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 REPLY BRIEF ON THE MERITS

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INTRODUCTION

This case presents a straightforward question and an equally straightforward answer.

The Question: Is the tax base for calculating room tax the amount that a customer is charged and must pay to rent a hotel room—i.e., his room rate? Or is the tax base some lesser amount that the customer knows nothing about, an amount based only on the portion of the customer's room rate that the hotel ultimately receives after the OTCs have taken their cut?

The Answer: The tax base is the room rate charged to and paid by the customer to gain the privilege of occupancy. Nothing less.

This is the only answer consistent with the manifest purpose and plain language of the room-tax ordinance, as well as with common sense. Historically, the rate that the customer must pay to rent a room has been the tax base, regardless of whether the transaction was completed by a hotel or by a third-party sales agent. There is no reason why the introduction of new technology (Internet room bookings) or the use of a different booking model (the "merchant model") should change anything. New technology cannot alter what the law demands.

The OTCs offer no explanation why customers, the only taxpayers, would expect to pay room taxes based on something less than the quoted room rates. Nor do the OTCs explain why a city would ever choose to tax amounts that are less than the room rates that the customers actually pay.

Instead of addressing these common sense issues, the OTCs use semantic games to argue they may calculate taxes based on only the share of the rental proceeds that the hotels have agreed to receive after the OTCs have taken their cut. These games don't work. The ordinance plainly imposes tax on what the taxpaying customer is charged and must pay to obtain a room. How that rent is split between the hotels and third-party sales agents like the OTCs is immaterial under the ordinace.

For years, the OTCs have underpaid millions of dollars in taxes, depriving the City and its residents of funds needed for important public services. It is time for the OTCs to remit what they owe.

ARGUMENT

I. UNDER THE PLAIN TERMS OF THE ORDINANCE, THE TAX BASE IS THE ROOM RATE THAT THE CUSTOMER IS QUOTED, IS CHARGED AND MUST PAY TO RENT A ROOM, *NOT* SOME HIDDEN, LESSER AMOUNT THAT THE HOTEL RETAINS AFTER SPLITTING RENTAL REVENUE WITH THE OTCS.

A. The Plain Terms And Clear Intent Of The Room-Tax Ordinance Are To Levy A Tax On The Room Rate The Customer Is Charged And Must Pay To Get His Room.

When a customer reads on an OTC's website that he must pay a $100 "room rate" to book a room, and the customer's guest receipt recites that he has been charged $100 for his room, then that $100 is the taxable "rent." (Opening Brief ["OB"] 29-46.) Indeed, the room-tax ordinance states that the tax is based on the amount of rent a customer is charged by the operator to obtain the privilege of occupancy, as that amount is shown on a guest receipt. (§§35.0102, 35.0103.) And the ordinance states that the tax must be levied at the time the customer books his room and pays his rent. (§ 35.0112, subd. (a).)[1] Thus, the tax base is the amount the customer is quoted, is charged, and must pay for his room, not some lesser amount.

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[1] The OTCs claim the City "rewr[o]te the definition of Rent by ellipsis" when it quoted the ordinance provisions defining "Rent" as the "*total* consideration charged to a Transient as shown on the guest receipt for the Occupancy of a room . . . without any deduction therefrom." (Answering

The OTCs argue that the City relies on "a supposed implied intent" of the ordinance. (AB21-22.) But there is nothing "implied" about what the ordinance plainly declares.

On its face, the ordinance taxes what the customer is charged and must pay for his room. That's why the opening brief correctly describes the tax base as the amount of rent the taxpaying customer is charged for his room, viewed from his perspective, and as reflected on his guest receipt. (OB29-31.) That's why the opening brief correctly explains that the "taxable moment" occurs at the second step of the merchant-model transaction, when the customer pays the quoted room rate and obtains a right of occupancy—and not at the third step of the transaction, when the hotel and OTC divvy up that rental payment, or even at the first step, when the hotel and OTC enter into an agreement. (OB36-37.) And that's why the opening brief correctly notes that the tax is imposed on what the customer is *charged* for occupancy, not on what the hotel *receives* at the end of the day. (OB38-40.)

It is undisputed that under every other room-rental model (i.e., the agency model), the room rate is the tax base, without regard to what portion of that amount the hotel ultimately keeps after sharing rental proceeds with third-party sales agents. (See OB11-12.) There is no possible justification

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Brief ["AB"] AB23-24.) The City stands by its appropriate use of ellipses to eliminate words that are immaterial to the issues presented.

for treating merchant-model transactions any differently, nor have the OTCs proffered any tenable justification for doing so.

B. The City Seeks To Tax Only The *Room Rate*. The City Does Not Seek To Tax The *Service Fees* That The OTCs Independently Charge Customers On Top Of That Room Rate As A Separate Line Item.

Just to be clear: The City did not assert in its opening brief any entitlement to taxes on the OTCs "service fees," nor does it do so now.

When a customer visits an OTC website to rent a hotel room, he sees two line items: a "room rate" line item and a "taxes and fees" line item. (OB11-12.) As the City explained in its opening brief, the ordinance levies a tax on the former, i.e., the "room rate." (OB30, 31, 36, 37, 43.) The City has not urged that the ordinance entitles it to taxes on the "service fees" that the OTCs separately charge customers who use the OTCs' websites or call centers.[2]

This distinction is important because the OTCs attempt to conflate the two line items. They fault the City for trying to tax "[t]he amount an OTC charges a customer for its services." (AB19; *id.* at pp. 4, 5, 23, 25.) They argue that such service fees are not taxable because they are not

[2] Below, the City sought taxes based on both the room rate and the service fees. The City argued that, at the very least, the room rate was taxable. In these proceedings before this Court, the City argues only that the room rate charged to and paid by the customer is taxable. The City no longer seeks to impose a tax on the OTCs' service fees.

charged by the operator (the hotel). (E.g., AB 23 ["'[t]he OTC service charges are *not* charged by the Operator'"].)

