Scholars typically distinguish tax evasion, a set of illicit activities aimed at reducing taxes, from tax avoidance, which includes various forms of *legal* maneuvering.").

[34] In some instances, regulatory arbitrage or legal avoidance may result in an unexpected benefit or may mitigate regulation driven by special interests. For example, some regulatory arbitrage "may serve as an impetus for technological innovation, or may signal to Congress an extant imbalance in statutory treatment of similarly situated entities, potentially resulting in societal benefit on balance." García (2019), p 203; see also Burk (2016), pp 3-5 (describing serendipitous technology as "perverse innovation" that is a byproduct of regulatory avoidance such as the development of mutagenic crops to avoid strict GMO regulation); Ayres and Kapczynski (2015), pp 1812-1827 (describing innovation to avoid or lessen the impact of a penalty such as the development of energy-efficient cars and light bulbs).

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innovations—products or services—that are designed to exploit legal classifications or exist in legal gray areas and rely on other forms of arbitrage such as geographical evasion. The music jukebox of the 1920s, for example, exploited an exception to the public performance right of copyright law regarding "coin-operated machines" that was intended for operators of penny arcades.[35]

More recently, in the Wild West of the 1990s and early 2000s internet, peer-music-sharing protocols evolved in ways that demonstrated arbitrage through both design and jurisdiction choices. Gnutella designed its file-sharing technology "on concepts of radical decentralization" to try to avoid the legal problems that led to Napster's demise.[36] The Gnutella design facilitated copyright infringement, as Napster had with its service, but unlike Napster it had virtually no intermediaries and the file-sharing network was "unowned and uncontrolled."[37] Its decentralized design allowed it to avoid legal liability, but it also had stability and performance problems that led to yet another generation of peer music file-sharing software such as Kazaa. Like Gnutella, the new generation avoided the centralized control that doomed Napster, but reintroduced some element of hierarchy that allowed for performance and scale. Scandinavian entrepreneurs founded Kazaa in the Netherlands and, after litigation there, engaged in "jurisdictional exit," selling the application to a company that incorporated in Vanuatu, a small island in the South Pacific that lacked a copyright law.[38] The popularity of these music-sharing

[35] García (2019), p 202.

[36] Wu (2003), p 731.

[37] Ibid., p 732.

[38] Ibid., p 736; Wu (2017), p10.

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services was eventually overtaken by the launch of sites with legal legitimacy such as Apple iTunes.

In the twenty-first century, one of the most notable examples of regulatory arbitrage in the tech industry involves ride-hailing company Uber and other "gig" or "sharing" economy companies that have organized their affairs to use workers they categorize as non-employees.[39] Employee classification implicates a number of areas of law such as labor, taxation, public accommodation, and more.[40] Uber and others characterize themselves as technology companies that connect users and service providers, such as riders and drivers—shaping their narrative as platforms rather than as principal providers of services through the use of employees. A platform intermediates a transaction on demand between customers and workers, by reducing search costs, providing information about reliability and other characteristics, and providing a digital infrastructure for the transaction to take place such as matching and clearing payments.[41] Platforms may represent a "transaction costs revolution"[42] but the business model quite critically also hinges on regulatory arbitrage—credible characterizations about legal ambiguities in employee status that allow companies to avoid the regulatory costs of a broad range of laws.[43] Platform companies provide an important example that sets the stage for the next part of discussion.

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[39] Oei (2018).

[40] Ibid., pp 109, 120-121.

[41] Prassl (2018), pp 19-20; Lobel (2016).

[42] Lobel (2016), p 106.

[43] Ibid., p 156 ("[D]efinitional defiance is central to the business model of the platform."); Tommassetti (2016), p 78 ("[C]laims about technological sophistication and the knowledge economy can be euphemisms for profit seeking not through productive enterprise, but through regulatory arbitrage, speculation, and other

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3. Constraints

In any legal system there will be some circumvention, some exploitation of differences or loopholes, and some strategic choices between jurisdictions.[44] To speak in general terms, the technology industry engages in no small amount of this conduct and even pursues entrepreneurial opportunities in this realm, sometimes testing legal boundaries. But we can also observe that there are some limiting forces or constraints.

Scant literature has pursued this line of inquiry.[45] In the most notable work to do so, Victor Fleischer sets out a taxonomy of five constraints on regulatory arbitrage: "(1) legal constraints, (2) Coasean transaction costs, (3) professional constraints, (4) ethical constraints, and (5) political constraints."[46] Fleischer explores these constraints as an explanation for why many sophisticated deals are structured in a way that does not optimally minimize transaction costs as theory would suggest—one of his key insights was that deal planning involves tradeoffs when attempting to minimize both regulatory costs and transaction costs.[47] Constraints to regulatory arbitrage therefore affect a company's ability to reduce overall costs in its business affairs.

In Fleischer's analysis, legal constraints refer to "antiplanning rules" in statutory schemes such as anti-avoidance sections, "look-through" or "catch-all" provisions, and

forms of asset manipulation."). This process is dynamic and the law responds in turn, such as by developing new statutes and case law on the issue of employee status.

[44] See Katz (2010).

[45] For a classic work that considers the complexity and limits of *financial* arbitrage in the real world given that it requires capital and entails risk, particularly in the agency context, see Shleifer and Vishny (1997).

[46] Fleischer (2010), p 230.

[47] Ibid., pp 231-232.

