

For January 17, 2020 Committee Meeting

Preliminary Issue Outline for Opinion Regarding Administrative Fee as Cost

I. ISSUES/QUESTIONS

- Is it proper for an attorney or law firm to charge an administrative fee based on a set percentage of the fee charged in lieu of itemized bill for costs?
- Does an administrative fee in lieu of itemized billing for in-house costs comply with Business & Professions Code §§6148(b) or 7147 (a)(2)?
- Does such a provision allow lawyers to make a secret profit since the amount of the fee may not have any relation to in-house expenses incurred during the billing period?
- To what extent does client consent to such a provision in the fee agreement affect the analysis?
- What obligations does a lawyer have to explain such a clause in the fee agreement in order for the client's execution of the fee agreement constitute informed consent?
- Does it make a difference whether this type of provision is used in non-litigation or litigation matters?

II. POINTS FOR DISCUSSION

A. Background

Mandatory fee arbitration proceedings and other attorney-client fee disputes involve often involve disputes regarding costs billed by attorneys. The ABA Standing Committee on Ethics and Professional Responsibility concluded in Formal Opinion 93-379 that in the absence of disclosure to the client in advance of the engagement, a lawyer may not charge a client for overhead expenses generally associated with properly maintaining, staffing and equipping a law office. The ABA further concluded that charges for in-house services, such as photocopying, computer research, deliveries and similar services may be billed to the client so long as the lawyer charges no more than the direct cost associated with the services. In other words, costs billed to a client may not be used as a source of secret profit for the attorney and should be billed to the client without a surcharge or markup.

Providing an itemized list of costs in a bill to clients requires that attorney maintain records of the photocopies, postage, phone charges and other in-house services billed to the client. In an effort to avoid keeping track of such in house expenses, some attorneys have opted to include a provision in their fee agreements that in lieu of itemized billing for costs,

they will charge an administrative fee based on a percentage of the fees incurred during the applicable billing period. The following is an example of this type of clause:

We assess a monthly charge of _% of the fees incurred which cover cost matters such as regular photocopying, telephone calls, general fax transmissions, regular U.S. postage and mail, and courier services when necessary.

The percentage used for the administrative charge varies, but I have seen many agreements use 4% of the fee. Questions arise in fee disputes whether this type of administrative charge is proper and the extent to which it must be explained to the client before a fee agreement is executed.

There is little authority in California regarding the propriety of charging an administrative fee in lieu of itemized billing of in-house expenses. The Committee on Mandatory Fee Arbitration addressed this issue in its draft Arbitration Advisory regarding Handling Disputes Regarding Costs and Expenses. That draft advisory has been passed on to COPRAC with the termination of the Committee on Mandatory Fee Arbitration and the subcommittee working on that advisory believes that it may be helpful to have a formal ethics opinion which addresses that issue, and possible other potential secret profit issues relating to costs.

B. Selected Existing Authority

“Attorney fee agreements are evaluated at the time of their making and must be fair, reasonable and fully explained to the client. Such contracts are strictly construed against the attorney.” (*Alderman v. Hamilton* (1988) 205 Cal.App.3d 1033, 1037; *Severson & Werson v. Bolinger* (1991) 235 Cal.App.3d 1569, 1572; *Bird, Marella, Boxer & Wolpert v. Superior Court* (2003) 106 Cal.App.4th 419, 430-431.)

Rule of Professional Conduct 1.5(a) provides that a lawyer shall not make an agreement for, charge, or collect an unconscionable or illegal fee. None of the thirteen factors in Rule 1.5(b) expressly address costs billed to a client. However, one of two new factors in Rule 1.5 is “whether the client gave informed consent to the fee.”

Business and Professions Code § 6148(b) provides that bills for the cost and expenses portion of a bill rendered to a client “shall clearly identify the costs and expenses incurred and the amount of the costs and expenses.”

The San Diego County Bar Association issued an opinion which address whether an attorney may ethically charge a client for providing in -hours services such as secretarial, overtime, photocopying, processing electronic discovery, electronic legal research, the cost of CDs, mileage and parking, meals, Federal Express and postage and long distance telephone. (SDCBA Legal Ethics Opinion 2013-3.) The San Diego County Bar Ethics Committee concluded that given the absence of California authority, a California lawyers should look, *inter alia*, to ABA Formal Opinions, including Opinion 93-379, and that a California lawyers

may bill a client for the direct cost of in-house services necessary for the lawyer's representation of the client. The Committee further noted that the intent of such charges is not that the lawyers make an additional profit, but rather that the lawyer be compensated – at actual cost – for expenses necessarily incurred in the client's representation. However, the San Diego County Bar opinion did not address the propriety of an administrative fee in lieu of an itemized bill for in-house costs and expenses and there is no California ethics opinion on point.

Ethics opinions from other states are split on the issue. In Formal Opinion 94-10, the Arizona State Bar Ethics Committee concluded that a lawyer may charge a percentage surcharge in lieu of billing actual expenses and costs if agreed to in writing, approximating the actual costs, and the amount charged is reasonable.

In Ethics Opinion 1056 (Fee – Overhead Charge), the Virginia State Bar Ethics Committee considered whether a “four percent overhead charge” based on the amount of the fee was proper where the lawyer did not otherwise bill for such expenses (telephone, photocopying, postage, etc.). The Committee concluded that it is not improper in matters not involving litigation to charge a client a predetermined percentage of the legal fee as administrative costs, provided that the attorney explains fully to the client the method by which client's bill will be calculated and the client consents. However, the Committee concluded that in matters involving litigation, the client must pay the actual cost associated with the case file and this it would therefore be improper for a lawyer to charge the client a percentage of overhead in litigation matters.

In Opinion 30989 (January 4, 2012), the Florida Bar Staff considered whether a provision in a fee agreement to charge a 4% of the fees incurred to cover regular copying, telephone calls, fax transmissions, regular postage and courier services was proper, and whether the client's knowing consent to the provision impacts the propriety of such a provision. The Florida Bar staff concluded that it would be impossible for each client to give truly informed consent to a cost average or administrative fee/charge without knowing the actual cost amount for all clients. The Florida Bar staff noted that while lawyers are allowed to charge clients for actual costs incurred for in-house expenses, they are not ethically allowed to turn those costs into profit centers. The Florida Bar staff concluded that a lawyer may not impose a 4% administrative fee even it is disclosed in the fee agreement.

In the bankruptcy context, courts have disallowed claims by counsel for reimbursement of in-house expenses calculated by utilizing a percentage of the total fee. (See, e.g., *In re Command Services Corp.*, (Bankr N.D.N.Y. 1988) 85 B.R. 230, 234 [“Only fully documented, actual, out-of-pocket expenses will be reimbursed. Thus, the Court cannot condone, for whatever reason, a percentage method to establish actual and necessary expenses within the meaning of Code § 330(a)(a).”]; *In re Williams* (Bankr N.D. Cal 1989) 102 B.R. 197, 198-199 [“As a matter of law, the Court finds that an expense is not “actual,” and therefore not reimbursable under section 330(a)(2), to the extent that it is based on any sort of guesswork, formula, or pro rata allocation. Concrete documentation, in the form of receipts and invoices, is therefore necessary to support any application for reimbursement.”].)