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**ARBITRATION ADVISORY**

**2020-0XB**

**HANDLING DISPUTES REGARDING COSTS  
AND EXPENSES**

**Date**

Disclaimer Box

**INTRODUCTION**

Business & Professions Code § 6200, et. seq., confers jurisdiction upon Mandatory Fee Arbitration (MFA) arbitrators to consider and make awards regarding disputes over costs and expenses billed to clients, in addition to disputes over fees. The purpose of this Advisory is to provide guidance to MFA arbitrators regarding disputes over costs and expenses that may arise from time to time in connection with MFA arbitrations. [Note to Mimi update the intro language]

**DISCUSSION**

**A. Key Authorities:**

The following California statutes, rules and ethics opinions provide guidance regarding the obligations and duties of an attorney to a client regarding billing for costs and expenses during the course of the representation:

- California Rules of Professional Conduct, Rule 1.5
- Business and Professions Code §6148 (billing for costs in hourly fee cases)
- Business and Professions Code §6147 (billing for costs in contingency cases)
- San Diego County Bar Association Legal Ethics Opinion 2013-3
- Los Angeles County Bar Association Formal Ethics Opinion 391

In addition, non-California ethics opinions that are cited below can provide secondary guidance, but are not binding authority upon California practitioners. A.B.A. Formal Opinion 93-379 (1993) Billing for Professional Fees, Disbursements and Other Expenses provides a detailed discussion on costs which can be billed to a client and difference between costs and attorney overhead expenses. The ABA’s opinion was endorsed by the State Bar Court in *Matter of Kroft* (1988) 3 Cal. State Bar Ct. Rptr. 838.

31 **B. General Considerations:**

32 a. Contractual Interpretation

33 The right of an attorney to charge a client for costs and expenses generally is a matter of  
34 contract. Consequently, the arbitrator should first look to the written fee agreement, if one  
35 exists, to determine the parties' understandings concerning costs and expenses. The initial  
36 agreement is generally considered an arm's-length transaction, where the presumption of  
37 overreaching does not apply. *See, generally, Setzer v. Robinson* (1962) 57 Cal.2d 213; *Baron v.*  
38 *Mare* (1975) 47 Cal.App.3d 304.

39 However, provisions governing the lawyer's right to charge and collect for fees, costs and  
40 expenses are evaluated based upon conditions foreseeable at the time they are made, must be  
41 explained fully to the client at the outset and must be fair and reasonable. *See, generally,*  
42 *Alderman v. Hamilton* (1988) 205 Cal.App.3d 1033; *In re County of Orange* (1999) 241 B.R.  
43 212, 221. As the State Bar Court has explained:

44 Generally, an engagement agreement between a client and an attorney is construed as a  
45 reasonable client would construe it. ([Rest.3d Law Governing Lawyers § 38](#), com. d; see  
46 also *Lane v. Wilkins* (1964) 229 Cal.App.2d 315, 323 [in construing contracts between  
47 attorneys and clients concerning compensation, construction should be adopted that is  
48 most favorable to the client as to the intent of the parties].) Moreover, "it is well  
49 established that any ambiguities in attorney-client fee agreements are construed in the  
50 client's favor and against the attorney." (*In the Matter of Lindmark* (Review Dept.2004) 4  
51 Cal. State Bar Ct. Rptr. 668, 676; see also *S.E.C. v. Interlink Data Network of Los*  
52 *Angeles, Inc.* (9th Cir.1996) 77 F.3d 1201, 1205.)

53 *Matter of Brockway* (Rev. Dept. 2006) 4 Cal. State Bar Ct. Rptr. 944; see also *Severson &*  
54 *Werson v. Bolinger* (1991 235 Cal.App.3d 1569. *Matter of Lindmark* (Rev. Dept. 2004) 4 Cal.  
55 State Bar Ct. Rptr. 668.

56 Initial disclosure of the basis for charges for costs and expenses, in addition to how fees  
57 are to be calculated, fosters communication that will promote the attorney-client relationship.  
58 The relationship similarly will be benefitted if the billing statements for services explicitly reflect  
59 the basis for the charges so that the client understands how the fee bill was determined. (ABA  
60 Formal Opinion 93-379 (1993; **See also, Business & Professions Code §§ 6147(a)(2) and**  
61 **6148(b)**).