But saying the City seeks to tax the OTCs' service fees does not make it so, no matter how often the OTCs repeat it. In these proceedings, the City does *not* claim that the OTCs' service fees are taxable. Indeed, the OTCs do not act as the hotel's agents for purposes of collecting the OTCs' service fees. Nor are those fees governed by the rate-parity agreements, pursuant to which the hotels dictate the room rates quoted to customers.

But the opposite is true for the room rate. While the hotels do not "charge" the service fees, there is no question that the hotels do "charge" the room rate. The law of agency compels this conclusion, as do the rate-parity agreements between the hotels and OTCs, as we now explain.

C. The Hotels "Charge" The "Room Rate" Quoted On The OTCs' Websites And That The Customer Must Pay To Obtain A Privilege Of Occupancy.

1. Because the OTCs act as the hotels' agents for purposes of charging the room rate, it is the hotels themselves who are charging the room rate—thus establishing that the tax base is the room rate, not just some portion of it.

The first reason why it is *the hotels* that are charging the room rate quoted to customers on OTC websites is that the OTCs act as the hotels' agents for purposes of charging and collecting rent, and under long-

established agency law, the acts of an agent are legally equivalent to the acts of the principal. (OB33-35.)

The OTCs concede that the acts of an agent in the scope of his agency are tantamount to and must be treated as the acts of the principal. (See AB30, citing *Columbia Pictures Corp. v. DeToth* (1948) 87 Cal.App.2d 620; see also *Atkinson v. Foote* (1919) 44 Cal.App. 149, 165 [same]; see also OB34-35.)

This rule governs the result here. Both the hearing officer's factual findings and the law governing the creation of agency relationships, independently compel that when the OTCs charge customers for rooms, it is the same thing as the hotels charging those amounts for rooms.

a. The hearing officer's undisputed factual finding that the OTCs act as the hotels' agents for purposes of charging customers the "room price," dictates that the room rate that the OTCs collect is taxable "rent."

The hearing officer made an unchallenged factual finding that the OTCs act as the hotels' agents for purposes of "assuming essentially (or absolutely) all of the marketing, reservation, room price collection, tax collection, and customer service functions as to those Transients who book online through the OTCs. . . . All dealings are with and through the OTCs as the authorized agents of the hotels." (1JA207; OB24-25 & fn. 17.)

Since the OTCs concede this finding is binding (AB4-5) and that the OTCs are the hotels' "agent[s] for the limited purpose of collecting the

amount charged by the hotel for providing Occupancy of a room, plus the tax the hotel will owe on that amount" (AB30), this should end the inquiry. As agents for the hotels in charging room rates, the OTCs' acts are equivalent to the hotels' own acts. In the ordinance's terms, that room rate is the "Rent" the "Operator" (the hotel) charges "for the Occupancy of a room." (See §§35.0102-35.0108.)[3]

b. Even if there wasn't an undisputed agency finding in this case, the OTCs would still be the hotels' agents as a matter of law for purposes of charging rent.

In addition, governing law establishes that when someone collects funds for someone else, he becomes an agent, such that his act of collecting funds is tantamount to the principal's own act. (See *Scholastic Book Clubs, Inc. v. State Bd. of Equalization* (1989) 207 Cal.App.3d 734, 739-740 [involving use tax which, like hotel bed tax, is legally incident on buyers but collected by vendors or their agents]; OB34-35.) Thus, even if there

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[3] In a bizarre argument accompanied by a Request for Judicial Notice, the OTCs claim the City should be bound by an argument made by its counsel while representing a different client in a different proceeding involving the application of the laws of Hawaii. (AB27.) The City is not a party to the Hawaii proceeding, its ordinance was not subject to interpretation in that proceeding, and its lawyers speak for the City only in *this* proceeding. Regardless, there is no inconsistency between the Hawaii statement that the hotels have delegated room-charging responsibilities to the OTCs and the City's position here that the OTCs are the hotels' agents and, thus, that the OTCs' actions within the scope of that agency are tantamount to the hotels' acts. (See RJN, Ex. 1, pp. 5-6.)

were not an undisputed finding that the OTCs act as the hotels' agents for purposes of collecting the room price, the OTCs would be the hotels' agents for that purpose as a matter of law.

The OTCs' response to *Scholastic* is that the court there "answered only whether 'use of California's teachers and school librarians to solicit sales from California students constitutes a sufficient nexus for the imposition of . . . use taxes.'" (AB32.) This is immaterial. *Scholastic*'s holding depended on the court's determination that an agency relationship had been been formed between teachers and Scholastic. (See *Scholastic, supra*, 207 Cal.App.3d at p. 738.)

Because the OTCs charge and collect the room rate for the hotels, the OTCs are the hotels' agents as a matter of law. The OTCs' acts are treated as the hotels' own acts. Since the hotels, through their agents, "charge" the room rate, that room rate constitutes taxable "rent."

2. Under the rate-parity agreements between the hotels and the OTCs, the hotels set the floor "room rate" that the OTCs must quote and charge to customers—such that the hotels are the ones doing the "charging" of that room rate.

Separate and independent from the agency relationship between the hotels and OTCs, there is another reason why it is the hotels that charge and collect the room rate from customers: Under the rate-parity agreements, the hotels mandate the minimum room rate that the OTCs may quote, charge and collect from customers. (See OB13-15, 31-33.)

a. The OTCs concede the rate-parity agreements require them to quote room rates that do not undercut the hotels' own customer-direct room rates.

