PUBLIC—REDACTS MATERIAL FROM SEALED RECORD PURSUANT TO RULE CALIFORNIA RULES OF COURT, RULE 8.46(f)(2)(A)

No. S218400

IN THE SUPREME COURT OF CALIFORNIA

In Re Coordinated Proceeding Special Title (Rule 3.550(c))
TRANSIENT OCCUPANCY TAX CASES

CITY OF SAN DIEGO, CALIFORNIA,

Appellant,

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)

PETITIONER'S OPENING BRIEF ON THE MERITS

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TABLE OF CONTENTS

TABLE OF CONTENTS

TABLE OF CONTENTS

TABLE OF CONTENTS

TABLE OF CONTENTS

TABLE OF AUTHORITIES

PAGE

CASES

TABLE OF AUTHORITIES

PAGE

CASES

TABLE OF AUTHORITIES

TABLE OF AUTHORITIES

INTRODUCTION

San Diego is an international tourist destination that welcomes millions of visitors each year. The City's economy depends on the money these visitors spend. Their tax dollars form a core part of the City's budget, funding services that both residents and tourists depend upon, including police, fire, paramedic, street maintenance, library, park, and homeless services, to name just a few.

Like most California cities, San Diego has enacted an ordinance imposing a transient occupancy tax ("room tax") on the "rent" that hotel guests are charged to obtain the privilege of occupying rooms in the City. Because these taxes contribute substantially to funding essential municipal services, it is crucial that the City be able to collect all taxes that are owed.

Historically, room taxes were generated by bookings made directly with hotels or indirectly through travel agents. The tax was always based on the rent the customer was charged and had to pay to obtain the right of occupancy. Thus, if a customer was charged and paid $100 in rent for a room, the tax percentage was applied directly to that $100 rent amount.

In recent years, the Internet has entered the picture and expanded the ways that customers book hotel rooms. Online travel companies ("OTCs") like Priceline.com, Orbitz.com and Hotels.com have become a significant source of hotel-room bookings. As part of their deals with the hotels, the OTCs have contractually assumed responsibility for collecting the rent due on bookings made through their auspices, and for calculating, collecting

and remitting room taxes for payment to the City.[1] The problem is that the OTCs are not remitting the correct amount of room tax.

The governing room-tax ordinance requires that the applicable tax percentage be applied to the "rent charged by the [hotel]" for transferring "the privilege of Occupancy" to the customer. "Rent" is defined as "the total consideration charged to a Transient as shown on the guest receipt for the Occupancy of a room . . . without any deduction therefrom." Since there is only one "rent" that is being "charged" and paid by the customer for the privilege of occupancy, the ordinance language itself, as well as logic, dictates that the "rent" on which the tax is based should be the amount charged to and paid by the customer.

The OTCs disagree. They have not remitted room tax based on the rent charged to and paid by the customer. Instead, they have remitted tax based on a *lower* amount—namely, on the portion of the rental proceeds that the hotels receive after the OTCs have taken their contractually-agreed cut. Thus, when a customer is charged and pays $100 rent for a room, the OTCs have remitted tax based *not* on this $100 room rate, but rather based

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[1] By orders dated March 14, 2012 and April 18, 2012, the trial court sealed substantial portions of the underlying administrative record. (7JA, T.21, pp. 1241-1479; 7JA, T.22, pp. 1784-1492.) Consistent with California Rules of Court, rule 8.46(f), the City has: (a) publicly filed a redacted version of its opening brief; and (b) applied for permission to file an unredacted version of its opening brief under seal. (Cal. Rules of Court, rules 8.46(f)(1), 8.46(f)(2)(A), 8.46(f)(2)(B).) In the unredacted version of its opening brief, the City has marked all disclosures of sealed materials with a dotted underline. (Cal. Rules of Court, rule 8.46(f)(2)(B).)

on some lower, never-disclosed "net" amount (say, $80) that the hotels have received from that rental payment.

In Section I, we will demonstrate why this practice is wrong. Regardless of whether a room is booked directly through a hotel or indirectly through a travel agent or an OTC, the tax on the taxpaying customer should be the same. The tax should be based on the *full* amount of rent the customer is charged and is required to pay to gain the privilege of occupancy. There is no possible justification for taxing a lesser amount.

The hotels own the rooms and dictate the minimum rent that a customer must pay to obtain the privilege of occupying one of them. Unless a customer pays the rent the hotel specifies, he cannot obtain a room. This rent must therefore constitute the tax base. Indeed, if a hotel determines that a customer must pay a room rate of $100, that $100 rental payment is taxable at $100, no matter how cleverly those seeking to avoid tax might try to package the transaction.

