Case No. 218400

IN THE SUPREME COURT OF CALIFORNIA

In re TRANSIENT OCCUPANCY TAX CASES

CITY OF SAN DIEGO, CALIFORNIA,
Petitioner,

v.

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

After an Opinion by the Court of Appeal, Second Appellate District, Division Two, Case No. B243800

On Appeal from the Superior Court for the County of Los Angeles
The Hon. Elihu M. Berle, Judge of the Superior Court, Department 323
Los Angeles County Superior Court Case No. JCCP 4472

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

CASES **PAGE(S)**

STATUTES

CONSTITUTIONS

RULES

ORDINANCES

MISCELLANIOUS

INTRODUCTION

In affirming judgment, the Court of Appeal properly rejected Petitioner City of San Diego's ("San Diego" or "City") attempt to go outside the bounds of its tax ordinance to impose Transient Occupancy Tax ("TOT") liability on the Respondent Online Travel Companies ("OTCs"). This Court should do the same.[1]

As this Court has made clear, a taxing authority may not impose tax obligations and liability beyond a tax statute's express terms, and any ambiguity in a tax statute must be construed strongly against the taxing authority and in favor of the citizen. These fundamental rules are essential because a government's exercise of its taxing power imposes burdens on citizens, takes their property, and has great potential for abuse. These same considerations led California's voters to enact Proposition 218, which amended the California Constitution to further ensure that general taxes – specifically including "hotel" occupancy taxes – cannot be broadened without voter approval. (Cal. Const., art. XIII C, § 2.) These rules doom San Diego's case.

This appeal turns on the express terms of San Diego's TOT Ordinance ("Ordinance"), which imposes tax on "the privilege of Occupancy." The Ordinance focuses entirely on "Occupancy" and the two parties to its transfer – the "Transient" who obtains Occupancy of the room, and the hotel "Operator" who provides it. The Ordinance imposes TOT obligations and liability only on those two persons, and taxes only the

[1] Respondent OTCs are Hotels.com, L.P., priceline.com Incorporated (n/k/a The Priceline Group Inc.), Travelweb LLC, Expedia, Inc., Hotwire, Inc., Hotels.com G.P., LLC, Travelocity.com, LP, Site59.com, LLC, Orbitz, LLC, Trip Network, Inc. (d/b/a/ Cheaptickets.com), and Internetwork Publishing Corp. (d/b/a/ Lodging.com).

"Rent" – the amount for the Transient's "Occupancy" – "charged *by the Operator*."[2]

These express terms are dispositive. The City has conceded the OTCs are neither Transients nor Operators. Rather, the OTCs are intermediaries between travelers and airlines, hotels and rental car companies. The OTCs do not operate airlines, hotels, or rental car companies; instead, they operate websites on which they provide comparative information about such travel providers, and help customers request and pay for reservations from those providers. Because they are neither Transients nor Operators, the OTCs have no tax obligations or liability under the Ordinance.

Until this case, San Diego asserted TOT obligations and liability against only hotel Operators on the amount they charge for Occupancy, and not OTCs or other travel intermediaries on any additional amounts they charge a customer for their own services. However, in 2006, the City filed a complaint, and then audited and assessed the OTCs, alleging that, in addition to the actual hotel Operators, each OTC also is the "Operator" of every hotel in the City from which any of its customers obtain room reservations, and that the additional amounts the OTC charges a customer for its services also are taxable "Rent charged by the Operator."

The Superior Court granted the OTCs' petitions for a writ of mandamus and set aside the assessments. The court ruled (i) the OTCs are not Transients or Operators, and therefore have no TOT obligations or liability; and (ii) the OTCs' added charges to customers for their services

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[2] The Ordinance is codified at Chapter 3, Article 5 of the San Diego Municipal Code: §§ 35.0101-35.0138. All emphasis in quotations is added, and internal citations omitted, unless otherwise indicated.

are not taxable "Rent charged by the Operator."

San Diego reversed course on appeal, conceding the OTCs are *not* hotel "Operators" under the Ordinance, and that *the hotel* is the Operator in an OTC "merchant model" transaction.[3] As the Court of Appeal recognized, the City's concession is fatal to its case. Because the OTCs are neither Transients nor hotel Operators, there simply is no basis for imposing TOT liability on the OTCs. Therefore, the court correctly affirmed judgment for the OTCs.

Judgment also was correctly affirmed because, unlike the amount "charged by the Operator" for the Transient's "Occupancy," the additional amounts an OTC charges a customer for its services are not taxable "Rent charged by the Operator."

