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No. S_____
2d Civ. No. B243800

#12

IN THE SUPREME COURT OF CALIFORNIA

In Re Coordinated Proceeding Special Title (Rule3.550(c))
TRANSIENT OCCUPANCY TAX CASES.

CITY OF SAN DIEGO, CALIFORNIA,

Petitioner,

v.

HOTELS.COM, L.P., et al.,

Respondents.

Appeal from the Los Angeles County Superior Court
Hon. Elihu M. Berle, Judge, Case Number: GIC861117
(Judicial Council Coordination Proceedings No. JCCP4472)

PETITION FOR REVIEW

[Request For Judicial Notice Filed Concurrently Herewith]

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ISSUES PRESENTED

In this case involving claims by the City of San Diego against the major online travel companies (e.g., Expedia and Travelocity) to collect more than $21 million in unpaid hotel-room occupancy taxes owed by reason of room rentals booked through those companies, the City requests review of two issues arising from a published opinion of Division Two, Second Appellate District (per Victoria M. Chavez):

Issue No. 1:

> When a customer books a hotel room through an online travel company, should the occupancy tax, which is levied on the "rent charged by the Operator [the hotel]" for the customer's "privilege of Occupancy" (language identically adopted by over 400 California cities and counties) be calculated based on the *retail* rate paid by the customer to obtain the right to use the room or, instead, be calculated based on the *wholesale* amount that the hotel receives from the online travel company after that company has deducted its markup and fees?

Issue No. 2:

> Whether an appellate decision issued after a separate trial in one of several coordinated actions, is automatically "law of the case" as to all of the other coordinated actions simply because the actions have been ordered coordinated? Or is more required, such as an order or stipulation merging the coordinated actions into one action or providing that issues will be commonly determined and giving the litigants in all of the coordinated actions an opportunity to participate in the proceedings that are to be afforded law-of-the-case effect?

INTRODUCTION

This is one of multiple coordinated actions by public entities against the online travel companies ("OTCs") to recover unpaid hotel occupancy taxes that the public entities contend are owed as a result of hotel stays booked through the OTCs. These actions have been ordered coordinated so that each action will be heard by the same trial court judge and each will be reviewed by the same appellate panel.

San Diego brought the present suit seeking over $21 million in back taxes, interest and penalties, based on an ordinance levying a transient occupancy tax ("TOT") on the "rent charged by the Operator [the hotel]" for the customer's "privilege of Occupancy." (San Diego Mun. Code, §§ 35.0101, subd. (a) [expressing intent to impose tax on the customer, formally called "Transient"], 35.0102 [defining "Occupancy" as the customer's right to use the hotel room]; 35.0103 [imposing tax based on "rent charged by the Operator" for the customer's "privilege of occupancy"].)

As demonstrated in the Request for Judicial Notice ("RJN"), the operative language has identically been adopted by more than 400 cities and counties in California.

The Importance Of Issue No. 1

The OTCs never purchase rooms from hotels. Instead, they act as sales agents: They sell rooms to the public from the hotels' own inventories. The OTCs then remit a pre-agreed "wholesale" amount to the hotel, and retain as compensation their markup, plus fees.

The OTCs assert, and the trial court and Division Two held, that the tax owed by a customer on his hotel stay are based on the *wholesale* amount that the hotel receives after the OTC has deducted its markup and fees. San Diego, in contrast, claims that the taxes owed by the customer and collected by the OTC must be based on the *retail* rate that the customer actually pays to obtain the privilege of occupying the room.

San Diego contends its interpretation is correct because it is the taxpaying customer who obtains the privilege of occupancy, who pays rent to obtain that privilege, and who is charged with the tax. Thus, the tax must be based on what the customer has paid. And, the customer can never acquire the room unless he or she pays the *retail rate* quoted by the OTCs. Indeed, no matter what net amount the hotel ultimately receives as a result of its arrangement with the OTCs, the customer must always pay retail to obtain the "privilege of Occupancy." That rate is, thus, the "rent charged" under the tax ordinance. It must serve as the tax base for calculating TOT.