62 Even in the absence of a specific agreement as to costs and expenses in the engagement  
63 contract or indeed, of any formal retention agreement, the attorney's fiduciary obligations to the  
64 client will include the handling of and charging for costs and expenses such that the attorney's  
65 charges for costs and expenses during the course of the representation also must be scrutinized  
66 for necessity, reasonableness and fairness. *See, Gutierrez v. Girardi* (2011) 194 Cal.App.4<sup>th</sup> 925.  
67 [The cited case does not support the highlighted language—is there better authority.] The  
68 question of whether a cost or expense may be incurred and charged to the client generally is  
69 within the implied authority of the attorney, as an agent for the client, unless specifically  
70 prohibited by the fee agreement. [Steve: had a question here] *See, Civil Code section 2319* ["An

71 agent has authority . . . to do everything necessary or proper and usual, in the ordinary course of  
72 business, for effecting the purpose of the agency.”]. Thus, absent specific client instructions not  
73 to incur a particular cost or expense, the arbitrator’s review will be only as to the necessity,  
74 reasonableness and fairness, or the possible unconscionability of the disputed cost or expense  
75 item. [Again, is there authority for this?]

76           b.       Statutory Requirements

77           Agreements to charge fees and costs in a non-contingent fee matter must comply with  
78 Business & Professions Code §6148. Subsection (b) sets forth statutory requirements for what  
79 must be included in a bill and provides that that the cost and expense portion of the bill “shall  
80 clearly identify the costs and expenses incurred and the amount of the costs and expenses.”

81           Agreements in contingent fee cases are governed by Business & Professions Code  
82 §6147. Subsection (a)(2) provides that the agreement shall include “A statement as to how  
83 disbursements and costs incurred in connection with the prosecution or settlement of the claim  
84 will affect the contingency fee and the client’s recovery.”

85           Business & Professions Code section 6147(b) and 6148(c) provide that the failure of the  
86 lawyer’s bills to clearly identify the costs and expenses incurred may also render the fee  
87 agreement voidable at the option of the client.

88           c.       Other General Considerations

89           It generally is held that in the absence of agreement to the contrary, an attorney may not  
90 charge a client for normal overhead expenses associated with properly maintaining, staffing and  
91 equipping an office, including the expense of maintaining a library. ([Rest.3d Law Governing](#)  
92 [Lawyers § 38\(3\)\(a\)](#); ABA Formal Opinion 93-379 (1993); SDCBA Opinion 2013-3 pp.3-5.) The  
93 reasoning is that when a client has engaged an attorney to provide professional services for a fee  
94 (whether calculated on the basis of the number of hours expended, a flat fee, a contingent  
95 percentage of the amount recovered or otherwise) the reasonable expectation of the client would  
96 be that charges for general office overhead are included in the attorney’s fee. Thus, in the  
97 absence of disclosure to the client in advance of the engagement to the contrary, the client should  
98 reasonably expect that the attorney's overhead costs in maintaining a library, securing  
99 malpractice insurance, renting of office space, purchasing utilities and the like would be  
100 subsumed within the charges the attorney is making for professional services. (SDCBA Opinion  
101 2013-3 at p. 4; ABA Formal Opinion 93-379 (1993); *see, also, In the Matter of Kroff* (1996) 3  
102 Cal. State Bar Ct. Rptr. 838 (1998) [endorsing ABA Formal Opinion 93-379; *In re Tom Carter*  
103 *Enterprises, Inc.*, 55 B.R. 548 (1985).) Thus, with respect to items traditionally viewed as  
104 overhead, unless the agreement is clear that such expenses will be charged, the attorney should  
105 not be able to recover them. (SDCBA Opinion 2013-3 at p.5; [Rest.3d Law Governing Lawyers §](#)  
106 [38\(3\)\(a\)](#).)

107           On the other hand, the attorney may recoup costs and expenses reasonably incurred in  
108 connection with the client's matter for non-overhead costs incurred, including services performed  
109 in-house, such as photocopying, long distance telephone calls, computer research, special  
110 deliveries, secretarial overtime, and other similar services so long as the charge reasonably

111 reflects the lawyer’s actual cost for the services rendered.” (SDCBA Opinion 2013-3 at p. 5  
112 (citing ABA Formal Opinion 93-179).) As discussed more particularly below, recoverable in-  
113 house costs and expenses include items such as photocopying, postage and messenger costs,  
114 long-distance phone charges, travel and parking, computer research charges. [Bundy: needs  
115 clarification about what can be recovered.] Even when the agreement does clearly encompass  
116 such expenses, they remain subject to scrutiny for necessity, reasonableness and fairness,  
117 whether they are billed periodically to the client or charged against the client’s recovery under a  
118 contingent fee contract. *See, generally*, California Practice Guide on Professional Responsibility,  
119 The Rutter Group, 5:550-5:552.

120 When charging for costs and expenses, the charges must reasonably reflect the attorney's  
121 actual cost for the services rendered or billed. The attorney may not add a profit element or  
122 mark-up on top of such actual cost, except where the client gives informed written consent to  
123 such profit element. American Bar Association (ABA) Formal Opinion 93-379 (1993). See also  
124 *Matter of Kroff*; and the SDCBA Opinion 2013-3 at pp. 5-6.

