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Hosting In The New Peer-To-Peer Marketplace: Better Barter Disrupts Regulatory Regimes

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by

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INTRODUCTION

Everyone loves a bargain and wants to cut out the middleman. The new lingo of “collaborative consumption,” the “sharing economy, and “disintermediation” all come down to connecting buyers and sellers directly through social media sites that facilitate commercial transactions. New sites promise faster, better, and more accessible services, all available on phones equipped with the latest app. But what are the downsides? This paper will focus on one of the major “disrupters” in the hotel industry, Airbnb, and review the regulatory risks for hosts operating under this new business model.

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BACKGROUND ON THE SHARING ECONOMY

Collaborative consumption is not new. Before industrialization, commerce thrived on a robust barter system that relied on direct personal exchanges. Today, food cooperatives and community supported agriculture programs offer the benefits of locally grown produce to participating members, typically at a reduced fee and/or in return for work contributed to the enterprise. Such traditional barter systems rely on face-to-face transactions. The availability and widespread use of the Internet now provides a vehicle that magnifies the possibilities of commercial exchanges on a global scale. Collaborative consumption has gone viral.

During the late 1990s, Napster facilitated peer-to-peer (P2P) file sharing of music. Despite years of legal battles that eventually shut down Napster, the technology revolutionized the music industry and dramatically brought down consumer prices.[1] It is not surprising that the $6 trillion travel business is now under similar assault.[2] The creation of hyper-efficient global digital markets allows one to obtain every type of product or service without moving through a physical supply chain and without paying a middleman.[3] In P2P, individuals transact exchanges directly through an Internet platform maintained by a third party, essentially a matchmaker. P2P property rental websites provide marketing and advertising, screen renters and owners, have access to the owners' inventories, manage rental bookings, collect payments, and provide some form of insurance coverage for damages caused by the renters.

AIRBnB MOVES IN, AND RAPIDLY GOES MAINSTREAM

No-cost room sharing was pioneered by the nonprofit site

CouchSurfing.com. In contrast, Airbnb (originally called Airbedandbreakfast) was founded in 2008 with a clear for-profit focus. In the last few years, it has grown by leaps and bounds. Currently its listings exceed 600,000 properties spread around the world in over 190 countries and 34,000 cities. Its couches, beds and rooms are used by more than 15 million people.[4]

Annual sales are reported to be in the range of $100-$250 million and it employs 700 people. Airbnb's main source of revenue is through the 12 percent fees (3% paid by the host and 9% paid by the guest) it collects for every completed transaction. Its operating expenses include:

- Hosting of the Internet platform
- Screening and identity verifications of both hosts and guests
- Collection of fees
- Maintenance of a secure payment process
- Insurance premiums for its $1 million host guarantee policy
- Litigation and related legal costs for compliance with local, state, and national regulatory laws[5]

Airbnb is the major innovator in the new sharing economy, with a valuation of anywhere from $2.5 to $10 billion. (It is difficult to be more specific as the company is privately owned and financial information is not readily available.) Many experts expect its IPO to be one of the largest, putting it squarely with other tech leaders like Facebook and LinkedIn. Its growth derives not only from internal expansion (it opened a new headquarters in Singapore to exploit the Asian market), but also through strategic acquisitions. Airbnb bought German competitor Accoleo and London-based Crashpadder. In addition, it has started experimenting with offering optional experiences to guests in which the hosts may choose to participate. These include guided tours, nature hikes, bike excursions, and food and drink tastings. The company's popularity also has been enhanced through mobile apps that allow for instant bookings and an interactive website which answers user questions in real time. Airbnb is beginning to enlist owners of unique properties for exchanges, mainly with the idea of attracting non-budget, upscale travelers.[6]

In fact, CEO Brian Chesky envisions Airbnb as a "full-blown hospitality brand" with consistent services that can generate lots of additional revenue. For starters, Airbnb is testing a full-service cleaning package that will include towels, bed sheets, mints and a welcome gift. The cost will be about $60 per rental, and it is anticipated that hosts will pass that fee on to guests. Also under consideration are airport-transportation services and a new "business-ready" designation to woo corporate travelers.[7] Airbnb seems to be gaining corporate recognition. Billionaire investor Warren Buffett has recommended that shareholders in his Berkshire Hathaway Company use it when attending the company's annual shareholders meeting in Omaha, Nebraska, since the city has a relatively small number of hotel rooms. And in another nod to respectability, American Express added Airbnb to its membership rewards program in December, 2014.[8]

There are several other external factors that have contributed to Airbnb's success. The Great Recession of 2008 left many home and condo owners holding upside down mortgages with the possibility of foreclosure. Job losses and lower incomes saddled many renters with unaffordable monthly payments. These two factors have increased both the supply of units made available by people looking for additional income and the demand for such units by people exploring ways to cut costs when traveling. Positive experiences with sites such as Taskrabbit (outsourcing routine and skilled jobs), as well as Uber and Lyft (ride-sharing) have led to general acceptance of the Internet-based sharing paradigm. Many guests, particularly those seeking a bargain, are willing to rent rooms through non-hotel avenues.