Before this Court, the City again has conceded:

- The Ordinance's express terms impose obligations and liability only on "Transients" and "Operators";
- The OTCs are neither "Transients" nor "Operators";
- Only the Hotel is the "Operator" in an OTC merchant model transaction;
- The only amount subject to tax is "the rent charged by the hotel for transferring the privilege of Occupancy" to the Transient (Op. Br. 2).

One need go no further. These concessions compel affirmance.

Having conceded the dispositive issues, the rest of the City's

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[3] While the OTCs use several different business models, the only one at issue is the "merchant model." In "merchant model" transactions, "[t]he OTCs handle all financial transaction related to the hotel reservations, and become the merchant of record." (*TOT Cases* (2014) 225 Cal.App.4th 56, 61 (hereafter *TOT Cases*).)

Opening Brief is an attempt to end-run the Ordinance's express limiting terms. The City primarily argues that the Ordinance must be construed to effectuate an implied intent to impose tax on the total amount charged to a Transient in a reservation transaction, regardless of by whom or for what. But this supposed *implied* intent directly conflicts with the intent evidenced by the Ordinance's *express* terms, which impose tax only on the amount "charged *by the Operator*" to the Transient for "Occupancy" of a room, and not amounts charged to a Transient by *anyone else* for *anything else*. None of the provisions the City cites purports to alter that express limitation, repeated six times in the Ordinance.

San Diego then contends the additional amounts the OTC charges a customer for its services should be treated *as if* they are "Rent charged by the Operator." But again, doing so is contrary to the Ordinance's express terms.

First, San Diego asserts that under the OTCs' contracts with hotels, the hotel "dictate[s]" the entire amount charged in the room reservation transaction, and, therefore, the additional amounts the OTC charges a customer for its services are also taxable "Rent charged by the Operator." But that assertion is directly contrary to the very contractual provisions the City cites, as well as the hearing officer's factual findings, which make clear the OTC, not the hotel, "sets," charges, and receives those additional amounts, and does so on its own behalf. Those amounts therefore are not "charged by the Operator."

Second, San Diego asserts that the additional amounts the OTC charges for its services are attributable to the hotel, and, thus, are taxable "Rent charged by the Operator," because the OTC functions as the hotel's agent. But the hearing officer found, and the City concedes, at most, an

OTC does so only to collect the rent the hotel is charging for Occupancy, along with tax on that rent, and remit those amounts to the hotel. Thus, only those amounts can be attributed to the hotel Operator, not the additional amounts the OTC charges a customer on its own behalf.

San Diego is left repeatedly asserting that the additional amounts the OTC charges for its services "should" be subject to tax. But, again, a taxing authority may not impose tax obligations and liability beyond a statute's express terms. If the City desires to impose TOT obligations and liability on persons *other than* hotel Operators, or impose tax on amounts *not* "charged by the Operator," it must convince its electorate to enact amendments that explicitly do so. Under Proposition 218, it is the voters' province to weigh the economic and policy interests implicated by so broadening the TOT. If San Diego could instead expand its tax by administrative fiat, then taxing authorities statewide could do so with every tax statute, and against every taxpayer, business or individual.

Judgment for the OTCs should be affirmed.

SAN DIEGO'S TRANSIENT OCCUPANCY TAX ORDINANCE

There can be no dispute about San Diego's "Transient Occupancy Tax" Ordinance's express terms. Its "purpose" is to "impose[] a tax on Transients." (§ 35.0101(a).) As its title reveals, it achieves this purpose by imposing a tax on "Occupancy."

"Occupancy" is defined as "the *use or possession*, or the right to the use or possession, *of any room … in any Hotel* …." (§ 35.0102.) A "Hotel" is "any *structure* … occupied, or intended or *designed for Occupancy, by Transients* for dwelling, lodging, or sleeping purposes, and is held out as such to the public." *Ibid.* Thus, "[f]or the privilege of *Occupancy* in any *Hotel* located in The City of San Diego, each *Transient*

is subject to and shall pay a tax in the amount of six percent (6%) of the *Rent charged by the Operator*." (§ 35.0103.)

The Ordinance therefore focuses exclusively on the two parties to the exercise of that privilege – the "*Transient*" who obtains occupancy of the hotel room, and the hotel "*Operator*" who provides it. The City asserts the Ordinance is "laser-focused" on the "Transient" (Op. Br. 3), but the Ordinance refers to the hotel "Operator" *eighty-five* times.