The OTCs concede that the rate-parity provisions are designed "to ensure that the 'room rate' shown to customers by the OTC is not less than the rate offered to customers by the hotel on its own website, because the hotel and OTCs are competitors for customers seeking reservations." (AB26-27.) These OTC concessions establish that the OTCs do not have the freedom to charge whatever they want. Rather, the hotels constrain that freedom by dictating the minimum room rate that must be charged before the hotels will confer occupancy.

Not only does the OTCs' Answer concede this, so too, do the OTCs' and hotels' executives; and courts from other jurisdictions confirm the concession is accurate.

OTC Executives: The OTCs' executives testified that the rate-parity agreements preclude the OTCs from ever charging less than what the hotels charge customers directly. (E.g., 26AR3427-3428 [rate-parity agreements mean "you cannot sell a room at the sell rate for less than the hotel"]; see also OB8-9, 13-16, citing additional testimony.)

Hotel Executives: The hotels' executives testified that the rate-parity agreements ensure that customers see "the same sell rate, no matter what channel they actually go, whether through a travel agent, through [an OTC], or on [the hotel's own] branded website direct."

(E.g., 51AR8144-8148 [rate-parity contracts mean customers "get the same price available for all of those, so that it's more of a level playing field in the channel"]; see also OB8-9, 13-16, citing additional testimony.)

The Courts: Courts across the country have held that rate-parity agreements are ubiquitous and have the uniform effect of requiring the OTCs to charge a room rate equal to what the hotel charges customers directly. (E.g., *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 the room"]; see also OB8-9, 13-16, citing additional courts.)

The OTCs note the rate-parity agreements "do not address how much an OTC can charge a customer for its services." (AB26.) So what? The City does not suggest that the rate-parity agreements affect the service fees that the OTCs charge as a part of the "taxes/fees" amount. The City's position is simply that the rate-parity agreements dictate the floor *room rate* that the OTC can quote to customers and that, for this reason, it is the hotels that are doing the "charging" of the floor room rate that the customer must pay. Under the ordinance, this room rate, charged by the hotel and paid by the customer, necessarily establishes the tax base.

b. The OTCs' assertions regarding the number of contracts containing rate-parity provisions are unsupported and wrong.

As shown, rate-parity agreements are the norm in the industry. The record in the present case bears this out: Fifty-nine of the 63 standard merchant-model contracts, each cited in this proceeding, include rate-parity provisions dictating the minimum room rate that the OTCs must charge customers. (OB13-16.)[4] The wording of the provisions varies from contract to contract, but all dictate in substance that an OTC cannot sell a room for rent that is less than the hotel's own customer-facing rate. (*Ibid.*)

As the opening brief showed, rate-parity agreements uniformly require OTCs to charge customers at least as much as the hotels charge customers directly via their own websites. These agreements establish that it is the hotels who control the minimum room rate quoted to customers, such that the hotels are the ones "charging" the minimum room rate. It is this hotel-mandated rate on which taxes must be calculated.

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[4] While OTCs concede that 38 (i.e., 60%) of the contracts include rate-parity provisions, they assert that the other contracts do not. (AB26 & fn. 10.) The OTCs provide no record citations to support their assertions or their calculations, and thus, they should be disregarded. (See *SCC Acquisitions, Inc. v. Central Pacific Bank* (2012) 207 Cal.App.4th 859, 863 [reviewing court will not consider factual allegations "unsupported by reference to the record"].)

c. Because the rate-parity provisions are not relevant to opaque transactions, the City did not reference those transactions when discussing rate-parity agreements in its opening brief.

The OTCs fault the City for not including so-called opaque-model transactions as part of the number of contracts the City asserted contained rate-parity provisions. (AB26.) The opaque-model transactions were not included because they are irrelevant to transactions covered by the rate-parity agreements. This is so because in opaque-model transactions, the OTCs do not quote a room rate. Instead, the OTCs allow the customer to specify the room rate he is prepared to pay and, after he does this, the OTC finds a hotel willing to allow a room to be rented at the rate specified by the customer. (See 1JA61, 207.) When this model is used, customers do not know in advance the identity of the hotel where the booking will be made. (1JA207.)

Given the nature of opaque transactions, there is no danger that an OTC will compete with hotels by quoting a room rate that undercuts the hotel's publicly available rate—i.e., the concern that drives the rate-parity provisions in standard merchant-model contracts. Simply put, opaque transactions don't fit what rate-parity provisions are designed to address.

Nonetheless, the room rates that customers pay in opaque transactions are still taxable, since agency law establishes that it is the hotels, acting through their OTC agents, who are "charging" that rent.

Indeed, this is so in opaque transactions, just as it is so in standard merchant-model transactions.

3. None of the OTCs' other arguments undercut the conclusive effect of either the OTCs' agency relationship with the hotels, or the rate-parity agreements.

a. The OTCs' attempts to dissect and rename the room rate in their contracts with the hotels do not govern the extent to which the room rate is taxable.

The OTCs point to their secondary payment arrangements with the hotels (which divvy up and rename portions of the rental payment), and argue that these arrangments establish the tax base as the lower amount that the hotel retains after the OTCs have taken their cut.

But *the ordinance* dictates the tax that must be paid. The parties cannot *by private agreement* alter what the ordinance compels. As this Court has held, "for tax purposes the economic reality of a transaction, not the form the parties employ, is dispositive." (*General Motors Corp. v. Franchise Tax Bd.* (2006) 39 Cal.4th 773, 785.)

Here, there is only one "economic reality": The customer must pay the full amount of the "room rate" quoted on the OTCs' website to book a room. That is the sole reality that dictates the tax base.