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statutory tests regarding economic substance.[48] Drawing on the "frictions" concept in the tax-planning literature, Fleischer explains that transaction costs include "the costs associated with market transactions, including search costs, asymmetric information between the buyer and the seller, bargaining costs, moral hazard and other instances of strategic behavior, and monitoring or enforcement costs."[49] Professional and ethical constraints pertain to considerations about maintaining reputational capital as a lawyer and law firm, and abiding moral obligations when advising clients about legal but aggressive strategies.[50] Fleischer notes that in reality the question of these professional and ethical constraints "almost seems quaint" and they may be "almost trivial" in practice since regulatory arbitrage is commonplace.[51] Finally, the last constraint in his taxonomy is political costs, which he says "are best understood in the context of corporations' long-term involvement in the political process."[52] Fleischer focuses primarily on the political capital required for sophisticated deal participants to navigate getting government approval or favorable regulatory treatment of a complex transaction such as in tax or mergers and acquisitions.[53]

[48] Ibid., p 252-253; see also Buell (2011) (describing good faith doctrines as serving a similar anti-avoidance function); Blank and Staudt (2012), p 1645 (discussing anti-abuse standards and examining judicial responses to "technically legal activities that may be perceived as shams").

[49] Fleischer (2010), p 258.

[50] Ibid., pp 262-274.

[51] Ibid., pp 252, 264; cf. Barry (2011), p 71 (noting that "professional constraints are by no means a perfect prevention mechanism," but they "do shift deals between different structures and [this] can affect the degree of regulatory arbitrage").

[52] Fleischer (2010), p 273.

[53] Ibid., pp 283-288 (discussing "the politics of the deal").

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This section turns now to extending this discussion of constraints by examining three additional categories of considerations that might be managed in decisions about engaging in regulatory arbitrage: social license, the bundling of laws and resources, and alternative strategies for new business models and innovations.

3.1. Social License

The public and governmental responses to Uber around the world have provided an interesting laboratory for watching the concept of social license at work. As a case study, Uber illustrates that social license is a related but separate force than the political constraint that Professor Fleischer identified. Whereas politics in his taxonomy concerned the political capital that a company cultivates and relies upon to seek a particular deal approval or regulatory outcome, social license operates more broadly as it comes from the public and is generated by trustworthy behavior and moral legitimacy.[54]

Social license, developed in the sociology and business ethics literature, refers to the concept that business exists by virtue of permission from communities and stakeholders.[55] Businesses are social institutions, as well as economic firms, and are subject to public accountability.[56] Imported into the business law literature by Hillary Sale, social license is understood as a necessary condition for business to exist just like a legal license to operate.[57] This concept shares roots in notions of a social contract and an

[54] Sale (forthcoming 2020).

[55] See, e.g., Melé and Armengou (2016); Demuijnck and Fasterling (2016); Wilburn and Wilburn (2011).

[56] Sale (forthcoming 2020).

[57] Sale (forthcoming 2020).

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understanding that when business fails to meet public expectations, a "loss of prestige, public standing and popular esteem" can follow that imposes costs on the business.[58]

Uber lost its social license, and then like a domino, its legal license to operate in London after a series of scandals at the company in 2017.[59] This episode highlights the potential that if a company engages in overt, aggressive regulatory arbitrage, particularly in combination with a culture that violates other public norms, a company may be reined in from continuing to pursue its activity.

Founded in 2009, Uber grew rapidly in cities around the world, gaining popularity among customers who enjoyed the low prices and convenience of the smartphone app. Uber's customers benefited from its willingness to engage in regulatory arbitrage by receiving low pricing relative to taxis, enabled by categorizing workers as independent contractors rather than employees (and avoiding taxi medallion regulation). But customers also embraced Uber, and its main competitor Lyft, for other reasons as well such as the user-friendly interface, widespread availability even in suburban areas, and quality of service driven by customer-rating systems.[60] With this formula of gains from

[58] See Berle (1959), pp 90-91, 114; see also Cheffins (2018-2019) (discussing mid-twentieth century notions of "countervailing power" on corporations); Pollman (2019), pp 634-39 (discussing Adolf Berle's concept of "inchoate law" that arises when corporations fail to self-regulate within expected social norms of responsibility).

[59] See Volpicelli G (2018) *Uber's London licence has been approved – but there's a big catch*. Wired, https://www.wired.co.uk/article/uber-london-licence-tfl-verdict; Satariano A (2018) *Uber regains its license to operate in London, a win for its new C.E.O*. NY Times, https://www.nytimes.com/2018/06/26/technology/uber-london.html.

[60] Lobel (2016), p 157 ("[T]he economic and social logic of the platform, pushing down transaction costs in all stages of the deal, as well as creating new markets that map onto new preferences and lifestyles, is the primary raison d'être of the rise of the platform."); Stone B (2017) *The $99 Billion Idea*, Bloomberg, https://www.bloomberg.com/features/2017-uber-airbnb-99-billion-idea/ (describing Uber's philosophy, "our product is so superior to the status quo that if we give people the opportunity to see it or try it, in any place in the world where government has to be at least somewhat responsive to the people, they will demand it and defend its right to exist").