The terms of the room-tax ordinance dictate this result. They are laser-focused on the *taxpaying customer* and on the rent he is charged and must pay to obtain a room. Who closes the rental transaction on behalf of the hotel, and how the hotel and the OTC might choose to share the rental proceeds, are entirely beside the point. Rent is rent. What the customer pays for his room is the tax base. That this is so is underscored by the fact that the ordinance commands that the taxable event occurs at the moment when rent is paid by the customer, not later when the rental proceeds are

divvied up between the OTC and the hotel. Thus, if a customer is charged and pays rent in a certain amount to obtain a room, that amount must necessarily constitute the tax base in *all* booking circumstances.

This conclusion is buttressed by the uncontroverted evidence establishing that the hotels "charge" the rent that the customer pays to book a room. In the hotel-OTC contracts, the hotels—in order to avoid price wars—set the minimum amount of rent that the OTCs are permitted to quote to customers. Under these "rate parity" clauses, the OTCs cannot quote (let alone charge) room rates that are lower than what the hotels themselves quote to customers directly on their own websites. Since the customer cannot obtain a privilege of occupancy by paying a penny less than the rent the hotels demand, this amount is taxable "rent" under the ordinance.

If there were any doubts about who is doing the "charging" of the rent that the customer pays to book a room, those doubts are put to rest by the administrative hearing officer's finding that the OTCs act as the hotels' agents when charging and collecting rent. This key agency finding, which was neither challenged by the OTCs nor disturbed by the lower courts, dictates the result here. As a matter of law, when an agent acts, those acts are the same as if the principal itself is acting. Thus, the hotels are the ones directly charging the rent that the customers pay to obtain occupancy. Again, there is no possible justification for calculating room tax based on some lesser portion of that rental amount.

Common sense, too, dictates that the amount of rent that the customer is charged and pays to obtain occupancy must define the tax base. Since the customer is the sole taxpayer and since the tax applies to the rent he is charged as consideration for obtaining the privilege of occupancy, it defies logic to conclude that the ordinance would contemplate *different* tax treatment depending on how the hotels and their booking agents choose to divvy up the rental proceeds after the fact. The amount of rent the customer pays is identical regardless of whether the transaction is completed with the hotel, with a travel agent or through an online travel agent. The tax result must be the same, too.

For these reasons and others to be explained in Section I below, the judgment must be reversed. The Court of Appeal prejudicially erred in holding that the rent charged and paid by customers is *not* the basis on which room tax must be paid. In reversing, this Court should direct that the *full* amount of the rent that is charged to and paid by the customer constitutes the basis on which room tax must be calculated.

Moreover, the OTCs cannot escape their obligation to remit the proper amount of room tax by contending they are not "Operators" under the ordinance and thus have no collection/remittance obligations. In Section II, we will show that there are multiple independent bases on which the OTCs are liable for remitting room tax, regardless of whether they qualify as an "Operator" under the ordinance.

Finally, in Section III, we will demonstrate why the Court of Appeal erred by holding that its prior unpublished decisions constitute law of the case. The law-of-the-case doctrine cannot apply here, as the coordinated cases were never merged as one and no notice or opportunity to be heard was ever given to San Diego. A coordination order, standing alone, does not result in a merger of the coordinated cases.

* * * * *

For many years, the OTCs have shortchanged San Diego by millions of dollars. They will continue to do so unless this Court puts a halt to their wrongful practices. The judgment must be reversed with directions compelling that room taxes must be calculated, collected and remitted based on the rent the customer is charged and must pay to obtain the privilege of occupancy. Nor can this result be undermined by the Court of Appeal's law-of-the-case determination.

STATEMENT OF FACTS

The facts of this case are essentially undisputed. (Court of Appeal Opinion [Opn.] 6.)

A. The Important Players.

1. The City.

San Diego levies a room tax on all customers who rent hotel rooms in the City. (8JA, T.25, p. 1632; 1JA, T.4, pp. 202-204, 212.)[2] These taxes constitute an important part of the City's tax base; the City relies upon room-tax revenue to fund vital municipal services. The City has sued the OTCs because it believes they are not remitting the full amount of room taxes that are due on the room bookings they complete. (1JA, T.2, pp. 18-19, 23; 1JA, T.4, pp. 199-201; 1JA, T.5, pp. 231-232, 235; 2JA, T.8, pp. 292-293; 2JA, T.9, pp. 345, 355, 362.)