The OTCs make much of the fact that in their private agreements with the hotels, they divide the "room rate" into two separate components:

(1) the amount the hotel retains on the room-rental transaction, which the hotel-OTC agreements name the "wholesale" price; and (2) the difference between that "wholesale" price and the room rate paid by the customer, which the hotel-OTC contracts name the "margin" or "markup." (AB14 ["The 'Room Rate,' is the Rent the hotel is charging for providing Occupancy of a room to the Transient (the 'wholesale' price), plus an amount the OTC sets and charges as compensation for its services (the 'margin,' together with the Room Rate, the 'retail' price)"].) The OTCs contend that only the amount they and the hotels have denominated, the "wholesale" price, constitutes "Rent charged by the Operator"—i.e. taxable rent. (AB23, fn. 8.)

But the terms "wholesale" and "retail" are not used in the room-tax ordinance. And it is *the ordinance* that governs, not the terms manufactured by the hotels and OTCs in their private agreements. The ordinance is as unconcerned with how the hotels and OTCs divvy up the room rate that the customer pays for occupancy, as it is with what the hotel pays its staff. The ordinance does not care what portion of the room rate the hotel pays to third-party sales agents like the OTCs as a commission for successfully renting a room that would otherwise sit empty. Rather, the sole concern of the ordinance is the amount *the customer* is charged for occupancy. (See OB29-40.)

There is no "wholesale" price from the customer's perspective. Because a customer cannot obtain a room for that price, it does not matter for tax purposes. It is just a fiction created by the OTCs to try to justify

their underpayment of room taxes. That fiction cannot trump what the ordinance compels.

That the OTCs and hotels have, between themselves, dissected the room rate into "wholesale" and "retail" components and have dubbed the difference "markup," has no effect on the tax treatment of the transaction. The "economic reality of the transaction" from the taxpaying customer's perspective governs—a reality under which the only room rate is the amount the customer pays to book a room.

b. The hearing officer's factual findings do not support the OTCs' contention that the scope of the OTCs' agency was limited to collecting a mere portion of the room rate.

The OTCs argue that under the hearing officer's findings, "the scope of any purported OTC agency is limited to 'charging and collecting' the hotel's 'wholesale' price and tax on that amount." (AB31 ["Only those amounts are collected on the hotel's behalf, and therefore can be attributed to the hotel"].) This is wrong.

The hearing officer found that the OTCs act as agents for the hotels in handling "all of the marketing, reservation, room price collection, tax collection, and customer service functions as to those Transients who book online through the OTCs." (1JA207.) Thus, the scope of the OTCs' agency includes "room price collection" and "tax collection," without any limitation whatsoever. The notion that the OTCs' agency is limited to collecting only the so-called "wholesale" amount is a fabrication.

Nor is it true, as the OTCs suggest, that the hearing officer found that the only "rent" the OTCs collect for the hotels is the so-called "wholesale" rate. The hearing officer declared that the "'wholesale' price" is the amount "charged to the OTCs" for the rooms. (1JA199.) Because OTCs do not rent rooms, this "'wholesale' price" does not fall under the ordinance's definition of "rent"—i.e., the amount charged "to a Transient" for the right of occupancy. (See § 35.0102.) Thus, whatever amounts the OTCs are "charged" are irrelevant to the tax base.

c. The rules governing construction of tax ordinances do not help the OTCs here.

The OTCs invoke the principle that if there's ambiguity in a tax law, the law must be construed "'most strongly against the government, and in favor of the citizen.'" (AB39.) The argument fails.

First, there is no ambiguity in the room-tax ordinance. The ordinance plainly levies a tax on the amount that the customer is told he must pay to rent his room. (See § I.A., *ante*.) Because there is no ambiguity, there is no need to resort to rules of statutory interpretation. (*Lungren v. Deukmejian* (1988) 45 Cal.3d 727, 735.)

Second, even if the ordinance were ambiguous, the OTCs cannot invoke the "favorable to the taxpayer" rule of construction because the OTCs are not making arguments on behalf of taxpayers. Taxpayers could never argue—as the OTCs argue here—that the tax base is the "wholesale" price, since that argument is based on facts that the hotels and OTCs have

secreted from the public. (See OB18-19.) Because of the secrecy agreements and the fact that the guest receipts issued in OTC transactions combine "taxes/fees" as a single undifferentiated line item, taxpaying customers never learn that the taxes the OTCs remit are not calculated based on the room rate that the customers are charged to book their rooms. The OTCs cannot credibly advance taxpayer-based arguments that their own secretive conduct prevents the taxpayers themselves from making. Indeed, the OTCs cite no case, and we are aware of none, in which a tax-collecting party was permitted to invoke the strict construction rule on behalf of the taxpayer, while also actively concealing from the taxpayer the true amount of the tax being charged and remitted.

Third, even if the OTCs could be said to be making arguments on behalf of taxpayers, they are wrong that their interpretation of the ordinance must automatically be adopted under the "favorable to the taxpayer" rule of construction. (AB39-40.) As this Court has explained, "we are aware that tax laws are to be construed against the municipality and in favor of the taxpayer, but it must also be remembered that such a rule does not take precedence over other fundamental rules of statutory construction. It is fundamental that 'judicial construction should be in keeping with the natural and probable legislative purpose, and avoid conflict, and harmonize all the applicable provisions of the law on the subject if possible.'" (*City of Los Angeles v. Belridge Oil Co.* (1954) 42 Cal.2d 823, 827.)

Here, the "natural and probable legislative purpose" is that the City intended to collect room taxes based on the amount charged to the customer to gain a privilege of occupancy, not a penny less. (See §I.A., *ante*.)

Fourth, the OTCs reliance on *Hospital Service of California v. City of Oakland* (1972) 25 Cal.App.3d 402, is misplaced. The OTCs claim the case supports their argument that if their interpretation of the ordinance is reasonable, it must be adopted. (AB39-40.) But as the OTCs are forced to admit (see AB40, fn. 20), *Hospital Services* did not involve construction of a tax statute, only an exemption. Even if that were not the case, the OTCs' interpretation of the ordinance is not reasonable—it is inconsistent with what customers expect will be taxed when they pay the quoted room rate; and it defies the clear language of the ordinance.