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regulatory arbitrage plus a differentiated service that customers wanted, and aggressive regulatory entrepreneurship discussed further below, the company grew to a private valuation of $69 billion by 2016.[61]

By 2017, however, Uber had already been plagued by a number of scandals and its combative approach to regulatory arbitrage was in plain view to the public, with protests around the globe. The year started with #DeleteUber, a social media campaign to boycott the company for continuing to operate after taxi drivers had called for a temporary boycott at New York's JFK Airport to protest President Trump's travel ban to several countries with Muslim majorities.[62] Many people viewed Uber's act of continuing to give rides, and turning off surge pricing, as an anti-labor attempt to profit from the taxi drivers' strike.[63] Also in early 2017, Uber drivers in India went on strike to protest falling fare rates and decreased driver incentives from the company.[64]

Additionally, among other controversies, it came to light that Uber had secretly developed a software tool it called "Greyball" to evade law enforcement agencies that were trying to crack down on its service.[65] Further, Uber was hit with a lawsuit from

[61] MacMillan D (2016) *Uber raises $3.5 billion from Saudi Fund*, Wall Street Journal, http://www.wsj.com/articles/uberraises-3-5-billion-from-saudi-fund-1464816529.

[62] Siddiqui F (2017) *Uber triggers protest for collecting fares during taxi strike against refugee ban*, Washington Post, https://www.washingtonpost.com/news/dr-gridlock/wp/2017/01/29/uber-triggers-protest-for-not-supporting-taxi-strike-against-refugee-ban/?utm_term=.7b5c4832b00e.

[63] Ibid.

[64] Ram A, Kazmin A (2017) *Uber's Indian drivers strike for fourth day over earnings squeeze*, Financial Times, https://www.ft.com/content/9653ace2-f1d9-11e6-8758-6876151821a6.

[65] The Greyball tool was part of a Uber program called VTOS, short for "violation of terms of service." It used data collected from the Uber app and other techniques to identify riders that it viewed as using or targeting its service improperly, such as public officials who were posing as customers to investigate or gather evidence that Uber was operating illegally. The tool showed such riders a fake version of the app and blocked them from booking rides. Isaac M (2017) *How Uber deceives the authorities worldwide*, NY Times, https://www.nytimes.com/2017/03/03/technology/uber-greyball-program-evade-authorities.html;

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Google's self-driving car unit, Waymo, regarding the alleged theft of trade secrets.[66] In addition, an Uber engineer published a blog post exposing a culture of gender discrimination and sexual harassment at the company.[67]

By several months later, additional scandals had mounted regarding its processes for vetting drivers and reporting crimes to the police, and subsequently the Transport for London (TfL) decided not to grant Uber a new Private Hire Vehicle Operator's License for the city, Uber's most valuable European market. In its decision, the TfL stated it was not satisfied that Uber was a "fit and proper person to hold a licence."[68] The cited basis for this decision was the Greyball tool, which "can be deployed for a variety of legitimate purposes, though some companies within the Uber group have used it for purposes of evading regulatory enforcement in other jurisdictions."[69] In addition, as a separate and sufficient basis for the denial, Uber "demonstrated a lack of corporate responsibility in relation to a number of other issues which have potential public safety implications."[70]

In response, the new Uber CEO at the time, Dara Khosrowshahi, issued a "Dear Londoners" public apology in the *Evening Standard*, acknowledging mistakes and stating that the company had to change to be "long-term partners with the cities we serve" and

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Isaac M (2017) *Justice department expands its inquiry into Uber's greyball tool*, NY Times, https://www.nytimes.com/2017/05/05/technology/uber-greyball-investigation-expands.html.

[66] Duhigg C (2018) *Did Uber steal Google's intellectual property?*, New Yorker, https://www.newyorker.com/magazine/2018/10/22/did-uber-steal-googles-intellectual-property.

[67] Dowd M (2017) *She's 26, and brought down Uber's C.E.O. What's next?*, NY Times, https://www.nytimes.com/2017/10/21/style/susan-fowler-uber.html.

[68] Transport for London, Sept. 22, 2017, https://www.ltda.co.uk/assets/files/downloads/TfL%20licensing%20decision%20letter.pdf.

[69] Ibid.

[70] Ibid.

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"run our business with humility, integrity and passion."[71] Khosrowshahi also noted that the company had already started "doing more to contribute to the city" such as providing wheelchair accessible vehicles and launching a clean air initiative.[72] By 2018, the company won an appeal to regain its license after agreeing to install new executive leadership in London, implement systems for reporting alleged crimes, share traffic data with the city, and submit to an independent board to oversee British operations.[73] During testimony, the TfL's director of licensing explained, "We've had five years of a very difficult relationship where Uber felt it didn't require regulation."[74] In rendering the decision on appeal, the Westminster Magistrates' Court granted a shorter license than normal and stated that Uber had to prove that it "can be trusted."[75]

Similarly, in other cities in which Uber won early battles, cracks in the social license manifest as new constraints and mechanisms for accountability. For example, although Uber triumphed over a 2015 attempt by New York's mayor, Bill de Blasio, to squash its growth, this was only a temporary respite. Just a few years later, in 2018, the New York City Council succeeded in passing legislation that limits the number of ride-share vehicles in the city so there would not be further growth.[76] Further, the city passed

[71] Crerar P (2017) *Uber boss Dara Khosrowshahi says sorry and promises to 'make things right' for Londoners…as he pledges to fight TfL ban*, Evening Standard, https://www.standard.co.uk/news/transport/uber-boss-says-sorry-to-londoners-and-pledges-to-fight-tfl-licence-ban-a3642631.html.

[72] Ibid.

[73] Satariano (2018), supra.

[74] Ibid.

[75] Ibid.

[76] Wolfe J, Levine, AS (2018) *New York today: capping Uber*, NY Times, https://www.nytimes.com/2018/08/15/nyregion/new-york-today-sunglasses-eye-safety.html.