A "Transient" is "any Person who *exercises Occupancy*, or is *entitled to Occupancy*, by reason of concession, permit, right of access, license, or other agreement for a period of less than one (1) month." (§ 35.0102.) An "Operator" is the one who owns or possesses and runs a Hotel that provides "Occupancy" of rooms to Transients:

> the Person who is the *proprietor* of the *Hotel*, ... whether in the capacity of owner, lessee, sublessee, mortgagee in possession, licensee, or any other capacity. "Operator" includes a *managing agent* ... of any type or character, other than an employee without management responsibility.

Ibid.

The Ordinance provisions stating the amount subject to tax further reflect its exclusive focus on "Occupancy" and the two parties to its transfer – the "Transient" and hotel "Operator." Tax is imposed only on "the *Rent charged by the Operator*." (§ 35.0103.)

The City Council amended the Ordinance four times to increase the tax, and each time reaffirmed that tax is imposed only on "the Rent charged by the Operator." (§§ 35.0104, 35.0105, 35.0106, 35.0108; see § 35.0107.)

"Rent" is defined as:

> the total consideration *charged to a Transient* as shown on the guest receipt *for the Occupancy of a room*, ..., in a Hotel. ... "Rent" *includes charges for* utility and sewer hookups, equipment ..., and *in-room services* .... "Rent"

> includes all receipts, cash, credits, property, and services of any kind or nature without any deduction therefrom.

(§ 35.0102.)

The Ordinance imposes tax obligations and liability only on the "Transient" and "Operator." The tax is a "debt owed by each Transient" (§ 35.0110(a)); the "Transient shall pay [the] tax imposed ... to the Operator of the Hotel" (§ 35.0110(b)); and (iii) if the Transient does not do so, the City "may require that the tax be paid directly to the City Treasurer" (§ 35.0110(e)).

All remaining obligations and liability are imposed *solely* on the hotel "Operator." Each "Operator" "shall collect" and "remit" the tax, or cause the tax to be collected and remitted. (§§ 35.0112, .0114(a), .0124(a), (b).) Each "Operator" "renting occupancy to transients" must "register" with the City, obtain a "Transient Occupancy Registration Certificate," and post it "on the [Hotel] premises." (§ 35.0113(a).) The "Operator" must (i) "maintain its financial and accounting records"; (ii) "account separately for ... taxable and nontaxable Rents and for taxes collected"; (iii) account for "[t]he costs of additional goods and services, which are not Rent" (§ 35.0112(f)-(h)); and (iv) use the same basis for accounting for "keeping books and records" that it uses for "reporting and remitting" (§ 35.0114(i)).

The Ordinance's administrative enforcement provisions also focus *solely* on the hotel "Operator." The Operator must "keep and preserve" all "business records as may be necessary to determine the amount of tax for which the *[O]perator* is liable for collection and payment to the City." (§ 35.0121.) The City Treasurer may "inspect" the "Operator's" "business records" and "apply auditing procedures necessary to determine the amount of tax due to the City." (*Ibid.*) If an "[O]perator" "fail[s] or refuse[s] to

collect" or "remit" the tax, the Treasurer "shall ... *assess* the tax and penalties ... *against the [O]perator.*" (§ 35.0117(a), (c).) An "Operator" may request a hearing to challenge the assessment, and must be given notice of the final "determination and the amount of such tax and penalties" imposed. (§ 35.0118(a)-(e).)

STATEMENT OF THE CASE

A. The San Diego Action Is Part Of A Coordinated Proceeding.

In December 2004, the City of Los Angeles filed an action in Los Angeles Superior Court alleging that, under its TOT ordinance, each OTC is the "Operator" of every hotel from which any of its customers obtains a reservation using the "merchant model," and as the Operator, is liable for TOT on the added amounts it charges a customer. (2JA10:407.) Los Angeles alleged the same claims on behalf of a purported class of all California cities with a TOT ordinance imposing tax liability on hotel "operators," and tax on the "rent charged by the operator." (*Ibid.*)

San Diego, a putative class member represented by the same outside counsel, then filed its own complaint, also alleging that, under its substantively identical ordinance, the OTCs are hotel "Operators" liable for TOT and their additional charges are taxable "rent charged by the Operator." (2JA10:407.) Because the two cases share common questions of fact and law, they were coordinated through the Judicial Council and assigned to the Hon. Carolyn B. Kuhl in Los Angeles Superior Court. (*Ibid.*) The court sustained the OTCs' demurrers, ruling both cities must exhaust administrative procedures under their ordinances. (*Ibid.*)