Definitive interpretation of the ordinance language is a matter of enormous statewide importance, as it directly impacts the budgets of public entities across the State. Substantially identical taxing language appears in

the TOT ordinances of over 400 California cities and counties. The back taxes, penalties and interest that the public entities contend are now due under these provisions, coupled with the hundreds of millions of dollars of taxes that will be due in the future, could easily exceed $1 billion. This is money that the public entities need to provide services to their residents.

If San Diego's interpretation of the TOT language is correct, only action by this Court will ensure the public entities receive the revenues they are due. This is so because Division Two has thrice held (once in the published opinion in this case and twice in unpublished opinions) that the tax base for calculating TOT is the wholesale amount received by the hotel.[1] By reason of the coordination order, all future TOT cases will be decided by Division Two. Thus, unless this Court intervenes now, the hundreds of public entities with have identically-worded (or operationally identical) TOT laws will be denied their just entitlements.

The bottom line: The TOT question presents a uniform issue of statewide importance to virtually every California public entity and resident. It begs for immediate, authoritative resolution by this Court.

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[1] Prior to its published decision in this case, Division Two rejected appeals by the cities of Anaheim and Santa Monica. (*In re Transient Occupancy Tax Cases* (Nov. 1, 2012, B230457) 2012 WL 5360907 [nonpub. opn.] (*Anaheim*); *In re Transient Occupancy Tax Cases* (Nov. 1, 2012, B236166) 2012 WL 5360882 [nonpub. opn.] (*Santa Monica*).)

The Importance Of Issue No. 2

The certainty that Division Two will not change its mind in any future case involving the commonly-enacted TOT language is reinforced by that court's newly-published proclamation in this case that its earlier unpublished decisions rejecting claims brought by other cities in the coordinated actions (see footnote 1, *supra*) automatically constitute "law of the case" as to the other coordinated actions simply because those actions are part of coordinated proceedings. Division Two's law-of-the-case pronouncement, if left undisturbed, permanently shuts the door to the identically-premised claims of over 400 cities and counties having TOT language identical to San Diego's, and possibly, the claims of any city with a TOT ordinance, however worded.

But, there are added reasons why Issue No. 2 should be reviewed. By declaring in a published decision that law-of-the-case consequences automatically flow from the mere fact that the cases have been coordinated, the opinion threatens to wreak havoc in all other coordinated cases. Unless this Court steps in and decides the issue, the opinion will be cited for the proposition that an appellate decision resolving issues in one coordinated action will automatically constitute law of the case in all the coordinated actions. This has never been the law.

Far from affording automatic law-of-the-case impact where actions have been coordinated, California law has always held that coordinated actions retain their separate identities unless the coordination judge issues

an order (or there is an agreement among the parties) providing otherwise. Even cases that have been ordered *consolidated for trial* are not automatically merged into a single action; they remain separate for law-of-the-case and all other purposes absent an order expressly merging the actions. This rule, which is grounded in due process principles, will be muddied and compromised if the opinion's published law-of-the-case pronouncement is allowed to survive.

This case presents significant and material issues of statewide importance and impact. The Court should grant review to interpret San Diego's TOT language (which is identical to that in over 400 cities and counties) and to weigh the propriety of Division Two's expansion of the law-of-the-case doctrine in coordinated proceedings.

STATEMENT OF THE CASE

The relevant facts are undisputed.[2]

A. How The Online Travel Companies Operate.

1. Online travel companies rent hotel rooms to the general public at retail rates.

OTCs act on behalf of the hotels by selling rooms to the public from out of the hotels' inventories. (Opn.3-4.) The OTC posts on its website the price that a customer must pay to secure the privilege of occupying the room. (1JA,T.4,p.198.) By industry standard, the prices that the OTCs offer to the public are never less than the retail rates that the hotels charge directly to customers renting rooms straight from the hotels. (26AR,T.210,pp.003427-003430; see also 17AR,T.64,p.001016.) Thus, a customer who rents a room through an OTC can never obtain the privilege of occupancy for less than that retail rate.

2. The compensation models utilized by the hotels and OTCs.

Two basic models are employed by hotels and OTCs when offering rooms to customers via the OTCs' websites: The agency model and the

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[2] Most factual citations are to the Court of Appeal's slip opinion ("Opn."), attached to this Petition, or to the Rulings Of The Administrative Hearing Officer, included in the Joint Appendix (1JA,T.4,pp.195-223). The remaining citations are to the Joint Appendix ("JA") and the Administrative Record ("AR") filed in the Court of Appeal.

merchant model. (Opn.3, 15; 1JA,T.4,pp.199-201.) The model used results in substantially different tax results.

a. The agency model.