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legislation that created a minimum wage for drivers, bumping up driver's pay by about 23 percent on average—a move that traditional yellow-cab drivers welcomed to reduce their competition and increase income—and effectively reducing the gain from arbitraging the employee classification.[77]

In all, the Uber example suggests that when a company pushes too hard on regulatory arbitrage and uses tools of "avoision" to evade enforcement and oversight, it can impact social license and result in a more difficult environment for sustainable operation. This is particularly likely when the regulatory arbitrage is of the "exploitative" variety or is combined with other activity that transgresses norms or community values. Because regulatory arbitrage can be commonly perceived in a negative light by the public—as circumventing obligations to society or unfairly taking advantage of loopholes—its propensity to trigger a loss of social license may be greater than other forms of business decisions more generally.

The costs that result from a loss of social license are hard to calculate. Uber's stumbles in navigating public backlash created pressure for governance changes, additional governmental oversight, and opened up opportunity for its competitors such as Lyft to gain market share.[78] Failing to manage the ingredients for social license such as trust and credibility could also affect the likelihood of enforcement, litigation, and rulings regarding regulatory arbitrage strategies. For example, the largest class action in Australian history has recently been filed against Uber for "conspiracy to act unlawfully"

[77] Ibid.

[78] Somerville H (2018) *Study finds Uber's growth slows after year of scandal; Lyft benefits*, Reuters, https://www.reuters.com/article/us-uber-growth/study-finds-ubers-growth-slows-after-year-of-scandal-lyft-benefits-idUSKCN1IF31A.

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by over a thousand taxi drivers from multiple Australian states, seeking $500 million, and with the class size expected to grow to tens of thousands of plaintiffs.[79] From an ex ante decisionmaking perspective, as companies engage in risk management and cost-benefit analysis regarding legal strategy, they should also consider the potential for social license to operate as a constraint on the successful pursuit of regulatory arbitrage.

We might also observe that for social license to function in this way, a certain amount of openness or transparency must exist such that the public sees the regulatory arbitrage and reacts. If a particular instance of regulatory arbitrage is viewed as an appropriate response to overly burdensome regulation, or is carried out by a company that offers a product or service that is embraced by consumers, regulatory arbitrage may incur little or no public pushback and may even receive support. By contrast, if regulatory arbitrage creates significant social costs that are apparent to the public, social opprobrium can kick in and stop the activity or make it more costly to engage in the arbitrage. This result may not always follow or provide a timely and effective constraint, but in situations when the public does have information and the will to push back against corporate activity, this response can trigger a range of costs in the form of new governance obligations and regulations, loss of customers, and the like. Given the importance of information for social license to operate as a constraint, the government

[79] Jacks T (2018) *'Largest' class action in country as lawsuit against Uber goes national*, Sydney Morning Herald, https://www.smh.com.au/national/largest-class-action-in-country-as-lawsuit-against-uber-goes-national-20181127-p50ipb.html.

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and media have a role to play in bringing attention to egregious and socially harmful instances of regulatory arbitrage.[80]

Furthermore, research on corporate reputation may hold insights for how social license functions as a constraint on regulatory arbitrage. Corporate reputation research suggests that when a firm harms its customers, the firm will suffer a loss of market reputation and internalize this cost.[81] As both social license and corporate reputation are similarly based on notions of trustworthy behavior and moral legitimacy, this dynamic of harm to customers may similarly help predict when regulatory arbitrage will incur a loss of social license. For example, when a company engages in regulatory arbitrage that cuts corners in compliance and results in harm to customer or user safety, we might expect the company to pay a price in terms of social license, particularly if the company is consumer-facing rather than business-to-business. In addition, corporate reputation research suggests that harm to third parties might not result in the same loss to market reputation as does harm to customers, but when media brings attention to the issue it could nonetheless impact a company's political reputation which could in turn increase the likelihood of government investigation or enforcement action.[82]

Finally, the strength of social license as a constraint may vary by company, industry, community, and across different time periods.[83] Social license may also take on

[80] For a related discussion of "publicness" as a mechanism by which citizens, media, other outside actors control public perception and can push for information and public accountability, see Sale (2013); Sale (2011); Langevoort and Thompson (2013).

[81] Armour, Enriques, Ezrachi, and Vella (2018), p 10.

[82] Ibid.

[83] For a discussion of the history of the relationship between corporate law and social welfare, see Bratton (2017).

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greater importance when other institutions, such as court systems and regulatory agencies, are overburdened, hobbled by outdated legal frameworks, or in a state of flux.[84] There are signs that the pendulum may be swinging toward a stronger awareness of the importance of social license in current times. For example, in 2019, Larry Fink, the founder and chief executive of BlackRock, the world's largest institutional investor with more than $6 trillion under management, wrote an open letter to CEOs reminding them of the historical "social compact" that has existed in many companies between stakeholders and corporations, and encouraged companies to embrace a greater responsibility.[85] In his previous annual letter, he had similarly highlighted the changing social and political environment: "Society is demanding that companies, both public and private, serve a social purpose. To prosper over time, every company must not only deliver financial performance, but also show how it makes a positive contribution to society."[86] If a company fails in this regard, "[i]t will ultimately lose the license to operate from key stakeholders."[87]

The stronger awareness of social license not only applies to the general business environment, as Larry Fink's letters suggest, but is particularly acute in recent times with respect to the tech industry. The rise of "big tech," and in particular the size, market dominance, and potential social dangers of Apple, Alphabet, Amazon, and Facebook,

[84] See Cohen (2017), p 176 (describing how "[p]latform companies are encountering legal systems worldwide at a time of crisis").

[85] Larry Fink's 2019 letter to CEOs: purpose & profit, BlackRock, https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter.

