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Electronic Commerce

Georgia Court Unseals Master's Report Critical of Expedia in Hotel Sales Tax Case

LOS ANGELES—A Georgia Superior Court judge on May 20 released a special master's report, held under seal for almost two years, which found that online travel company (OTC) Expedia Inc., and by inference other OTCs, crafted a strategy to withhold documents in a lawsuit seeking unpaid hotel occupancy taxes (*Columbus, Ga. v. Expedia Inc.*, Ga. Super. Ct., No. SU-06-CV-1794-7, *special master's report unsealed 5/20/11*).

The report said that documents were withheld “in order to thwart legitimate discovery,” as part of “a conscious and deliberate effort to avoid the payment of [Expedia's] full measure of occupancy taxes, in violation of state and local law.”

At the same hearing, Superior Court Judge Douglas Pullen denied Expedia's motion to hold the city of Columbus, Ga., and its lawyers in contempt for disclosing internal Expedia documents the company believed were confidential. He also ruled the documents in question were not covered by the protective order Expedia cited for its motion.

The impact of the release of the “Report and Recommendation of the Special Master,” under seal since August 2009, and the ruling that the three internal Expedia documents were not confidential could extend well beyond Georgia, as attorneys for scores of cities, counties, and states will inevitably seek to use the disclosures contained in the documents in their own hotel occupancy tax lawsuits against the OTCs.

Internal Documents Blamed for Florida Bill Failure

In fact, the public release to the Florida Legislature earlier in May of the three internal Expedia documents almost certainly helped kill an OTC-backed bill exempting the companies' margins from such occupancy taxes, despite a heavy OTC lobbying effort, several sources who closely followed the Florida proceedings told BNA.

Expedia, and other major OTCs like Travelocity.com LP, Orbitz LLC, and Priceline.com Inc. for years have argued publicly that the difference between the wholesale, discounted price they negotiate with hotels and the retail price they charge consumers who reserve rooms on company websites is a service fee for facilitating the transaction, and thus is not subject to hotel sales and/or occupancy taxes.

The cities, counties, and an increasing number of states who have sued the OTCs for unpaid taxes on those markups insist the taxes are due on the full price paid by the customer.

Attorneys for the suing municipalities believe the internal Expedia documents amount to a “smoking gun”—essentially proving what they have argued for years—that the OTCs knew all along that they owed the relevant hotel occupancy and/or sales taxes but, instead of paying, devised an aggressive and organized lobbying and litigation strategy to thwart any efforts to collect them, because to do so would have cost the companies a significant portion of their profits every year.

Marion Pope, retired chief judge of the Georgia Court of Appeals, who served as special master in the *Columbus, Ga. v. Expedia* case, came to much the same conclusion after months reviewing, in camera, some 26,000 internal Expedia documents.

“Expedia knew that hotel tax was calculated on the entire price of the occupancy,” he wrote in his report. “Expedia knew it would take a dramatic financial ‘hit’ to its bottom line if it was *forced* to collect and remit taxes to the local jurisdiction,” he added, pointing to one internal Expedia document that warned of a 13 percent decrease in the company’s domestic margin if that occurred.

‘Semantic Fiction’ OTCs Not Selling Rooms, Pope Says

Given those stakes, “Expedia gambled on not paying the taxes by deliberately bundling the line item charges into ‘taxes and fees’; by engaging in an aggressive legal defense with other OTCs to specifically hold out from disclosing any of its insider tax data unless absolutely forced to; by engaging in a massive lobbying effort to try to get local legislators and tax commissioners to buy into their semantic fiction that OTCs are not entities that sell hotel rooms,” Pope wrote.

He cited a document listing the strategic goals of the Interactive Travel Services Association (ITSA), the OTC’s Washington, D.C.-based trade and lobbying group, calling on the OTCs to “fight an aggressive grassroots political battle in a targeted jurisdiction to send a message and make an example for others,” and in particular, to “[m]ake an example out of Georgia to put other states/jurisdictions on notice.”