Although tax statutes are generally construed in favor of the taxpayer, "this does not mean that the language of a statute must be given an unnatural construction to defeat tax legislation or that the evident intention of the Legislature in this particular may be disregarded." (*Riley v. Havens* (1924) 193 Cal. 432, 440.)

Here, the City's construction gives effect to the evident intention for which the tax was enacted: To tax the amount a customer pays for a room. The Court should give effect to that clear intention.

*****

The terms of the ordinance, the mandates of the rate-parity provisions, the law of agency, and plain common sense all compel the same conclusion: The customer's room rate constitutes the tax base.

II. THE OTCS HAVE FAILED TO REFUTE ANY OF THE MULTIPLE INDEPENDENT BASES ON WHICH THEY CAN BE HELD LIABLE FOR UNPAID ROOM TAXES.

The OTCs claim that even if additional room tax is owed, they cannot "be assessed and held liable for tax on those amounts," since they are not "Operators" or "Transients" under the ordinance. (AB32.) But as shown (OB46-54), there are multiple independent contractual and statutory bases for holding the OTCs liable even if they do not qualify as Operators or Transients. The OTCs have not rebutted any of them.

A. The OTCs Have Not Rebutted That Ordinance Section 35.0123 Imposes Tax Liability To The City.

Most of the OTCs' arguments sound a common theme: The ordinance makes only "Operators" and "Transients" responsible for paying tax, and since the OTCs don't fall into either of those categories, they cannot be held liable. (See AB36, 38.)

But the drafters of the ordinance were not so short-sighted. Rather than limiting liability just to Operators and Transients, section 35.0123 provides that *anybody* can be held liable: "*Any person* owing *money* to the City under the provisions of th[is] Article shall be liable to an action

brought in the name of [the City] for the recovery of such amount." (§ 35.0123, subd. (a), italics added.)

Here, as shown, the OTCs have contractually assumed the tax liabilities owed by hotels under the ordinance and thus can be held liable under ordinance section 35.0123, subdivision (a). (See OB10, fn. 5.)

Nor can the OTCs escape liability by arguing that the drafters could not have had them in mind when the tax law was enacted. As this Court recently observed: "In construing statutes that predate their possible applicability to new technology, courts have not relied on wooden construction of their terms. Fidelity to legislative intent does not 'make it impossible to apply a legal text to technologies that did not exist when the text was created . . . . Drafters of every era know that technological advances will proceed apace and that the rules they create will one day apply to all sorts of circumstances they could not possibly envision.'" (*Apple Inc. v. Superior Court* (2013) 56 Cal.4th 128, 137, citing Scalia & Garner, Reading Law: The Interpretation of Legal Texts (2012) pp. 85–86.)

Accordingly, even if there were no other basis for imposing liability on the OTCs, they would still be liable under the catch-all provision of the ordinance. But as we now show, there are multiple other, independent bases that also justify imposing liability on the OTCs.

B. The OTCs Have Not Rebutted The Contractual Bases For Their Tax Liability To The City.

1. There is no merit to the OTCs' claim that they never agreed, nor could they legally agree, to be "solely responsible" for room-tax underpayment.

The OTCs have contractually agreed with the hotels to collect and remit room tax: The OTCs have agreed to be "solely responsible" or "solely and directly responsible" for remitting room tax on the full room rate, including any taxes determined to be due and owing. (OB47-48.)

The OTCs assert they did not agree to be solely responsible for collecting and remitting taxes on the full room rate. (AB33-34.) But the hotel-OTC contracts themselves refute this assertion. Those contracts say exactly what the City says they provide. (See, e.g., 16AR937 ["Expedia shall be solely responsible for all taxes, if any, assessed by any governmental entity or agency on the difference" between the portion of the rent the hotels have agreed to retain and the "price quoted . . . to the guest"]; 17AR1125 [Travelscape and Hotels.com "shall be solely and directly responsible and liable" for "collecting and remitting" unpaid room tax to a "government agency" if such remittance is "required"]; 20AR1818 ["Travelocity is solely responsible for any Taxes determined by any state, county or local taxing jurisdiction to be due and owing on any amount collected by Travelocity from a guest in excess of the" portion of the rent the hotel has agreed to keep].)

The language in the handful of agreements that the OTCs cite in their Answer *confirm* that the OTCs have agreed to be "solely responsible" for room-tax underpayments. (See 16AR937; 17AR1125 [the OTC "shall be solely and directly responsible and liable . . . if . . . a government agency responsible for administering an Occupancy Tax finally determines . . . that either [the OTC] or [hotel] is required to collect and remit Occupancy Taxes on the Gross Margin, collecting and remitting such Occupancy Taxes to the government agency or [hotel], as required"].)

Case law is clear that the OTCs' agreement to be "solely responsible" for unpaid room tax obligates them to remit the tax to the taxing authority. (See OB48, citing *California Medical Assn v. Aetna U.S. Healthcare of California, Inc.* (2001) 94 Cal.App.4th 151, 167.) *Aetna* establishes that when one party agrees to be "'solely responsible for paying'" a counter-party's remittances, the "'payment obligation has been shifted by contract.'" (OB48, citing 94 Cal.App.4th at p. 167.) Tellingly, the OTCs fail to address the application of *Aetna* here.