[86] Larry Fink's 2018 letter to CEOs: a sense of purpose, BlackRock, https://www.blackrock.com/corporate/investor-relations/2018-larry-fink-ceo-letter.

[87] Ibid.; see also Sorkin AR (2018), *BlackRock's message: contribute to society, or risk losing our support*, NY Times, https://www.nytimes.com/2018/01/15/business/dealbook/blackrock-laurence-fink-letter.html.

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have provoked a public backlash and global conversation about how to rein in the power of these companies.[88] In this environment, a loss of social license from regulatory arbitrage could be triggered more quickly or have potentially larger magnitude in terms of costs. For some companies such as Facebook, user trust is essential to its economic and political power, and the loss of trust or social legitimacy poses an existential threat to its business model.[89] Given the specter of additional regulation already looming, companies in this business environment might view social license as a more salient constraint on aggressive maneuvering around the law.

3.2. Bundling of Laws and Resources

A second constraint to regulatory arbitrage that deserves greater examination concerns the way in which opportunities arise in legal systems and with other interests at stake.[90] We can explore this point by looking at where technology companies choose to locate headquarters and important centers of development.

In recent times, regulatory competition has heated up as jurisdictions fight to become centers of technology development in an era in which economic growth is fueled by innovation. Just a few years ago, venture capitalist Marc Andreessen advocated for this competitive approach through deregulatory programs: "Think of it as a sort of 'global arbitrage' around permissionless innovation — the freedom to create new technologies

[88] See, e.g., McNamee (2019); Zuboff (2019); Wu (2018); Khan (2017); Galloway (2017).

[89] See Osnos E (2018), *How much trust can Facebook afford to lose?*, New Yorker, https://www.newyorker.com/news/daily-comment/how-much-trust-can-facebook-afford-to-lose; Harvard Business Review (2019), *Can Mark Zuckerberg rebuild trust in Facebook?*, https://hbr.org/podcast/2019/04/can-mark-zuckerberg-rebuild-trust-in-facebook.

[90] For a discussion of this point in the context of economist Charles Tiebout's model of jurisdictional competition, see Bratton and McCahery (1997). For a discussion of the tax "frictions" literature, see Fleischer (2010), pp 232-233, 258.

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without having to ask the powers that be for their blessing."[91] In his vision, there would be a Bitcoin Valley, where a jurisdiction had fully legalized cryptocurrency for all purposes, and a Drone Valley, that removed all legal obstacles to unmanned aerial vehicles, and so on by technology. Since that time, innovation clusters or hubs have emerged and while they are permissive, they are not entirely permissionless. Andreessen correctly observed that the relaxation of rules and the creation of innovation-friendly programs was starting to transform certain cities and diffuse technology development.

The rollout of Google Fiber in the past decade provides a useful illustration of the competitive dynamic. In 2009, the U.S. Congress charged the Federal Communications Commission with developing a National Broadband Plan to expand high-speed internet service, but it relied significantly on private investment.[92] Google recognized the importance of advancing the fiber-based infrastructure to enable other technology such as autonomous vehicles, smart grids, advanced health technology and more.[93] When Google announced it would build a small number of experimental infrastructure projects for broadband, fiber-based high-speed internet, it expected 10 to 50 proposals and instead received 1,100 proposals from cities competing for the technology.[94] This represented a reversal from the traditional model in which telecommunications companies competed to

[91] Andreessen M (2014) *What it will take to create the next great Silicon Valleys, plural, Andreessen Horowitz*, https://a16z.com/2014/06/20/what-it-will-take-to-create-the-next-great-silicon-valleys-plural/; see also Thierer (2016) (discussing innovation and regulatory competition).

[92] Levin B, Downes L (2018) Why Google Fiber is high-speed internet's most successful failure, Harvard Business Review, https://hbr.org/2018/09/why-google-fiber-is-high-speed-internets-most-successful-failure.

[93] Ibid. ("[G]oogle's own interest in fiber stemmed from a conviction that faster speeds would eventually generate more revenue and services for the broader Alphabet enterprise, making the investment justifiable if not profitable.").

[94] Ibid.

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get permission to operate in a particular city—instead it was cities that competed to get Google Fiber and they showed up in huge numbers.[95] The cities most attractive to Google offered administrative efficiency to reduce costs, time, and political frictions that would slow installation.[96] Once Google demonstrated that an environment existed of cities willing to work with private industry players, incumbents such as AT&T, Comcast, and Time Warner subsequently prioritized deployments of broadband internet as well.[97]

Other examples highlight the clustering of technology development occurring in jurisdictions that have styled themselves through permissive regulation as hubs for drones, fintech, and autonomous vehicles. For instance, in 2013, Amazon revealed plans for a new drone-delivery service called Amazon Prime Air, and subsequently moved its drone research and development from the U.S. to the Canadian border and the U.K. Around this time, the relevant U.S. regulatory body, the Federal Aviation Administration, had restrictive rules on unmanned aerial activity and long waits for permits to engage in drone testing.[98] It was not until 2018, after a rebuke from the National Academies of Sciences for holding back progress, that Congress ordered the FAA to take a more permissive "risk-based approach" to regulating drones, but by then other jurisdictions had the first-mover advantage and had attracted key innovators.[99]

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[95] Andreessen (2014).

[96] Levin and Downes (2018).

[97] Ibid.

[98] Chung E (2015) *Amazon tests delivery drones at a secret site in Canada—here's why*, CBC, https://www.cbc.ca/news/technology/amazon-tests-delivery-drones-at-a-secret-site-in-canada-here-s-why-1.3015425; Murgia M (2017) *Amazon primed for UK expansion with AI and drones*, Financial Times, https://www.ft.com/content/8d045294-2c2c-11e7-9ec8-168383da43b7.