2. The Online Travel Companies ("OTCs").

The OTCs are the defendants and respondents in this action. Pursuant to their contracts with hotels, the OTCs rent hotel rooms to customers by acting as the hotels' rental agents, connecting customers to the hotels and completing the bookings that customers choose to make through the OTCs' websites. (1JA, T.4, pp. 198-200.) The OTCs never

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[2] Most factual citations in this brief refer to the Court of Appeal's March 27, 2014 slip opinion ("Opn."), to the Joint Appendix ("JA") filed in the Court of Appeal, and to the Administrative Record ("AR") filed in the Court of Appeal. The citations refer to the volume number, the JA or the AR, the tab number, and sequential page numbers; for example, "1JA, T.4, pp. 202-204" refers to volume 1 of the Joint Appendix, tab 4, at pages 202 through 204.

purchase rooms; they do not pre-purchase and resell room inventory; they do not buy or obtain any right of room occupancy; and they never pay rent. Rather, they complete room bookings and share rental proceeds with the hotels, as per their agreements with the hotels. (See 1JA, T.4, pp. 199-201, 208; 2JA, T.10, p. 424 [OTCs "are not 'lessees' or 'sublessees' of hotels, (and) do not take 'title' to hotel rooms"].)

3. The Transients.

The "transients" (also referred to herein as "customers" or "hotel guests") are not parties to this action. They are the people who purchase the right to occupy hotel rooms in the City.

4. The Hotels.

The hotels are not parties to this action either. They are, however, important players since they own the hotel rooms and have the exclusive right to dictate the terms under which those rooms are to be occupied. (2JA, T.10, p. 424; 8JA, T.25, p. 1643; see Opn. 14 ["In merchant transactions, it is the hotel that sets the price for the transient's occupancy of a room"]; Opn. 15, fn. 12 ["Each hotel establishes and maintains complete control of its room rates and availability"].)

The hotels have entered into agreements with the OTCs defining their relationships. These agreements contain "rate-parity" provisions establishing a minimum amount of rent that the hotels require the OTCs to charge customers. (See discussion at pp. 13-15, *post.*) Specifically, the hotels bar the OTCs from quoting room rates that are lower than the room rates quoted on the hotels' own websites. (*Ibid.*) These provisions ensure

that the OTCs do not undercut the rental prices at which the hotels sell their rooms directly to the public.[3]

B. The Governing Ordinance.

The City's room-tax ordinance (appearing as San Diego Mun. Code, §§ 35.0101 et seq.)[4] provides in relevant part as follows:

- The purpose and intent of the ordinance is to impose tax on hotel room customers, called "Transients." (§ 35.0101, subd. (a).)
- A "Transient" is any person who exercises or is entitled to Occupancy. (§ 35.0102.)
- "Occupancy" means the use or possession of a hotel room, or the right to use or possess a hotel room. (*Ibid.*)
- "Operator" is defined as the owner or proprietor of the hotel, or the hotel's managing agent. (*Ibid.*)
- The tax is imposed as follows: "For the privilege of Occupancy" in any hotel in the City, each customer is subject to and shall pay

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[3] See, e.g., 26 AR, T.210, pp. 3427-3428 (Travelocity executive: Rate-parity contracts mean "[y]ou cannot sell a room at the sell rate for less than the hotel"; "you can't undercut the hotels on that first line as to the sell rate or the room rate"); *id.* at pp. 3427-3430 (rate-parity contracts are common with the big hotel chains, and standard as a matter of practice even with independent chains); 4AR, T.7, pp. 14241-14243 (Priceline.com executive: "the hotel doesn't want you to undercut the price that they want to make available"); 51AR, T.365, pp. 8144-8148.

[4] All further section references are to the San Diego Municipal Code, unless otherwise noted.

a tax equal to a percentage "of the Rent charged by the Operator." (§ 35.0103.)

- "Rent" means the "the total consideration charged to a Transient as shown on the guest receipt for the Occupancy of a room . . . without any deduction therefrom." (§ 35.0102.)
- The amount of the tax is determined and must be collected "at the same time as the Rent is collected from every Transient." (§ 35.0112(a).)
- If tax is not paid as required, penalties are imposed. (§ 35.0116.)[5]

C. The Hotels And The OTCs Have Primarily Used Two Compensation Models, The "Agency" Model And The "Merchant" Model, The Latter Being The Only One At Issue In This Case.