The OTCs assert that even if they agreed to be solely responsible for the hotels' tax payment obligations, those "obligations and liability" cannot be contractually extended "beyond what is authorized by the Ordinance's express terms." (AB34.) The assertion is unsupportable. Of course, tax liabilities can lawfully be transferred and assumed by contract. (See *City of Burbank v. Nordahl* (1962) 199 Cal.App.2d 311, 325-326.) That's what happened here. Such a contract violates no public policy (AB34), as it does

nothing to relieve the original debtor from its obligations to pay the tax. These agreements simply add another obligor to pay the tax.

2. The OTCs' assertion that their agreements to assume room-tax liability do not render them primarily liable is meritless.

The OTCs challenge the City's reliance on other hotel-OTC covenants, under which the OTCs agreed to assume the hotels' room- tax obligations. (OB50-51; AB36.) The OTCs claim that they "have not assumed any known debt obligation owed by hotels to the City" and that they cannot be held primarily liable on that basis. (AB36.)

But the covenants mean exactly what they say. By agreeing that the hotels shall "in no event" be liable for unpaid room tax on the full room rent (see OB50), the OTCs have covenanted to limit the hotels' room-tax liability and thus have taken on that liability themselves. (Cf. *Food Safety Net Services v. Eco Safe Systems USA, Inc.* (2012) 209 Cal.App.4th 1118, 1128 [agreement stating that party was "'[i]n no event' . . . liable for damages" was "broad and unqualified language" that "must be regarded as establishing a limitation on [its] liability"].) While such contract provisions would not preclude the City from suing the hotels on such obligations, these provisions provide the City with a basis for *also* seeking compensation from the OTCs.

For example, the Orbitz-Hilton contract states that Orbitz "acknowledges that certain government agencies and other persons have asserted claims that tax is owed in amounts greater than" the OTCs have

been remitting "and (Orbitz) assumes all risk, responsibility and liability relating to these and the possibility of other claims regarding Occupancy Tax. This risk, responsibility and liability is unconditional." (18AR1379.) By agreeing to assume Hilton's responsibility for room taxes, Orbitz became responsible to pay those taxes. (See *Nordahl*, *supra*, 199 Cal.App.2d at p. 325 [discussing contractual assumption of counter-party's taxes and stating "the term 'assume' . . . under accepted usage include[s] an agreement 'to pay'"].) That's the necessary effect of an assumption covenant.

3. The OTCs' claim that the City is not a third-party beneficiary of the hotel-OTC contracts is meritless.

The OTCs attempt to avoid their contractual obligations by arguing that the City is not an intended third-party beneficiary of the contracts requiring collection and remittance of room tax. (AB34-35.) But as the opening brief showed, the clear goal of the contracts' tax-collection-and-remittance terms is to ensure payment to the City of all taxes due and owing. (OB47-50.) Of course, the City is a direct and obvious intended beneficiary of any contract whereby one person undertakes to pay taxes due to the City.

The requirement that a contract be made "expressly" for the benefit of the third party does *not* require that the beneficiary be specifically named or identified in the contract. (See *Lucas v. Hamm* (1961) 56 Cal.2d 583, 590; *Garratt v. Baker* (1936) 5 Cal.2d 745, 748.) Rather, the word "expressly" has "now come to mean merely the negative of 'incidentally.'"

(*Spinks v. Equity Residential Briarwood Apartments* (2009) 171 Cal.App.4th 1004, 1022.)

Likewise, while a third-party beneficiary must show that a contract was "made expressly for [its] benefit," (*Johnson v. Superior Court* (2000) 80 Cal.App.4th 1050, 1064), that requirement has not been construed to mean "exclusively," "solely," or "primar[il]y" for the benefit of a third person (see *Hartman Ranch Co. v. Associated Oil Co.* (1937) 10 Cal.2d 232, 247; *Le Ballister v. Redwood Theatres, Inc.* (1934) 1 Cal.App.2d 447, 448; *Montgomery v. Dorn* (1914) 25 Cal.App. 666, 674).

The City is the only entity in the world that is entitled to receive the taxes that it has levied and that the hotel-OTC agreements obligate the OTCs to collect and remit. Thus, the City was an intended third-party beneficiary of the contracts.

4. The OTCs' assertion that the indemnity provisions in their contracts do not afford a basis for imposing liability for room-tax underpayments is meritless.

The opening brief established that the OTCs are also liable because their contracts require them to indemnify the hotels against underpayment of room tax. (OB51-52.) The OTCs' arguments to the contrary are confusing and self-contradictory. At one point, the OTCs acknowledge that there *are* "indemnification provisions" in these contracts, but claim those provisions only provide for OTC reimbursement of the hotels once the hotels have "incurred" liability for unpaid room tax. (AB36-37.) Later in their brief, however, the OTCs claim that they have *not* agreed to

"indemnify the hotel[s] if the OTC[s] fail[] to" pay room tax "to any tax authority on a hotel's behalf." (AB37-38.)

Regardless, the language of the contracts leaves no doubt as to what the OTCs agreed. That language explicitly provides that the OTCs have agreed to indemnify the hotels against room-tax underpayments. (See OB51-52 & fn. 28, citing language.) And the hearing officer's factual finding says exactly this: "In their contracts with the OTCs dating back to the 1990s, the hotels have always required that the OTCs *agree to indemnify* the hotels for any [room tax] not paid . . . under the Merchant Model." (1JA214, italics added.)

The OTCs agree that the hearing officer's factual findings are binding here. (AB4-5.) Thus, where the OTCs have agreed to indemnify the hotels against room-tax underpayments, the OTCs are jointly liable with the hotels for any such underpayments.

C. The OTCs Have Not Rebutted The Multiple, Independent Statutory Bases For Their Liability.

The opening brief demonstrated that, in addition to the contractual bases for the OTCs' liability, there are multiple, independent statutory bases for their liability, as well. (OB51-53.) The OTCs offer no tenable reason why they are not liable under those statutes.