B. The Anaheim Action: The Court Of Appeal Affirmed Judgment For The OTCs.

Following dismissal, the same outside counsel that represents San

Diego and Los Angeles decided to use a different putative class member, the City of Anaheim, as the "test case" for their theory that the OTCs could be held liable for TOT as hotel "Operators." (2JA10:407.) Thus, Anaheim was the first city to audit and assess the OTCs as purported "Operators" under its substantively identical TOT ordinance. (*In re Transient Occupancy Tax ("TOT") Cases* (Anaheim), Case No. B230457 (Nov. 1. 2012) (hereafter *Anaheim* Opn.) at p. 4 (unpub.).)

A hearing officer selected by Anaheim upheld the assessments. The OTCs petitioned for writs of administrative mandamus. (*Anaheim* Opn. at p. 4.) Those actions were added-on to this coordinated proceeding, and transferred to Judge Kuhl. (*Ibid.*)

Judge Kuhl, accepting the hearing officer's findings of fact, granted the OTCs' petition and set aside the assessments, ruling (i) the OTCs are not hotel "operators"; and (ii) the added amounts charged and retained by the OTCs for their services are not taxable rent "charged by the operator." (*Anaheim* Opn. at pp. 5-6.)

The Court of Appeal affirmed on both grounds: "Under the plain meaning of the ordinance, the *OTCs cannot be considered to be operators* of the hotels for which they provide room reservations .... Therefore the *service fees and markups* that they charge to transients are *not 'charged by an operator.'*" (*Anaheim* Opn. at p. 10.) On January 23, 2013, this Court denied Anaheim's petition for review.[4]

C. The San Diego Administrative Action.

In the meantime, San Diego audited and assessed the OTCs, again

[4] The same Court of Appeal panel affirmed judgment against the City of Santa Monica, which sought to impose TOT liability on OTCs under its ordinance. (*TOT Cases* (Santa Monica), Case No. B236166 (Nov. 1, 2012).) This Court denied Santa Monica's petition for review on January 23, 2013.

asserting that each OTC is a hotel "Operator," and that an OTC's additional amounts are taxable "Rent charged by the Operator." (2JA10:412; 10AR, T.39, p. 236.) A hearing officer selected by San Diego upheld assessments totaling more than $21 million.

The hearing officer made the following findings of fact: The OTCs use "the internet to advertise hotels and complete transactions between customers and hotels for reserving rooms." (1JA4:198.) The OTCs "contract with hotels" for the right to advertise room reservations, and "handle all financial transactions related to the hotels reservations, and ... become the 'merchant of record.'" (1JA4:199.) The hotel sets and charges a "wholesale price" for the room; and the OTC sets the "mark-up" or "margin" that is added to that price before the customer is charged for the room, as well as an additional fee "for the services rendered by the OTCs to their customers." (1JA4:199, 200.) After the customer "appear[s] at the hotel[] and check[s] in," the hotel "send[s] the OTC[] a bill for (1) the wholesale price[] of the room[], and (2) the actual TOT required to be paid by the hotels for those rooms based on the wholesale price charged to the OTCs." (1JA4:201.) The OTC then forwards the billed amount to the hotel, which remits the TOT to the City. (*Ibid.*)

Despite factual findings that make clear the OTCs do not possess or control the premises of any hotel, the hearing officer concluded (a) each OTC is somehow the "Operator" of every hotel from which any customers book any reservations using the OTC's merchant model; and (b) the additional amounts the OTC charges for its services are taxable "rent charged by the operator." (1JA4:208-10, 217.)

D. <u>The Superior Court Set Aside San Diego's Assessments</u>.

The OTCs petitioned for writs of administrative mandamus.

(6JA19:1201.) San Diego, in its pleadings and briefing to the Superior Court, continued to assert that the OTCs are hotel "operators," and that the OTCs' additional amounts are "Rent charged by the Operator." (2JA9:372, 381.) The Superior Court, the Hon. Elihu M. Berle now presiding, granted the OTCs' petitions, denied San Diego's cross-petitions, and issued a writ vacating the hearing officer's decision and setting aside the assessments. (8JA26:1702.)

