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It May Be 'Bon Voyage' for a Travel Site's Fee

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FOR years, online travel companies like [Expedia](#), Orbitz, Travelocity and others have successfully defended one of their most profitable practices: capturing the sizable difference between what they charge customers for taxes on hotel rooms and taxes the companies actually pay.

But threats to this enviable income stream are mounting.

On May 28, for example, a Washington State court ruled in a consumer class-action case filed against Expedia that the company's fee disclosures breached its contract with customers. Monica J. Benton, a judge in the Superior Court of King County, ordered Expedia to pay \$184.5 million in damages for misleading customers about fees they paid for hotel rooms between February 2003 and December 2006.

While Expedia's Web site said hotel booking fees simply covered room taxes and the company's costs, the court said that the fees contained hidden charges that fell right to Expedia's bottom line. An expert retained by the plaintiff in the case estimated that the total service fees charged to the consumers by Expedia were \$184.5 million — hence the size of the damage award.

Expedia has appealed the decision, and Katie Deines, an Expedia spokeswoman, says the Washington court is wrong on the facts and the law.

"[Expedia.com](#) charged its customers a service fee for certain transactions during the period fully disclosing those fees to each customer before a booking was completed," she said. "We are confident that we have fulfilled all applicable obligations to our customers."

Meanwhile, a second claim in the same case is pending. It alleges that Expedia violated Washington's consumer protection act by concealing the components of its bundled tax and service fees and the profits they generated. That matter is scheduled to go to trial in Judge Benton's courtroom next month; plaintiffs estimate damages of \$45 million, a figure that the court has the option to triple.

Expedia disputes the second claim, saying that consumers know its fees include a markup and can choose whether to pay the price. But Steve W. Berman, a lawyer at Hagens Berman Sobol Shapiro in Seattle who represents the plaintiffs in the case, says Expedia faces high hurdles in his state.

“Washington’s consumer protection law is very powerful, and our courts take it very seriously,” he said.

THE Washington case isn’t the only legal battle for Expedia. Lawsuits have been filed by 46 cities and counties related to the way Expedia calculates and pays taxes on the rooms it sells to travelers. Expedia’s regulatory filings stated that 15 of these cases had been dismissed but that most can refile.

Tax authorities in 3 of those 46 places — Broward County, Fla., San Francisco, and Anaheim, Calif. — contend that Expedia owes them \$55.3 million in unpaid taxes and are suing for it.

Those matters revolve around what happened when Expedia bought blocks of hotel rooms at a wholesale price struck with the property’s operator. When it resold those rooms to online customers, Expedia paid so-called bed taxes based on the wholesale price of the rooms. But it collected taxes from its customers on a higher retail price for the rooms that it did not pay.

Expedia then pocketed the difference as part of a single charge it called a “taxes and service fee.” The three municipalities suing Expedia believe that they are entitled to the profit the company makes on the tax difference — which they peg at \$55.3 million.

All this scrutiny of online travel fees and practices couldn’t come at a worse time for the industry. With consumers pinching pennies, travel is down sharply; profits are under pressure as most of the big players have already eliminated booking fees for airline tickets and cut charges for other services.

Expedia is the world’s leading online travel company, with a stable of brands that includes hotels.com, Hotwire, TripAdvisor and Egencia, its corporate travel service. Formerly a unit of IAC/InteractiveCorp, the conglomerate overseen by [Barry Diller](#), Expedia was spun out as a separate public company in 2005.

Mr. Diller, who controls Expedia, remains its chairman; its chief executive is Dara Khosrowshahi.

Reflecting the travel industry’s woes, Expedia’s revenue fell 7.5 percent in the first quarter of 2009 while profits fell by 20 percent. Revenue per ticket in its airline business dropped 14 percent from the same period in 2008, and average daily rates in Expedia’s hotel bookings declined 18 percent.

The company’s most recent regulatory filing states that it has set aside a \$21 million reserve for potential settlement of cases relating to hotel taxes.

Nevertheless, Expedia’s shares have been on a tear this year, doubling in price.

Investors might consider the tax disputes to be background noise because they’ve been percolating for seven years. One argument the online travel companies have made in battling the tax collectors is

this: since they are not hotel operators, they do not have to hand over the higher taxes that they collect.

Tax authorities have repeatedly rejected this view, but litigating with the companies and their enormous law firms has been a protracted process.

Steven D. Wolens, a Dallas lawyer representing the city of San Antonio in a case against hotels.com and others, said travel companies “have repeatedly and systematically ignored admonitions of tax authorities to remit the tax based on the retail price the consumers pay for the room.”

Adding to the difficulties that Expedia and its competitors may experience in their lawsuits is the fact that many states require companies that have been found to owe taxes through an administrative action to pay those assessments before being allowed to contest them in court.

Some states, like California, require that cash be put up while others allow a bond to be posted.

“The occupancy tax lawsuits pending against online travel companies are simply attempts by some local governments to tax our customers at a higher rate than we believe the law allows,” said Ms. Deines, the Expedia spokeswoman. “The company remains confident in its position that hotel occupancy tax is not due on the compensation that it receives for the services it provides.”

With so many cities and states in dire financial straits, they are likely to continue looking at companies like Expedia for money they believe belongs to them. And that means Expedia’s future income from its tax collection practices is no sure thing.