1. The OTCs are statutorily liable under Civil Code section 2777.

In addition to being liable because the City is a third-party beneficiary of the indemnity provisions in the hotel-OTC contracts, the OTCs are liable because Civil Code section 2777 provides that "[o]ne who indemnifies another against an act to be done by the latter, is liable jointly with the person indemnifid, and separately, to every person injured by such act." (Civ. Code, § 2777.) *Bryan v. Banks* (1929) 98 Cal.App. 748 so holds in circumstances that render it on point here. (See OB51-52.)

The OTCs seek to distinguish *Bryan*. (AB37-38.) But a review of *Bryan's* facts shows the present case is on all fours with it. In *Bryan*, two businessmen purchased a business from its owners and gave the owners a promissory note. (98 Cal.App. at pp. 750-751.) Later, a corporation agreed to indemnify and "hold harmless" both businessmen against "payment of the balance due" on the note. (*Id.* at pp. 752, 756.) The appellate court rejected the argument that the creditor had no right of action against the indemnitor, reasoning that the creditor "was the person for whose benefit the contract was made—the person injured, and the subsequent default or nonpayment was the future act indemnified against and by which she suffered injury." (*Id.* at p. 756.) Thus, the indemnitor "became jointly liable with" the indemnitees. (*Ibid.*)

So, too, here. The "nonpayment" (or underpayment) of room tax is the "future act indemnified against." The indemnifying OTCs thus have "bec[o]me jointly liable with" the indemnitee-hotels for that nonpayment.

Under *Bryan* and the express language of Civil Code section 2777, the City is allowed "'to proceed against the [OTC-indemnitors] separately or jointly with the'" indemnitee-hotels. (See *Bryan, supra*, 98 Cal.App. at pp. 756-757.)

2. The OTCs are statutorily liable under Civil Code section 2344.

The opening brief demonstrated that Civil Code section 2344 establishes yet another separate basis for OTC liability. That statute requires that "[i]f an agent receives anything for the benefit of his principal, to the possession of which another person is entitled, he must, on demand, surrender it to such person . . . ." (OB52-53.)

The OTCs argue that despite the unchallenged finding that they are the hotels' tax agents for purposes of collecting and remitting taxes, they cannot be held liable under section 2344, since they are already remitting taxes on the only rent they are collecting for the City (i.e., the so-called "wholesale" room rate). (AB38-39). But the OTCs' argument is a bootstrap that assumes the correctness of the position they seek to prove. If, as the City contends, tax is owed over and above the amounts that have been remitted, then the funds that the OTCs have charged to the customer but failed to remit are certainly being held "for the benefit of [the OTCs'] principal," the hotels, and must certainly be "surrender[ed]" to the City. (Civ. Code, § 2344.)

Once again, the hearing officer's factual finding on agency is controlling: "The OTCs serve as the hotels' *agents* in assuming essentially

(or absolutely) all of the . . . room price collection, tax collection, and customer service functions as to those Transients who book online through the OTCs." (1JA207.) As shown, when the OTCs collect room rent and taxes, they act as the hotels, as operators. That being so, the OTCs must collect and remit all room tax that is due to the City.

The OTCs argue that they cannot be liable as agents because the room-tax ordinance imposes liability "only on three types of designees of the hotel 'proprietor,'" namely, a "managing agent, resident manager or resident agent." (AB38.) But the OTCs' liability under section 2344 does not depend on the room-tax ordinance's definition of who constitutes an "Operator." Rather, the OTCs' liability stems from contractual agreement, the provisions of section 2344 itself and from agency principles. So long as someone is an agent, section 2344 compels that agent to surrender amounts collected for the benefit of his principal, to the party to whom the principal owes such amounts.

D. The City Need Not Amend The Room-Tax Ordinance To Accomplish What It Is Already Designed To Accomplish.

The OTCs argue at length regarding Proposition 218 and urge that the City must amend its ordinances if it wants to impose liability on them. (AB42-43.) These arguments fail because there is no need for amendment to impose liability where such liability presently exists—as it certainly does for all the reasons stated above and in the opening brief. All the City asks is that its ordinances be enforced as written.

E. The OTCs' Suggestion That They Could Not Properly Have Been Subjected To Administrative Liability Is Meritless.

With the OTCs' liability under the contract terms and the ordinance itself established, that should end the matter. Nonetheless, the OTCs suggest that because they are not Operators or Transients, they were not properly subjected to administrate liability. (AB32, 34.) Not only does ordinance section 35.0123 refute their claim, so, too, do the facts.

The City commenced this action by suing the OTCs in Superior Court, and the OTCs responded by objecting that the action should be dismissed because administrative remedies had not first been pursued. (1JA46-47.) The OTCs succeeded in obtaining dismissal of the civil action, after which administrative proceedings against them were pursued at their request and an award was entered against them. (*Ibid.*) At no time during the administrative proceedings, during the Superior Court mandate proceedings, or in the Court of Appeal, did the OTCs ever contend that the administrative proceedings against them were improper. Instead they insisted, over the City's objection, that the administrative process be followed.

The OTCs are thus precluded from now suggesting that they are somehow improper parties here. Not only does their successful motion to dismiss the civil action in favor of administrative proceedings judicially estop them from making such a claim (see *Aguilar v. Lerner* (2004) 32 Cal.4th 974, 986–987), but also their failure to timely raise the point

previously amounts to a waiver of the claim (*Bank of America, N.A. v. Roberts* (2013) 217 Cal.App.4th 1386, 1399).

In sum, the OTCs requested administrative proceedings, got the administrative proceedings they requested, willingly participated in such proceedings without objecting to their propriety, and cannot now complain that they got exactly what they requested.

*****

For multiple, independent contractual and statutory reasons, the OTCs are properly subject to liability for unpaid room taxes, regardless whether they are "Operators" under the ordinance.