For the parties directly transacting business through Airbnb, the benefits and costs are obvious. Tenants and owners with rooms to rent earn financial rewards and simultaneously enjoy the pleasure of meeting new people. Guests save money, meet new people and stay in neighborhoods where hotels may be rare or very expensive. Nonetheless, potential costs to a tenant may be high:

- Theft of and damage to their own and neighbors' properties
- Consequences of crime for hosts and their neighbors
- Possibility of eviction due to severe infraction of the rules by guests and/or the Airbnb rental being deemed in violation of the lease

Guests may encounter poor quality rooms and furniture, unfriendly hosts, and rentals that are not in compliance with safety, health and fire regulations.

Renting out one's own private home is quite different than turning one's residential tenant lease into a commercial source of personal income. Unless they receive compensation, landlords will not want to incur the added liability of their tenants serving as paid hosts to unknown guests. Possible responses may include increases in rent to grab a share of the income generated by the tenants. Alternatively, leases may completely ban any form of re-rental without prior permission of the landlord. Some landlords may take a few rental units off the market to reserve for their own use of Airbnb type services, particularly if the unit is likely to attract high rental fees from travelers. If a significant number of landlords follow suit, the supply of long-term rentals could go down, making housing less affordable and disrupting many communities. This strategy may favor tourists over the locals.

The definite losers in this sharing economy are hotels and local, state and federal governments. Hotels are at a significant competitive disadvantage. Hotels have to build and maintain their facilities, assure compliance with the Americans with Disabilities Act, meet fire, food, safety, and health codes related to their operations, and pay sales, occupancy, real estate, franchise and income taxes. Airbnb's low overhead is based on essentially contracting out all of its operational and managerial expenses to its hosts—it can lay claim to being the world's largest hotel chain without owning a single hotel.[9]

Arguably, competition may help drive hotel prices down to more reasonable rates. It has been estimated that in 2013, in New York City alone, over one million hotel room nights were not filled due to P2P sharing arrangements.[10] Airbnb now has 16,000 accommodations available in the city, representing 11 percent of the city's inventory.[11] Spending on Airbnb by Big Apple tourists in 2014 is estimated at $282 million. The service has become especially popular in trendy, up-and-coming areas, and value hotels (those in the $150-$250 per night range) are feeling the pinch. Average revenue per available room in New York has fallen about 5% from its peak, to $225 per night, and Credit Suisse lodging analysts note that competition will continue to exert downward pressure as New York is also experiencing a surge of hotel construction. Although major lodging companies may withstand pressure from oversupply because they derive 60% of their New York business from corporate travel, another worry is that the strong dollar may put a significant dent in summer tourism.[12] Fewer room nights translate to a significant loss of tax revenue, and workers employed in the hospitality industry may experience lower income and possible job losses due to lack of business for traditional hotels.

As a counterpoint, Airbnb contends that it makes contributions to local economies by bringing in travelers who otherwise might not visit expensive cities. The company released a study in 2013 claiming that its services generated $632 million for New York City that year by attracting visitors who couldn't otherwise afford hotel rooms. Airbnb enabled them to stay longer and to spend more money on food and shopping, rather than blowing their budgets on hotel rooms.[13] These assertions are hard to verify because it is impossible to separate such incremental visits from the business siphoned off from standard lodging.

LEGAL AND ECONOMIC CONSIDERATIONS

Not surprisingly, many cities oppose the presence of Airbnb and the impact it has on revenue raised by visitors. Rental properties in New York City are a good example of the competing economic interests at play. Renters there have the second highest average rent in the country.[14] Tenants have found that renting out their apartments is an easy way to offset their high rents. Given the fact that New York has a seemingly never ending supply of tourists seeking housing, and a relatively equal supply of tenants willing to give up their apartments, it is no surprise that Airbnb has been so successful.