Historically, the hotels and the OTCs have employed a number of rental and compensation models. (Opn. 15-16.) The most common models are known as the "agency" and "merchant" models.[6] (Opn. 5, 15; 1JA, T.4,

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[5] While the transient is the sole person upon whom the tax is imposed (§ 35.0110, subd. (a)), if the tax is not collected from the transient, then the City may file a collection action against the hotel operator or any other "person owing [the] money to the City." (See §§ 35.0110, subd. (b); 35.0123, subd. (a) ["Any person owing money to the City under the provisions of the Article shall be liable to an action brought in the name of The City . . . for the recovery of such amount"].)

[6] The Court of Appeal's opinion mentions several other models, and the record reflects at least one more (the "opaque" model), but as the Court of Appeal recognized, the operation of the standard merchant model is at the heart of this case. (Opn. 4 ["At issue here is what the parties refer to as the 'merchant model' or 'merchant transactions.'"].)

pp. 199-201.) While this case involves only the merchant model, it is helpful to briefly examine both models.

Agency model. Under the agency model, the OTC's website quotes the rent the customer must pay to book a room. (Opn. 14-15; 1JA, T.4, p. 199.) The customer pays both the rent and the room tax directly to the hotel at check-in. (Opn. 15; 1JA, T.4, p. 199.) After the customer's stay, the hotel remits a pre-agreed percentage of the rent—e.g., 20%—to the OTC as a commission. (*Ibid.*) Although the hotel ultimately retains less than the full amount of rent that the customer has paid, room tax is calculated based on the *full* rent charged to and paid by the customer. What the hotel ultimately receives as its contractually-dictated share of the rental proceeds does not enter into the tax calculation. (See 1JA, T.4, p. 199; 2AR, T.4, p. 13812:13-18; 36AR, T.240, pp. 5617:2-5618:2.)

Merchant model. Under the merchant model, the OTC's website quotes the rent that a customer must pay to book a room. (1JA, T.4, p. 199.) Pursuant to the rate parity provisions in the OTC-hotel contracts, that quoted rent can never be less than the rent the hotel is currently quoting to customers renting rooms directly from the hotel (i.e., on the hotel's own website). (See pp. 13-15, *ante*; see also 26AR, T.210, pp. 3427-3430; 17AR, T.64, p. 1016.)[7] To procure a room, the customer pays the room rate

[7] While each OTC has its own separate "merchant model" agreement with the hotel operators, all of the OTCs' merchant models operate substantially identically, virtually all providing that the hotels set the minimum rent that must be paid by the customer. (See pp. 13-15, *ante*.)

quoted on the OTC's website, plus an undifferentiated amount referred to as "taxes and fees." (E.g., 1JA, T.4, p. 200; Opn. 4, 16; 2JA, T.10, p. 413; 41AR, T.310, pp. 6370-6374.) Once the customer makes this payment, he gains the right to occupy the room. (1JA, T.4, pp. 200, 205, fn. 5.)

After collecting the rent and taxes, the OTC remits a pre-arranged portion of the rental proceeds to the hotel, plus the taxes collected, while retaining the remainder (plus whatever additional fees the OTC has charged) as the OTC's compensation. (*Id.* at pp. 199-201.)

Although the agency and merchant models involve the same players and the same rental payment, the OTCs insist the tax result should be different. They maintain that although taxes under the agency model are calculated based on the rent charged to and paid by the customer to obtain an occupancy privilege, the merchant model results in a lower tax base, one calculated based on *the portion* of the customer's room rate that the hotels receive as their share of the rental proceeds.[8]

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[8] The Court of Appeal compared the agency-model and merchant-model transactions by using hypothetical examples involving a $100 customer-facing room rate and a 15% room-tax rate. (Opn. 15-16.) Under the agency model, room tax is paid on the $100 rent the customer pays for occupancy. (*Ibid.*) But under the merchant model, room tax is instead paid only on the $80 the hotel retains after the OTC has taken its cut. (Opn. 16.) Thus, even though the customer pays the same $100 room rate and the hotel retains the same $80 amount under both models, the City receives $15 in room tax under the agency model, but only $12 under the merchant model. (Opn. 15-16.)

D. The Three Transactional Steps Of The Merchant Model.

The merchant model involves three transactional steps. Only the second of those transaction steps involves the customer actually paying rent in exchange for the privilege of occupancy.