[99] O'Sullivan A (2018) *The good and the bad of FAA reauthorization: drone policy*, Mercatus Center, https://www.mercatus.org/bridge/commentary/good-and-bad-faa-reauthorization-drone-policy.

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Similarly, in 2016, the U.K.'s Financial Conduct Authority pioneered a "regulatory sandbox" that allows fintech startups to conduct a limited test of their products with reduced regulatory constraints and risk of enforcement action.[100] Australia, Canada, Singapore, Switzerland, the United Arab Emirates, and others have followed suit in adopting their own versions.[101] The early moving jurisdictions have attracted a significant amount of fintech activity. Likewise with respect to autonomous vehicles, certain jurisdictions—the U.S., Germany, the U.K., and the Netherlands—were pioneers for licensing that enables testing and have become hotbeds for technology development. Even within jurisdictions, competitive federalism thrives—for example, Arizona and California became the first two U.S. states to allow autonomous vehicles to operate on public roads without drivers and have attracted the lion's share of companies developing this technology.[102]

Decisions do not only reflect unfettered arbitrage and competition, however. Although in isolation a particular law might be efficiently arbitraged, in the fuller picture these laws arise in systems and with individuals who have personal benefits and preferences as well. How else might one explain the decision of technology companies to launch, establish headquarters, and expand in some of the most expensive regions in the world such as the San Francisco Bay Area, New York, and Seattle?

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[100] Allen (2019).

[101] See id.; see also Van Loo (2018) (arguing that the U.S. lags in consumer financial technology because of a lack of an agency with the authority and expertise to promote consumer financial competition).

[102] Synced (2018) *Global survey of autonomous vehicle regulations*, Medium, https://medium.com/syncedreview/global-survey-of-autonomous-vehicle-regulations-6b8608f205f9; see also Campo-Flores A (2017) *Cities rush to build infrastructure—for self-driving cars*, WSJ, https://www.wsj.com/articles/cities-rush-to-build-infrastructurefor-self-driving-cars-1510236002.

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A variety of factors are at play and can be thought of as constraints for certain decisions about arbitrage. The availability of talented human capital in a region is often a critical factor. Investors may be more likely to place bets on technology companies that are being founded nearby their own offices and in areas known for launching success stories. Company brand and status can also be linked to locations—just think of Apple's slogan "designed in California" and its 2.8-million-square-foot futuristic mothership campus built in Cupertino based on Steve Jobs' "idealized California."[103]

Further, even with regard to laws, the constraints on arbitrage are not simply about anti-avoidance regimes—strategic decisions arise within legal systems that have other kinds of tradeoffs.[104] As we have seen, Facebook backed off its regulatory arbitrage for tax advantages because of emergent privacy restrictions. Despite a high tax rate and cost of operations, innovation has flourished in California with its particular mix of laws, including labor law that encourages "knowledge spillovers" and facilitates employee mobility—and falls under U.S. law with relatively strong intellectual property protection.[105] Bundling can act as a constraint on regulatory arbitrage to the extent a law is non-separable from another law or regulatory regime that offers value.

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[103] Budds D (2017) *The fascinating history of "Designed in California," Fast Company*, https://www.fastcompany.com/90129351/the-history-of-designed-in-california; Levy S (2017) *One more thing: inside Apple's insanely great (or just insane) new mothership*, Wired, https://www.wired.com/2017/05/apple-park-new-silicon-valley-campus/. Many of the company's products have been labeled "Designed by Apple in California. Assembled in China."—pointing to issues of both brand and labor availability. Rawson C (2012) *Why Apple's products are 'Designed in California' but 'Assembled in China'*, Engadget, https://www.engadget.com/2012/01/22/why-apples-products-are-designed-in-california-but-assembled/.

[104] See Bratton and McCahery (1997), pp 222-23 ("[I]ndividual sorting proves difficult to effect because of the complex packaging of public goods and regulations. Although private goods tend to be produced and sold separately, public goods tend to be jointly produced and made available on a bundled basis.").

[105] Chander (2014); Gilson (1999); Lobel (2013).

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Extensive literature documents the benefits of the mix of these various factors—"agglomeration" economics—and how challenging it is to manufacture these ecosystems.[106] Some locations are difficult to arbitrage because functional substitutes do not exist or alternatives are simply not quite the same.

A related point is that private benefits can also be at stake in these location decisions, particularly when there is physical presence involved. Founders and corporate executives are likely not indifferent regarding the decision to spend significant time in thriving, metropolitan cities with world-class amenities versus other locations that may have cost efficiencies.[107] Location choices implicate the vision that founders and executives may have for not only the company's brand, but also for their own lifestyles, "personal brands," status, and values.[108] Salesforce CEO-founder Marc Benioff built the "Salesforce Tower," dramatically altering the San Francisco skyline, and invested heavily in the community, including by giving millions of dollars and his personal support to an initiative to raise taxes on corporations in the city to fund homeless programs.[109] He remarked: "San Francisco is amazing. We have these incredible companies and

[106] See, e.g., Rodrigues and Schleicher (2012) (discussing how "location decisions are valuable because of the 'agglomeration' benefits they provide"); Porter (2018) (explaining that "[b]eing a part of a cluster allows companies to operate more productively in sourcing inputs; accessing information, technology, and needed institutions; coordinating with related companies; and measuring and motivating improvement"); Ibrahim (2010), p 717 ("Silicon Valley's success has led other regions to attempt their own high-tech transformations, yet most imitators have failed.").