III. THE OTCS PROVIDE NO JUSTIFICATION FOR THE COURT OF APPEAL'S ERRONEOUS HOLDING THAT THE *SANTA MONICA* AND *ANAHEIM* OPINIONS ARE BINDING AS LAW OF THE CASE.

The OTCs attempt to defend the Court of Appeal's reliance on its prior unpublished opinions by arguing that the "court did not suggest it was constrained" by its prior ruling in the *Anaheim* litigation, and the *Santa Monica* decision was mentioned "only in passing." (AB44-45 & fn. 22.)

But as explained in the opening brief (OB54) and as the opinion makes clear, the Court of Appeal deemed the prior unpublished opinions to be "law of the case" and, therefore, that those unpublished opinions "must be adhered to" under the law-of-the-case doctrine (Opn. 3, fn. 4, citing *Kowis v. Howard* (1992) 3 Cal.4th 888, 892-893). Clearly, the Court of Appeal considered the earlier decisions binding.

The Court of Appeal erred by doing so. The law-of-the-case doctrine does not apply unless there is both *case identity* and *party identity*. (See OB54-56.) Neither element is satisfied here. The OTCs do not make any argument to the contrary, forfeiting the point.

The OTCs' remaining arguments are attacks on straw men:

First, the OTCs claim that it was "imperative" for the Court of Appeal to "consider" its prior *Anaheim* decision. (AB44-45.) But the City has never claimed the appellate court should ignore the reality of what it previously held; indeed, that's why the parties, recognizing the reality that the court would remember what it had previously held, found it necessary to address that reality in trying to convince the court that its prior reasoning should not apply here.

The problem is that the unpublished prior decisions were treated as *binding law* despite the fact that the City seeks recovery here based its own, different room-tax ordinance, and despite the fact that the City was never afforded notice and an opportunity to be heard in the *Anaheim* and *Santa Monica* proceedings. Applying those separate, prior rulings as binding law of the case is not only contrary to the law-of-the-case doctrine, it violates settled rules governing merger of cases, contradicts the California Rules of Court, and violates due process. (OB56-62.)

Second, the OTCs argue that the City seeks a "blanket rule" prohibiting the citation of unpublished decisions within a coordinated proceeding. (AB46.) Not so. The City simply contends that (a) citing unpublished decisions as binding authority is generally prohibited, (b) the

"law-of-the-case" exception to citing unpublished decisions does not apply in these circumstances, and (c) the mere fact that many room-tax cases are coordinated (but not merged) does not permit the court to do what is otherwise prohibited. (OB54-62.)

Third, the OTCs argue that if this Court concludes the Court of Appeal erred by citing its prior unpublished decisions, the Court should not reach the merits of this now-fully-briefed case, but rather should just order the Court of Appeal to modify its published opinion to omit its references to the unpublished decisions. (AB47, fn. 24.) But this would be an empty exercise. Based on its rulings in the prior cases and in this case, we know where the Court of Appeal stands on issues presented here and we know how it will decide future cases given its previous dispositions, unless this Court decides the merits of the issues presented. The many public entities whose room-tax ordinances are sustantively similar to the City's ordinance should not have to go through the burdensome process of litigating their claims through administrative tribunals and the Superior Court and Court of Appeal just to bring their cases to where this fully-briefed appeal now stands.

CONCLUSION

The Court should reverse with directions that the tax base for calculating room tax is the "room rate" quoted to, charged to and paid by customers to book a room. The Court should hold that the OTCs are subject to liability for unpaid room taxes. And the Court should hold that the Court of Appeal erred in holding that prior unpublished cases are binding as law of the case.

DATED: May 20, 2015

Respectfully Submitted,

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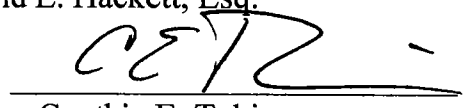
By: 
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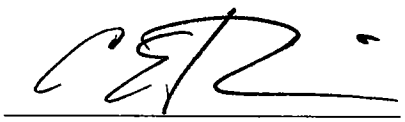
CERTIFICATE OF COMPLIANCE

Pursuant to California Rules of Court, rule 8.204(c)(1), I certify that this **PETITIONER'S REPLY BRIEF ON THE MERITS** contains **8,280 words**, not including the tables of contents and authorities, the caption page, signature blocks, the verification or this certification page, as counted by the word processing program used to generate it.

Dated: May 20, 2015



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PROOF OF SERVICE

STATE OF CALIFORNIA, COUNTY OF LOS ANGELES

I am employed in the County of Los Angeles, State of California. I am over the age of 18 and not a party to the within action; my business address is 5900 Wilshire Boulevard, 12th Floor, Los Angeles, California 90036.

On May 20, 2015, I served the foregoing document described as: **PETITIONER'S REPLY BRIEF ON THE MERITS** on the parties in this action by serving:

SEE ATTACHED SERVICE LIST

(X) By Envelope - by placing () the original (X) a true copy thereof enclosed in sealed envelopes addressed as above and delivering such envelopes:

(X) By Mail: As follows: I am "readily familiar" with this firm's practice of collection and processing correspondence for mailing. Under that practice, it would be deposited with United States Postal Service on that same day with postage thereon fully prepaid at Los Angeles, California in the ordinary course of business. I am aware that on motion of party served, service is presumed invalid if postal cancellation date or postage meter date is more than 1 day after date of deposit for mailing in affidavit.

Executed on May 20, 2015, at Los Angeles, California.

(X) (State) I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct.

Charice L. Lawrie

Charice L. Lawrie

2d Civ. No. B243800
In Re Coordinated Proceeding Special Title (Rule 3.550(c))
TRANSIENT OCCUPANCY TAX CASES

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