### 125 C. Charges for Specific Costs and Expenses

126 ***Percentage of Fees Administrative Charges:*** One way some attorneys have sought to  
127 recoup costs incurred in the representation of a client without providing an itemized billing for  
128 costs is to charge the client an additional percentage amount, above the agreed upon fee, to  
129 reflect such costs. There is no direct California authority regarding the propriety of charging an  
130 administrative fee in lieu of itemized billing of in-house expenses. In *Matter of Kroff*, the State  
131 Bar Court noted that whether lawyers ethically may charge a flat periodic fee or lump sum to  
132 cover disbursements “is a matter of some controversy.” The court stated that such charges may  
133 be valid if the client has given informed consent to arrangement and it does not result in an  
134 unreasonable charge to the client. (*Matter of Kroff, supra* at 13.) Thus, any such agreement  
135 should be scrutinized for unconscionability pursuant to California Rules of Professional Conduct  
136 (CRPC) Rule 1.5, such as where it can be established that the administrative charges are unduly  
137 high due to the size of the bill unrelated to the actual overhead consumed in support of the billed  
138 fees.

139 While no California ethics opinions has addressed the propriety of an administrative fee  
140 in lieu of an itemized bill for in-house costs and expenses, ethics opinions from other states are  
141 split on the issue. (*See, e.g.*, Va. LE Op. 1056 (1988) [approving a 4% overhead charge based  
142 upon the amount of the fee pursuant to a written fee agreement in matters not involving  
143 litigation]; Arizona State Bar Formal Ethics Opinion 94-10 [a lawyer may charge a percentage  
144 surcharge in lieu of billing actual expenses and costs if agreed to in writing, approximating the  
145 actual costs, and the amount charged is reasonable]; *but see* Florida Bar Staff Opinion 30989  
146 (2012) [a 4% administrative charge may not be imposed for each file even if it is disclosed in the  
147 client’s contract as it would be impossible for each client to give truly informed consent to a cost  
148 average or administrative fee/charge without knowing the actual cost amount for all clients].)

149 In the bankruptcy context, courts have disallowed claims by counsel for  
150 reimbursement of in-house expenses calculated by utilizing a percentage of the total fee.  
151 (*See, e.g., In re Command Services Corp.*, (Bankr N.D.N.Y. 1988) 85 B.R. 230, 234 [“Only  
152 fully documented, actual, out-of-pocket expenses will be reimbursed; the Court cannot

153 condone, for whatever reason, a percentage method to establish actual and necessary  
154 expenses within the meaning of Code § 330(a)(a).”]; *In re Williams* (Bankr N.D. Cal 1989)  
155 102 B.R. 197, 198-199 [“As a matter of law, the Court finds that an expense is not “actual,”  
156 and therefore not reimbursable under section 330(a)(2), to the extent that it is based on any  
157 sort of guesswork, formula, or pro rata allocation. Concrete documentation, in the form of  
158 receipts and invoices, is therefore necessary to support any application for  
159 reimbursement.”].)

160 ***Travel and Parking:*** Normally, where the engagement reasonably requires the attorney  
161 to travel on behalf of the client in the course of the representation the client can reasonably  
162 expect to be billed as a disbursement the reasonable amount of the airfare, taxicabs, meals while  
163 traveling, parking and hotel room. ABA Formal Opinion 93-379 (1993), See also, Code of Civil  
164 Procedure §1033.5(S)(C) [travel expenses to attend depositions as an allowable item of costs in  
165 litigation]; . *But see, e.g., In re Tom Carter Enterprises, Inc.*, 55 B.R. 548 (1985) [parking is  
166 considered general overhead not recoverable from a bankruptcy estate].

167 ***Luncheons and meals:*** These are considered general overhead, and are not recoverable  
168 from a bankruptcy estate. *See, e.g., In re Tom Carter Enterprises, Inc.*, 55 B.R. 548 (1985); *see,*  
169 *also, In re Maruko Inc.*, 160 B.R. 633 (1993); [in house luncheons among attorney staff alone  
170 are considered overhead]. Where requested and approved by the client, such luncheon expenses  
171 may be charged to the client. However, meal expenses incurred while traveling for depositions,  
172 out-of-town travel on a case may be a proper cost charged to the client. (ABA Formal Opinion  
173 93-379, p.7; *Howard v. American National Fire Ins. Co.* (2010) 187 Cal.App. 4<sup>th</sup> 498, 541  
174 [analyzing recovery of meal expenses as an item of recoverable costs under Code of Civil  
175 Procedure §1033.5]; but see, *Gorman v. Tassajara Development Corp.* (2009) 178 Cal.App.4<sup>th</sup>  
176 44, 72 [distinguishing between local mean expenses and meals incurred while traveling].)