The city, on the other hand, oversees a rental system with layers of arduous regulations including rent control, as well as a hotel industry vying for the very same visitors as Airbnb. Apartment building owners and the state have reacted with an aggressive, legalistic approach to rein in Airbnb. Two examples are illustrative.

First, in one of the only reported cases involving Airbnb, *Brookford, LLC v. Penraat* [15] a property owner in New York City challenged one of its tenants' rights to rent via Airbnb. This particular tenant had a rent-controlled apartment on Central Park West, with multiple bedrooms at her disposal to lease. Other tenants in the building became suspicious at the constant stream of strangers entering their building. The defendant left keys with the doorman and instructed him to allow the visitors into her apartment. Perhaps this is how the owner of the building became aware of her Airbnb activity.

The building owner set forth four different arguments to the court. First, the plaintiff argued that the defendant utilized her apartment for business purposes, thus commercializing and profiteering from an illegal hotel and/or bed and breakfast. Second, the presence of transient guests was disturbing to the tenants of the building as both a safety issue (the tenants complained about the noise and disruption caused by the visitors and were frightened by the number of strangers in the building). Third, renting rooms to customers violated the fire safety protections required of hotels in New York, constituting a health, safety and welfare argument; and finally, New York City's rent control law prohibited the renting of an apartment to visitors for stays of fewer than 30 days.[16] The court agreed that the defendant's actions were an "incurable violation of the Rent Control Law as well as a violation of New York's MDL § 4.8, a 2010 city ordinance "intended to prohibit building owners of Class A multiple dwellings, which are intended for permanent residencies, from renting out dwelling units for less than 30 days or on such a transient basis."[17] As a result of the court's decision, precedent clearly exists for building owners to evict tenants who rent their rooms via Airbnb.

Yet one problem still exists for building owners. Unlike the plaintiff in *Brookford,* most landlords do not know if their tenants are leasing rooms. Enter New York State Attorney General Eric Schneiderman (AG). He filed suit against Airbnb in 2013, alleging that virtually no rooms were rented for more than 30 days and that nearly two-thirds of the close to 20,000 listed hosts planned to rent their entire apartment and would not be present.[18] Airbnb initially resisted the AG's subpoena to supply information about its hosts on privacy grounds, but in May 2014 it agreed to provide anonymous data and to identify the names and contact information of individual users the AG's office chooses to investigate for possible enforcement action.[19] Though the AG stated that the focus of his investigation will be on renters of multiple apartments and not on occasional one room rentals, many observers worry about a chilling effect on hosts who might pull out in fear of a violation of their lease or New York law.[20] No statistics exist for how many potential hosts were alarmed about possible eviction and stopped offering their properties through Airbnb, but one could assume a not insignificant affect. Some hosts also have been rattled by Airbnb's tactics, which have involved aggressive emails to solicit properties and very demanding identity verification processes.

New York is not the only city to try to limit Airbnb via legal means. Landlords in British Columbia are keeping an eye out for rentals and threatening eviction of errant tenants. In spite of its efforts to stem the rentals, however, one of British Columbia's politicians acknowledged that, "This is likely something that is going to grow, and we don't pretend that we're going to be able to stop it." [21]

In Lousiville, Kentucky, owners renting properties were told by the city to cease and desist or face considerable fines. The city claimed that owners were acting like hotels without the necessity of complying with laws about fire or health inspections. Mayor Greg Fischer believes there is an un-level playing field because those staying in lodging through sharing sites like Airbnb are not paying the same lodging tax paid by those who stay in hotels. Those revenues are used to help fund the Louisville Convention Center and Visitors Bureau.[22]

What New York, British Columbia, and Louisville all have in common is an effort to stem the tide of a popular and lucrative business whose offenders are nearly impossible to catch and whose admirers are countless. Perhaps to avoid more intrusive regulation and to support its assertion that it adds value to city economies, Airbnb now wants its hosts to tax users. Despite Airbnb's estimated projection of raising $21 million per year in state and city taxes, the Hotel Association of New York City adamantly rejects any approach that taxes hosts or users because it would provide legitimacy for Airbnb's business model.[23]