1. Transactional step no. 1: The agreements between the hotels and the OTCs.

The first transactional step occurs when the hotels and OTCs enter into the master agreements that define their working relationships. While the precise terms of these contracts are not the same, virtually all of them have similar features. They provide that: (1) the hotels set the minimum rent that must be charged by the OTCs and paid by the customer in order to obtain the privilege of occupancy, (2) the OTCs act on behalf of the hotels in the room-rental transactions, including by collecting rent from customers, (3) the OTCs collect the room taxes due on these bookings, and (4) the rental revenue received by the OTCs will be divvied up between the OTCs and the hotels in accordance with a pre-arranged formula stated in the hotel-OTC agreements. The common agreement terms are as follows:

a. *Rate-parity provisions establishing the minimum room rate that the OTCs must charge their customers.*

As owners, the hotels have the right to dictate the amount of rent that a customer will be charged to let a room. The hotels exercise this right by setting the minimum rent in the rate-parity provisions that appear in almost all of the hotel-OTC contracts.[9] While the wording can vary from contract

[9] The record includes 63 standard merchant-model contracts between the hotels and the OTCs. Fifty-nine of those contracts (i.e., 93.6% of them)

to contract, these provisions all dictate in substance that an OTC cannot sell any room for rent that is less than what the hotel quotes to its customers directly.[10]

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contain rate-parity terms. (See, e.g., 16AR, T.57, pp. 904-905; 16AR, T.58, p. 937; 16AR, T.60, pp. 963, 961-962; 17AR, T.62, pp. 988, 982, 985-986; 17AR, T.64, pp. 1015-1016; 17AR, T.65, p. 1025; 17AR, T.66, pp. 1040-1041; 17AR, T.67, pp. 1049, 1097-1098; 17 AR, T.68, pp. 1117-1118; 17AR, T.70, p. 1145; 17AR, T.71, pp. 1162, 1164-1165; 17AR, T.72, p. 1182; 17AR, T.74, pp. 1015-1016; 18AR, T.79, pp. 1286, 1303; 18AR, T.83, p. 1343; 18AR, T.85, pp. 1371-1372; 18AR, T.86, p. 1382; 18AR, T.87, pp. 1394, 1419; 18AR, T.88, pp. 1429-1430; 19AR, T.92, pp. 1517, 1519; 19AR, T.93, pp. 1542-1543; 19AR, T.94, pp. 1560, 1568; 19AR, T.95, pp. 1577, 1603; 19AR, T.96, p. 1622; 19AR, T.97, at p. 1661; 19AR, T.98, p. 1678; 19AR, T.99, p. 1690; 19AR, T.100, pp. 1698, 1700, 1702; 19AR, T.101, pp. 1708, 1710; 20AR, T.102, pp. 1735, 1738; 20AR, T.103, p. 1764; 20AR, T.105, p. 1784; 20AR, T.106, p. 1794; 20AR, T.106, p. 1812; 20AR, T.107, pp. 1822, 1825; 20AR, T.108, pp. 1838, 1835, 1837, 1845; 38AR, T.264, pp. 12053, 12056; 39AR, T.284, p. 12241; 40AR, T.289, p. 6193; 40AR, T.292, p. 6260; 40AR, T.293, pp. 6273, 6277, 6284; 40AR, T.294, pp. 6289, 6292; 40AR, T.295, pp. 6298, 6301; 41AR, T.312, p. 6469; 41AR, T.313, p. 6476; 41AR, T.314, p. 6487; 41AR, T.315, pp. 6496, 6499; 41AR, T.316, pp. 6506, 6509; 41AR, T.317, p. 6520; 41AR, T.319, pp. 6549-6550; 41AR, T.320, p. 6556; 41AR, T.321, pp. 6569, 6573; 42AR, T.322, p. 6577; 42AR, T.323, p. 6586; 42AR, T.325, p. 6609; 42AR, T.326, p. 6620; 42AR, T.327, pp. 6632, 6636; 42AR, T.328, pp. 6646, 6650; 43AR, T.349, p. 6916.) Only four contracts do not contain rate-parity terms; and these contracts nonetheless do not prevent the hotels from undercutting whatever rates the OTCs quote to customers (thus effectively driving the price of the room to whatever the hotel is charging customers directly). (See 16AR, T.52, pp. 862-868; 16AR, T.55, pp. 894-899; 17AR, T.69, pp. 1139-1140, 1130; 18AR, T.80, pp. 1321-1322.)

[10] OTCs' Answer To Petition For Review 16 (hotel-OTC agreements set a "floor" below which OTCs cannot quote room rates to customers); *Expedia, Inc. v. City of Columbus* (Ga. 2009) 681 S.E.2d 122, 124, fn. 1 ("In most of its contracts with hotels, however, there is 'rate parity' language which prohibits Expedia from charging a room rate that is less than the rate the hotel would charge the consumer directly for occupancy of