[107] See Florida and Mellander (2016), p 32 (describing the preferences of tech executives, workers, and venture capitalists to be in urban environments). These patterns give rise to other social issues such as concerning the connection between inequality and geography. See, e.g., Florida (2014).

[108] See Goshen and Hamdani (2016) (discussing entrepreneurs' pursuit of private benefits and idiosyncratic vision); see also Bratton and McCahery (1997), p 234 ("Family, community, and cultural ties also may make movement an undesirable response to dissatisfaction with public goods, taxes, or regulation.").

[109] Levy A (2019), *Salesforce's Marc Benioff unplugged for two weeks, and had a revelation that could change the tech industry*, CNBC, https://www.cnbc.com/2018/12/30/salesforce-marc-benioff-talks-tech-ethics-time-magazine-and-vacation.html.

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entrepreneurs, innovation and technology, . . . and we are responsible for the city that we are living in and growing our businesses in."[110] The media has frequently featured his philanthropic efforts and speculated about whether the tech billionaire might have personal ambitions in politics.[111]

The Amazon second headquarters competition also provides an interesting illustration of these points. The company created a tournament for its attention, announcing a nationwide search and seemingly stoking regulatory competition for its "business" of bringing jobs to a community.[112] Out of many cities offering lucrative deals, the company chose to develop new headquarters in the Washington DC and New York metro areas—two of the most expensive U.S. cities. Yet these cities offer bundled resources—"agglomeration" benefits including large talent pools, big-city lifestyles and branding, as well as the potential to build political capital.[113] Amazon's founder-CEO, Jeff Bezos, purchased a notable mansion in DC's well-heeled and politically-connected Kalorama neighborhood, minutes from the new Amazon site as well as the politicians and lobbyists around Capitol Hill. In a surprising twist, Amazon quickly dropped its plans for the New York-area site after public outcry stemming from "residents' fears of economic insecurity and displacement" that might result if the tech behemoth developed a corporate

[110] Reints R (2018), S*alesforce CEO Marc Benioff lashes out at San Francisco Billionaires 'Hoarding' Their Money*, Fortune, http://fortune.com/2018/10/17/marc-benioff-proposition-c-homelessness/.

[111] See, e.g., Zetlin M (2018), *Here's what Salesforce CEO Marc Benioff would do if he were president—even though he's not running*, Inc., https://www.inc.com/minda-zetlin/marc-benioff-salesforce-ceo-us-president-msnbc-kara-swisher-interview.html.

[112] For a discussion of business location tax incentives, see Enrich (1996).

[113] See Streitfeld D (2018), *Was Amazon's headquarters contest a bait-and-switch? Critics say yes*. NY Times, https://www.nytimes.com/2018/11/06/technology/amazon-hq2-long-island-city-virginia.html.

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outpost in the community[114]—illustrating that both social license and bundling issues were at play in the decision. And, even beyond Amazon's second-headquarters saga, recent reporting has highlighted that the company has not been able to fully exert leverage in choosing locations for development efforts because the company cannot get around the fact that it needs certain locations in and near major cities in order to do deliveries.[115] These examples demonstrate that while tech companies might use tax inversions and havens for some assets, especially if not subject to public transparency and pushback, they will not fully exit jurisdictions that have a gravitational pull for other reasons.

3.3. Alternative Strategies for New Business Models and Innovations

Finally, a third constraining force on regulatory arbitrage is the presence of alternative strategies for interacting with and responding to the law. Regulatory arbitrage can be broadly understood as one type of business decision or approach to the law, whether it is designing a particular transaction to take advantage of a loophole or selecting a location for economic activity based on a favorable legal regime. Some laws have differences or gaps that provide entrepreneurial opportunities and make regulatory arbitrage an attractive strategy, but others present obstacles that limit the ability of a company to lawfully operate or grow. In particular, when a fundamental mismatch exists between new business models or innovations and laws, regulatory arbitrage may get a

[114] De Blasio B (2019) *Bill de Blasio: The path Amazon rejected*. NY Times, https://www.nytimes.com/2019/02/16/opinion/amazon-new-york-bill-de-blasio.html?action=click&module=Opinion&pgtype=Homepage#commentsContainer.

[115] Weise K, et al. (2019), *Amazon's hard bargain extends far beyond New York*. NY Times, https://www.nytimes.com/2019/03/03/technology/amazon-new-york-politics-jobs.html?action=click&module=News&pgtype=Homepage

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company only so far toward its desired outcome. In these circumstances, an alternative strategy might hold more promise, and this option could affect the degree to which a company might attempt to arbitrage the law.

For example, Uber chose to "arbitrage" employee classification but to "entrepreneur" transportation laws. That is, Uber had at least a credible claim regarding employment classification law such that it could strategically design a relationship that arguably fit in the independent contractor status category and functionally achieved what the company needed from drivers.[116] By contrast, taxi and transportation laws were different all over the world, but they were still generally prohibitive for Uber's ride sharing business model when the company was in its early years. Although there may have been some jurisdictions that would have allowed the company to operate immediately and without protest, the company wanted to grow globally. The size and reach of the network of drivers and users impacted the company's value, and the ability to scale its business was important for raising funds from venture capital investors.[117] Engaging in regulatory arbitrage by selecting only the jurisdictions that provided favorable legal treatment or legal gaps that could be exploited would only get the company a limited way toward its business goals.