Under the "agency" model, the customer reserves a room through the OTC, but pays both the retail rate and the TOT directly to the hotel when checking in. (Opn.15; 1JA,T.4,p.199.) The hotel remits an agreed-upon percentage—say, 20%—of the retail rate to the OTC as a commission. (*Ibid.*)

Under the agency model, the TOT is calculated based on the retail rate charged to the customer, not just on the portion that the hotel retains after paying the OTC's commission. (See 1JA,T.4,p.199; 2AR,T.4, p.013812:13-18; 36AR,T.240,pp.005617:2-005618:2.) For example, if the customer is charged $100 for the room and the TOT rate is 10%, the customer pays a total of $110. (See Opn.15.) The hotel remits $10.00 in TOT to the City, and pays $20 in commission to the OTC. The hotel retains $80.00. (Opn.15; 1JA,T.4,p.199.) Thus, TOT is calculated based on the full $100 that the customer has paid to rent the room (rather than on the $80 that the hotel has retained after paying commission to the OTC).

b. The merchant model—the model applicable in this case.

Under the "merchant" model, the customer reserves the room through the OTC and then pays the retail rate plus taxes and fees to the OTC (usually over the OTC's website). (1JA,T.4,p.199; Opn.4, 15.) The

OTC forwards a portion of the retail rate to the hotel, as well as the TOT, which the hotel then remits to the city or county. (*Ibid.*) The OTC retains the rest as its compensation or commission. (*Ibid.*)

As to the specific amounts that the OTC retains and remits, the hotels' arrangement with the OTC is as follows: For each room that a customer books through the OTC, the hotels agree to accept a pre-agreed wholesale amount from the OTC. (1JA,T.4,pp.199-200; Opn.4, 15.) The OTC then markets the rooms to customers at a marked up rate—i.e., at the *retail* rate (plus combined taxes and fees). (*Ibid.*) After the customer's hotel stay, the OTC retains the difference (called the "markup") between the retail rate that the customer has paid and the wholesale amount that the OTC must give to the hotel. (1JA,T.4,p.199.) Part of the OTC's compensation includes certain "fees" charged to the customer. (*Id.* at p. 200.)

The OTC also collects and forwards the TOT to the hotel to be remitted to the city. (*Id.* at p. 201; Opn.4, 15.) The amount of TOT that the OTCs remit is calculated based on the *wholesale* amount that the hotel pockets after the OTC deducts its markup, rather than on the *retail* rate paid by the customer to book the room. (Opn.4, 15; 1JA,T.4,pp.199-201.) The OTCs collect that TOT through the "taxes and fees" charged to the customer on top of the retail rate, and then transmit just the wholesale-based TOT amount to the hotels for payment to the cities or counties. (Opn.4, 15.)

Thus, under the merchant model, as compared with the agency model described above, if the hotel receives $80 on a $100 room, the OTC's markup (i.e., its commission) is still $20. But given the same 10% tax rate, the OTC only remits $8.00 in TOT. The OTC retains the $2.00 difference ($10.00 minus $8.00) as additional profit: Instead of remitting this $2.00 to the City as part of the TOT, the OTC calls this amount a "service fee" and pockets it along with the $20 markup. (See 2AR,T.3, p.013749:16-25; 20AR,T.103, p.001768; 20AR,T.105, p.001790; 26AR,T.211, pp.003587-003588; 34AR,T.238, p.005270, pp. 1-17.)

The present case concerns the merchant model. (Opn.3-4.)

3. Although customers booking rooms through OTCs must always pay the retail rates, they never know that their tax rate varies depending on which compensation model is being used.

A customer booking a room through an OTC is never informed which tax model is being used or what the tax base is for her transaction. (1JA,T.4,p.201.) Instead, the customer knows only that she is being charged the retail rate for her room (as posted on the OTC website) and is being additionally charged "taxes and fees," without any breakdown. (Opn.4, 10, fn. 10; 2JA,T.10,p.413.)

Customers are never told about the wholesale amount that the hotel receives from the OTC for the room. (1JA,T.4,p.201; Opn.4, 16, fn. 12.) Nor are customers apprised of the amount of TOT they are paying.