Airbnb appears to be winning this latest battle in many prime locations. In late October 2014, San Francisco Mayor Ed Lee signed a law that legalized Airbnb-style home-sharing in the city.[24] The 14 percent tax is expected to yield as much as $11 million annually.[25] In San Jose, a vote in December 2014 to levy the hotel tax on Airbnb guests also legalized the platform. Chicago and Washington, D.C. have yet to adopt measures that would officially legalize short-term Airbnb rentals, but Airbnb entered into arrangements with both cities "to assist in the collection of a 'transient accommodations' tax equal to 14.5 percent of the listing price plus cleaning fees (D.C.), while in Chicago it is 4.5 percent of the same."[26]

Portland, Oregon, one of Airbnb's largest host cities, is trying to regulate hosts by making them apply for permits, pay lodging taxes and endure housing (safety) inspections.[27] Though the city estimates 1,600 short-term rental hosts list their properties on sites such as Airbnb, HomeAway and

FlipKey, only 166 permit applications have been received since August 30, 2014, when the city's transient lodging tax (11.5%) went into effect requiring hotels and other properties to collect this tax.[28] In January 2015, another ordinance expanded the permit requirement from hotels to "multi-dwellings" hosts, but only an additional 34 applications were received by the end of February 2015.[29] Airbnb began collecting hotel taxes on behalf of its users in July 2014. Nonetheless, Portland's goal to achieve accountability for occasional hosts through its new licensing system may prove elusive.

Interestingly, some cities have declined to regulate or tax rooms rented out, citing other more pressing priorities. The Palo Alto City Council views the few complaints it has received about Airbnb as either invalid or of minimal concern.[30]

Perhaps not surprisingly, Airbnb has created a face-saving escape for its most ardent opposition. It has proposed an ingenious system by which it agrees to collect hotel taxes from its own renters and remit that money to the very cities that oppose Airbnb's existence. Gone then is the argument that Airbnb deprives municipalities of revenue, leaving traditional hotels and licensed bed and breakfast operators to dispute the unfair disparities in the application of fire, health and safety codes. Local government support for increased regulation is less likely once the respective cities have been, in a sense, "paid off." In short, Airbnb may have out-smarted its opposition. By directly addressing the major arguments against its existence, it may have guaranteed its future.

Yet Airbnb's biggest market, New York City, remains unmoved. In a contentious, eight-hour City Council meeting in late January 2015, lawmakers refused to change the city's short-term rental laws and urged stricter enforcement, particularly against commercial operators. In 2014, the Mayor's Office of Criminal Justice fielded 1,150 complaints—up from 713 in 2013—and exercised 900 inspections. City Council wants the unit to be more proactive and to seek operators out through Airbnb's website. More lawsuits have been filed, and the strength of the New York City anti-Airbnb crowd appears to be growing.[31]

CONCLUSIONS AND RECOMMENDATIONS

Airbnb’s routine violations of existing housing laws finally have come under legal challenge. Regardless of the outcome of the pending court cases, the concept of collaborative consumption, where the focus is on access and not necessarily ownership, will lead to significant changes in the laws and regulations. We are accustomed to having one set of laws that businesses need to follow and another set of laws people need to abide by. In the new sharing economy, people and their interactions are the business. One key point that has yet to be addressed is whether individuals participating in these transactions are subject to anti-discrimination laws. P2P platforms ostensibly facilitate connections between private individuals, yet hosts offer accommodations to the general public and then review guest profiles to select a match. Here the blurred lines between places of public and private accommodation may contravene established public policy.

Millennials place great faith in P2P platforms, but that trust is grounded in a relatively high set of standards established by previous generations as the basis of any bargain they strike. Those expectations are the consequence of a long history of hard won consumer protection health and safety regulations. Airbnb already has acknowledged its obligations to police baseline standards such as clean linens and smoke detectors, and it appears to be moving into the higher end market by offering typical concierge services. If taxes are assessed and collected, the price gap between Airbnb rooms and traditional hotels may begin to close, and amateur hosts may find the venture less appealing. As Airbnb settles into its own distinctive brand and niche, new trendsetters will move in. It is clear that P2P transactions will command a growing segment of the hospitality industry. The latest disrupters are social networks such as EatWith, Feastly, and Cookapp that connect chefs with diners, bypassing the licensing and food inspections required of restaurants.[32]

While hoteliers and restaurateurs decry the modern technology that circumvents existing laws and call for a level playing field, to date they have failed to identify the core regulations to which such new business models should adhere. Rather than trying to outlaw the creative energy generated by P2P sharing, regulators and industry leaders must develop a new framework in which these many independent contractors can operate and flourish. A more fluid regulatory regime may engage far more consumers in travel and hospitality pursuits. Old-style businesses must reposition themselves to capitalize on that gain.

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