[116] As discussed above, this path has not been without cost and friction. Uber's business model has notably incurred billions of dollars of losses and arbitraging employee status has led to lawsuits, settlements, and other expenses, leading to speculation that the company is engaged in a big bet or long game to driverless vehicles. See, e.g., Sherman L (2017), *Why can't Uber make money?*, Forbes, https://www.forbes.com/sites/lensherman/2017/12/14/why-cant-uber-make-money/#1253265910ec.

[117] See Pollman (2019); Coolican D, Jin L (2018) *The dynamics of network effects*. Andreessen Horowitz, https://a16z.com/2018/12/13/network-effects-dynamics-in-practice/.

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With some business models and innovations, or some strategies for growth, it is infeasible to pretend that law can be ignored, avoided, or elided altogether—it must be changed. Professor Jordan Barry and I have referred to this activity as "regulatory entrepreneurship"—where companies "pursu[e] a line of business in which changing the law is a significant part of the business plan."[118] Recent examples include Uber, Lyft, Tesla, Airbnb, among others.[119] Regulatory entrepreneurship in some ways could be seen as a close relative to regulatory arbitrage—both involve strategic maneuvering in light of laws. But in other ways, regulatory arbitrage and entrepreneurship represent contrasting strategies that can act to constrain each other. With regulatory entrepreneurship, instead of trying to move around the law, exit, or recategorize, the actor is trying to change the law. The entrepreneur might use evasion and political techniques to do so,[120] but these efforts are aimed at ultimately trying to shape or change the law, not work around the law as it stands. When circumventing the law or re-categorizing would not be sufficient or plausible at scale for certain business models or other innovations, regulatory entrepreneurship becomes a more appealing strategy.

To take another example, electric scooter rental companies such as Bird launched in multiple cities despite facing a patchwork of different laws, some silent regarding permissibility or even prohibitive. Electric scooters have the potential to solve the "last mile" problem for public transportation, taking cars off the road and thereby easing traffic

[118] Pollman and Barry (2017), p 383.

[119] Ibid. Not all companies succeed at regulatory entrepreneurship. See, e.g., Tusk (2018), p 9 (discussing startup companies that failed or encountered prolonged difficulty with regulatory entrepreneurship).

[120] Pollman and Barry (2017), p 398-408 (discussing how regulatory entrepreneurs may break the law or operate in legal gray areas while trying to change the law, grow too big to ban, mobilize users and other stakeholders for political gain, and use traditional political techniques such as lobbying).

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congestion and lowering pollution. But as the scooters are dockless and tracked by GPS, users can park them anywhere at the end of their ride, which can create a nuisance littering sidewalks. Further, scooter riders create safety hazards for pedestrians and cars when they inevitably fail to stay in prescribed bike lanes. Like other regulatory entrepreneurs, when Bird launched, it received cease and desist letters and then began building popular support with users and working with local regulators to make a more hospitable regulatory environment.[121] After being pulled from the streets in some cities, Bird has often leveraged support from users and lobbied to come back and play by new rules that city officials are pressured into rolling out.[122] When companies cannot simply engage in regulatory arbitrage to their advantage such as by moving technology development to an innovation cluster with permissive laws, they may instead use these strategies of regulatory entrepreneurship to introduce innovative technology.[123]

The success of companies engaged in regulatory entrepreneurship depends on a variety of legal and business factors.[124] For example, a company might engage in a sophisticated strategy of sequencing wins in locations that can build leverage for taking on intransigent regulators in other important markets. To the extent that the laws targeted are local or state rather than federal, this strategy may be more likely to lead to a

[121] See, e.g., Mancuso K (2019), *The rise of electric scooter regulations*, Regulatory Review, https://www.theregreview.org/2019/01/03/mancuso-electric-scooter-regulations/.

[122] See, e.g., Holley P (2018), *Electric-scooter companies conquer with a simple strategy: act first, answer questions later*, Washington Post, https://www.washingtonpost.com/news/innovations/wp/2018/06/22/electric-scooter-companies-conquer-with-a-simple-strategy-act-first-answer-questions-later/?utm_term=.03d45ad49574.

[123] See Tusk (2018).

[124] Pollman and Barry (2017), pp 410-424.

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favorable outcome.[125] Similarly, companies that can mobilize their users for political support are also at an advantage, particularly when dealing with regulators and legislators that can be held accountable by the ballot box.[126] Thus, while platform companies like Uber and Airbnb are constrained in their ability to arbitrage the transportation and short-term rental laws at the heart of their business models, they are well-positioned to try to challenge those laws by using their platform to rally their user base to exert political pressure, in combination with other forms of politicking.

Conclusion

Regulatory arbitrage can be understood in a neutral or negative light—either as simply a subcategory of business decisionmaking or as harmful maneuvering that can distort regulatory competition, shift costs, and undermine the rule of law.[127] Viewed from either perspective, understanding the constraints, boundaries, and limits of regulatory arbitrage is a worthy aim to the extent it can shed light on the dynamic relationship between business and law, and more specifically as it holds potential for policy makers interested in reducing activity that can sometimes harm social welfare.

This essay has explored extensions to the existing literature on constraints to regulatory arbitrage, including social license and the bundling of laws and resources. Further, it has examined how companies that have legally disruptive business models or innovations may find regulatory arbitrage of limited value in comparison to other

[125] Ibid., pp 419-421.

[126] Ibid., pp 411-412, 421.

[127] See Fleischer (2010), p. 227.

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strategies focused on shaping the legal environment. The above discussion of these three points—social license, bundling, and regulatory entrepreneurship—suggest that a complex set of factors and forces are at play in decisions about regulatory arbitrage, ranging from transparency of information to the public to the ability of a company to mobilize its users in support of legal change.

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