(1JA,T.4,pp.200-201; Opn.10, fn. 10, 16, fn. 12.) For all the customers know, the applicable room taxes are always being calculated and charged based on the retail rates quoted on the OTCs' websites.

4. Customers booking rooms through OTCs using the merchant model cannot gain the privilege of occupancy unless they pay the retail rate.

Regardless whether a customer books her room directly through the hotel or books it online through an OTC, she must pay the retail rate. (See pp. 8-9, *ante*.) Under the merchant model, customers booking hotel rooms through OTCs can never secure the privilege of occupancy unless they pay the retail rate quoted by the OTCs, as well as the "taxes and fees." (1JA,T.4,p.200.) Customers are never offered rooms at the wholesale rate. (See *ibid.*) Rather, the wholesale rate exists only in the context of the behind-the-scenes transaction between the OTC and the hotel.

B. The City Assesses The OTCs For Failing To Remit Sufficient TOT.

San Diego performed TOT audits of the OTCs and subsequently issued assessments for unpaid TOT, plus interest and penalties for the OTCs' failure to remit the full amount of hotel-room occupancy taxes. (Opn.4; 1JA,T.4,p.196.) The City took the position that the TOT should have been calculated based on the *retail rate* paid by the customer to gain the privilege of occupancy, rather than on the *wholesale amount* that the hotel retained after the OTC took its cut. (2JA,T.8,p.288, 293.) The City

claimed more than $21 million in unpaid taxes, interest and penalties. (2JA,T.8,p.288; 1JA,T.4,pp.222-223.)

C. The Litigation.

1. Administrative proceedings.

The OTCs invoked the TOT ordinance's administrative hearing procedures to challenge the City's tax assessments. (1JA,T.4,pp.195-196.) An administrative hearing officer conducted a hearing to determine whether the OTCs had any TOT liability and, if so, the amount of unpaid taxes, interest and penalties owed. (1JA,T.4,p.196.)

In a lengthy decision containing extensive factual findings, the hearing officer determined that the OTCs owed TOT based on the retail rates. (1JA,T.4,pp.203-206.) He concluded "it is clear that in promulgating the Ordinance, the City Council intended to collect TOT on all monies charged to the Transient for the privilege of Occupancy of a given hotel room" (1JA,T.4,pp.203-204); that "the City Council anticipated that all due TOT would be paid as a straight pass-through from the Transient to the Operator [hotel] to the City without reduction and without exception," so that "whatever the Transient paid for the right of Occupancy would be the basis upon which the TOT would be calculated and paid to the City on behalf of a Transient by the Operator" (1JA,T.4,p.204; 1JA,T.4,pp.205, 206, 212, 217); and that the TOT ordinance requires a tax on "*whatever is ultimately charged for the room*" (1JA,T.4,p.213, original emphasis;

1JA,T.4,p.216).[3] The hearing officer assessed over $21 million in back-taxes and penalties. (1JA,T.4,pp. 222-223.)

The OTCs challenged this ruling by petition for writ of mandate (1JA,T.3,pp.35-101) and the case was assigned to the Los Angeles Superior Court in accordance with a coordination order we now describe.

2. The coordination order has assigned all transient occupancy tax cases to the same Superior Court judge and Court of Appeal panel.

Numerous claims similar to the instant one are pending throughout California.[4] On July 27, 2006, all of these TOT proceedings were coordinated as *Transient Occupancy Tax Cases*, JCCP 4472. (1JA,T.3,pp.54-55; see also RJN, Exs. A-C.) Under the coordination order, all California litigation involving asserted TOT obligations owed by OTCs

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[3] The hearing officer also found that the OTC is an "Operator" under the TOT ordinance because the OTC acted as the hotel's agent (1JA,T.4,pp.206-211); and that "[a]ll dealings [by customers] are with and through the OTCs as the authorized agents of the hotels" (1JA,T.4,p.207).