The court explained that the Ordinance's express terms impose tax liability and obligations only on "Transients" and hotel "Operators," and tax only "the '*rent charged by the operator*' to the Transient for the privilege of occupancy 'in any hotel'" – a limitation "repeated six times." (6JA19:1199, 1210.) "Operator" is limited to the "proprietor" or "managing agent" of a hotel. (6JA19:1210.) By their plain meaning, "operator" and "proprietor" "have in common the concept of a person or entity that controls and runs ... a hotel." (6JA19:1213, citing dictionaries.) The court, based on the hearing officer's "findings of fact," determined the OTCs do not have "the right to run the business of the hotel," and, thus, are not hotel "proprietors." (6JA19:1199-220.)[5]

The court held that "managing agent" refers only to the "type of agency relationship" where the agent has the "discretion" to make "decisions that will ultimately determine corporate policy." (6JA19:1218-220, citing cases.) The OTCs are not "managing agents," as none has "the right to manage any hotel or to exercise operational authority over a hotel, much less set corporate policy for any hotel." (6JA19:1220.) "Instead,

[5] The OTCs did not challenge, and the Superior Court accepted, the hearing officer's factual findings, but not any conclusions of law mislabeled as factual findings. (6JA19:1203.)

they run their own websites and perform online sales functions for the hotels, which is a very limited function far away from corporate policy decision making." (6JA19:1221.)

Finally, the court concluded the additional amounts the OTC charges for its services are not subject to tax:

> The phrase "*charged by the operator*" ... *limits the tax base* to those amounts that are charged by the operator for the privilege of occupancy. Since ... the *OTCs are not operators of the hotels*, the amount that the OTCs charge for their reservation services [is] *not part of the rent.*

(6JA19:1222.)

E. The San Diego Appeal: The Court Of Appeal Affirmed Judgment For The OTCs.

As one of the coordinated cases, San Diego's appeal was assigned to the same panel as *Anaheim*. Although the City sued the OTCs as alleged "Operators," audited and assessed them as "Operators," and then defended those assessments on that basis before the hearing officer and Superior Court, the City reversed course on appeal. The City finally conceded the OTCs are not hotel "Operators," but asserted the OTCs "need not be" Operators to be liable under the Ordinance. (App. Br. 39.)

Instead, the City argued the OTCs should be held liable for TOT on the entire amount charged to a customer in a reservation transaction because the OTC sets the additional amounts it charges for its services, and directly charges the customer's credit card. (App. Br. 40.) The Court of Appeal rejected the City's attempt to impose TOT obligations and liability contrary to the Ordinance's express terms.

The court explained that San Diego's Ordinance, "[l]ike the Anaheim ordinance," imposes tax only on "the rent charged by the hotel operator," and "makes ... clear that the tax obligations are imposed only on

transients and hotel operators." (*TOT Cases*, *supra*, 225 Cal.App.4th at p. 64.) The Ordinance simply includes no provision "imposing any tax liability on any entity other than the hotel operator or the transient." (*Ibid.*) Presented with the same facts, the court reaffirmed and adopted the "logic" of its *Anaheim* decision, and held, "under the plain meaning" of the Ordinance's express terms, the "OTCs cannot be considered to be operators – proprietors or managing agents – of the hotels for which they provide rooms reservations." (*Id.* at p. 65.)

Adhering to the Ordinance's "Rent charged by the Operator" limitation, the court also held: "[T]he words of the ordinance do not reveal an intent to impose a tax on the service fees and markups charged by the OTCs." (*TOT Cases*, *supra*, 225 Cal.App.4th at pp. 63-64.) A court cannot "enlarge the scope of the tax to embrace matters not included in the specific language of the statute," and thus "the OTCs' service[] charges and markups are not within the scope of the City's ordinance." (*Id.* at p. 65.)

Therefore, the court concluded the City's concessions "that OTCs are not transients, and that OTCs are not hotel operators" were fatal to its case; in light of them, "there is simply no basis for imposition of TOT liability on the OTC[s]." (*TOT Cases*, *supra*, 225 Cal.App.4th at pp. 72-73.)[6]

STATEMENT OF FACTS

The facts, as found by the hearing officer, and summarized by the Court of Appeal, are not in dispute:

The OTCs "publish comparative information about airlines, hotels,

[6] During San Diego's appeal, Judge Berle issued judgments for the OTCs in two other actions in this coordinated proceeding, rejecting San Francisco and Los Angeles' attempts to impose TOT liability on the OTCs. (Resp. Br. 1.) Appeals in those cases are stayed pending this Court's decision here.