Part of the OTCs’ strategy also involved stretching out litigation, and delaying the legal process at virtually every step, Pope noted. For example, the Columbus case “was essentially ‘inactive’ for two years,” while Expedia removed the case to federal court on two separate occasions, only to have the federal court remand it “as improvidently removed,” he stated.

In fact, one of the internal Expedia documents released to the Florida Legislature, discussing in a 2003 analysis whether to litigate if any tax authorities sued the company on the issue, noted that while there was no simple answer, “it appears that the stakes are high enough that we should resist, delay and make it as difficult as possible for any state to require us to collect occupancy tax.”

Similarly, the Joint Defense Agreement among the OTCs, formed as lawsuits multiplied around the country, adopted an aggressive stance against discovery of virtually anything related to the occupancy issue, Pope wrote.

Joint Defense Pact Required Broad Privilege Claims

The JDA “required the parties to cloak ‘... any and all information or documents, including but not limited to discussion, conferences, phone calls, e-mails, memos, correspondence, memoranda of law, debriefing memoranda, factual summaries, interviews, transcript digests, analyses, appraisals and other materials or communications related to or concerning the Issue ...’ as confidential, protected from disclosure to any third party by the common interest privilege, joint-defense privilege, the clients’ attorney-client privilege, the work product doctrine and all other applicable privileges and immunities,” Pope stated.

As a result, Expedia sought some kind of privilege or immunity for communications involving public relations firms, ITSA, and even documents detailing software development, Pope said.

“Defendant has evidently attempted to dip every document in the ink of work product immunity or some other privilege,” he found.

“It is abundantly clear that Defendant has interposed claims of privilege where none legitimately exist. It is further evident that Defendant has engaged in deliberate efforts to conceal its true liability for occupancy taxes, to refuse disclosure, and to hold onto a ‘position’ which is untenable under Georgia law,” he concluded.

Noting that Expedia has maintained “from the inception of this litigation until the present that it is not subject, in any manner whatsoever, to the tax payment obligations set forth in the Code of the City of Columbus ... or the state Enabling Act” despite decisions from the Superior Court and the Georgia Supreme Court that taxes are owed on the full room price, Pope also found that the city had made “an adequate *prima facie* showing that the crime/fraud exception applies.”

“The Defendant’s steadfast, but errant, interpretation of the law, or its ‘position’ as to the law, is at the very least nothing more than a strategic test to withhold documents in order to thwart legitimate discovery in this lawsuit. Moreover, it

demonstrates a conscious and deliberate effort to avoid the payment of its full measure of occupancy taxes, in violation of state and local law,” he concluded.

Company Calls Documents ‘Routine Legal Work.’

A spokeswoman for Expedia told BNA in an email that the company did not have anyone available to discuss the special master's report, or the internal documents, and added that the company would have no comment on either at this time.

However, in recent court filings, attorneys for the company have insisted that the internal documents disclosed in Florida— all 2003 analyses and discussions of the occupancy tax issue by an in-house counsel, an outside law firm, and an international accounting firm—represented “routine legal work” that contained “nothing nefarious or remotely improper.”

Nevertheless, Expedia went to considerable lengths to try to block dissemination of the internal documents.

The May 20 hearing in Columbus was on Expedia's May 6 emergency motion for civil contempt, in which it not only sought a court order holding the city and its lawyers in contempt and fining them \$50,000 a day, but a requirement that Columbus and its lawyers try to retrieve all copies of the documents—which were posted on the Internet shortly after surfacing in the Florida Legislature.

The company on May 9 also filed an ex parte application in the California cases, seeking to block the presiding judge from reading the documents in camera.

In that May 9 filing in California Superior Court, Expedia noted that two federal judges in lawsuits in other jurisdictions rejected as unsound and “a leap of logic” Pope's finding of a crime/fraud showing in a similarly critical 2008 special master's report in an almost identical case brought by Columbus against Orbitz (19 DTR K-1, 2/2/09).

By Tom Gilroy