[4] As discussed (p. 1, fn. 1, *supra*), three suits have already been resolved by Division Two. Others have been resolved at the trial court level, including suits brought by Los Angeles and San Francisco, and appeals are pending. (See Los Angeles Superior Court Case Nos. JCCP4472, BC326693; San Francisco Superior Court Case Nos. CGC 09-488289, CGC 09-488292, CGC 09-509573, CGC 09-489356, CGC 11-510705.) Dozens more TOT claims are working their way through the system; they are in the early assessment process, the precursor to administrative proceedings and superior court litigation. (See Expedia, Inc. Form 10-K for fiscal year ended December 31, 2013, pp. 35 & 36, found at http://www.sec.gov/Archives/edgar/data/1324424/000119312514039090/d648005d10k.htm [reflecting claims against OTCs by 46 cities and one county].)

are assigned for decision by the same Los Angeles Superior Court judge (currently Judge Elihu Berle) and the same panel of the Court of Appeal (Division Two, Second District). (*Id.* Exs. C & D.)

3. The writ of mandate proceedings.

In the mandate proceedings brought by the OTCs to review the hearing officer's assessment of unpaid taxes and penalties, the trial court (Judge Berle) accepted the hearing officer's factual determinations and reviewed only his legal determinations—namely, whether the hearing officer "properly interpreted the ordinances at issue." (8JA,T.25,p.1632.)

Judge Berle issued a writ of mandate rejecting the hearing officer's interpretation of the TOT ordinance. (8JA,T.25,p.1620, 1622-1654.) He reasoned that the ordinance based the TOT on the amount "charged by the operator" (i.e., the hotel), and so the proper tax base was the wholesale amount received by the hotel (rather than the retail rate charged to the customer). (8JA,T.25,pp.1639-1654; see also San Diego Mun. Code, § 35.0101, subd. (a).) He concluded, therefore, that no additional TOT was owing.

4. In an initially unpublished, but now-published decision, Division Two of the Second District Court of Appeal affirms the trial court's determination that TOT need only be paid based on the wholesale amount.

Division Two affirmed Judge Berle's interpretation of the TOT ordinances in an initially-unpublished decision, holding that the proper tax base for calculating TOT is the *wholesale* amount received by the hotel, not the *retail* rate charged to the customer. (Unpub. Opn.6-7.) Division Two reasoned that "the words of the ordinance do not reveal an intent to impose a tax on the service fees and markups charged by the OTCs." (*Id.* at p. 7.) "Because the City's ordinance imposes tax only on rent charged by an operator, it does not reach amounts charged by the OTC for its services." (*Id.* at pp. 7-8.)

Division Two's opinion cited, relied on and is consistent with the unpublished decisions that the court previously issued in two of the other coordinated actions, rejecting the TOT claims asserted by Anaheim and Santa Monica. (*Anaheim, supra*, 2012 WL 5360907; *Santa Monica, supra,* 2012 WL 5360882.) Division Two said those unpublished decisions decided "the question of whether OTCs are liable for TOT" and that "[i]n both of those cases, we determined that the ordinances at issue did not impose a tax on the service fees charged by the OTCs." (Unpub. Opn.7.)

5. The Court of Appeal grants rehearing and issues a new, published decision that relies on the "law of the case" doctrine as justification for its citation of and reliance on its earlier unpublished decisions.

San Diego sought rehearing of the Court of Appeal's unpublished opinion on the ground that it improperly cited and relied on two unpublished decisions. The City based its argument on California Rules of Court, rule 8.1115(a), which prohibits citation and reliance on opinions not certified for publication, except in certain circumstances not applicable here. (Cal. Rules of Court, rule 8.1115(a).)

Division Two granted both rehearing and the City's concurrent publication request, yet its newly-issued opinion continued to cite and rely on its prior unpublished decisions. In order to justify its reliance on the unpublished decisions, the court declared that the unpublished decisions are law of the case and, thus, citation to those decisions was permissible under an exception to Rule 8.1115(a). (Opn.3-4, fn. 4, citing Cal. Rules of Court, rule 8.1115(b) [unpublished opinion can be cited when relevant as law of the case].) The court reasoned that because all of the coordinated TOT cases comprise "the same single coordinated proceeding," necessarily involving common issues of law and fact, the court could properly cite its earlier unpublished opinions as binding law of the case. (*Ibid.*)[5]

[5] Footnote 4 of the opinion states, in relevant part: "Pursuant to California Rules of Court, rule 8.1115, subdivision (b), this court may cite and rely upon an unpublished case when it is relevant as law of the case. The