177 ***Secretarial and staff:*** Regular secretarial services are normally considered general  
178 overhead, and are not recoverable from a bankruptcy estate. *See, e.g., In re Tom Carter*  
179 *Enterprises, Inc.*, 55 B.R. 548 (1985). However, if secretarial overtime was incurred because of  
180 an emergency or time exigency related to the client’s case, then such costs may be billed to the  
181 client as a cost. (SDCBA 2013-3 pp. 7-8.) Other staff overtime is also generally considered  
182 part of general attorney overhead, except where actions of the client or the nature of the case may  
183 require extraordinary overtime.

184 ***Messenger Services:*** Such charges may be billed where the needs of the matter or of the  
185 client legitimately and reasonably require the service and where the client may agree in advance  
186 to such charges. SDCBA 2013-3; ABA Formal Opinion 93-379 (1993). However, such charges  
187 may not be reasonable where the need for such delivery services arises from the attorney’s  
188 procrastination or inattention.

189 ***Computer Assisted Legal Research (CALR):*** Billing for CALR is not a settled issue as  
190 courts are split on whether some portion of electronic research expenses should be considered  
191 overhead costs that are not charged to the client. (See, e.g., *Cairns v. Franklin Mint Co. (C.D.*  
192 *Cal 2000)* 115 F.Supp.2d 1185, 1189.) There is a school of thought that holds that CALR is  
193 overhead, particularly as is the case more and more where the attorney’s “library” is  
194 predominately electronic and the attorney or law firm has a fixed-fee contract with the service

195 provider. Another school of thought holds that CALR is billable to the client; and, such charges  
196 specifically have been found to be recoverable from a bankruptcy estate. *See, In re Maruko Inc.*,  
197 160 B.R. 633 (1993); *In re Tom Carter Enterprises, Inc.*, 55 B.R. 548 (1985). In **SDCBA 2013-**  
198 **3, the Committee, applying ABA Formal Opinion 93-379 as endorsed by the State Bar Court in**  
199 ***Kroff***, concluded that an attorney could legitimately charge a client the actual direct cost of  
200 CALR.

201 In light of developing law in this area, at a minimum, the arbitrator should first confirm  
202 whether such charges have been agreed to by the client in advance. The next area of inquiry will  
203 be the reasonableness of the charge. If the charge is based on the firm’s actual cost, it may be  
204 billed to the client as a cost in connection with the representation. Some providers offer “pro-  
205 forma” invoices for such charges, but these are not usually the actual amount charged to the firm  
206 relative to each client. Thus, where such charges are passed along to the client, the arbitrator  
207 should inquire as to the methodology used to assure that the charges were reasonably allocated  
208 among all clients using such services for the month or other billing period. Again, the arbitrator  
209 should determine whether the client knowingly and voluntarily agreed to pay any premium [what  
210 does premium mean in this context—do we mean profit or markup?] charged for CALR.  
211 Finally, the arbitrator should consider the mathematical unfairness, if any, where, for example,  
212 the attorney pays \$1,000 per month for the services and one client is the only client using the  
213 service for the month. Under such circumstances, charging the client the full \$1,000 for a small  
214 amount of CALR may be improper and potentially unconscionable.

215 *Photocopying:* Discrete or large photocopying projects specific to a client’s  
216 representation may generally be charged to the client, especially where there is some  
217 extraordinary need for such services, including pleadings, document productions, etc., and where  
218 the client agrees in advance. Thus, the attorney and the client may agree in advance that, for  
219 example, photocopying will be charged at \$.15 per page. However, the question arises what may  
220 be charged to the client, in the absence of a specific agreement to the contrary, when the client  
221 has simply been told that costs for these items will be charged to the client. Under those  
222 circumstances the attorney is obliged to charge the client no more than the direct cost associated  
223 with the service (i.e., the actual cost of making a copy on the photocopy machine) plus a  
224 reasonable allocation of overhead expenses directly associated with the provision of the service  
225 (e.g., a fair percentage of the salary of a photocopy machine operator). *See, ABA Formal*  
226 *Opinion 93-379 (1993); SDCBA Legal Ethics Opinion 2013-3.* On the other hand, where a large  
227 photocopying project may be completed by an outside provider at a page rate less than the  
228 general page rate agreed upon by the attorney and client at the outset of the representation, the  
229 attorney ~~should~~ **may want to consider** retaining an outside service (subject to client  
230 confidentiality safeguards) to complete the project and bill the client only for the actual cost of  
231 the project charged by the outside provider.

232 *Long Distance Calls:* **Long-distance telephone charges incurred in a client’s case have**  
233 **generally been considered a cost which can be charged to the client, as opposed to an overhead**  
234 **expense, especially if the fact that an attorney will charge the cost of long-distance calls is**  
235 **included in the fee agreement. (See, ABA Formal Opinion 93-379 (1993); SDCBA Legal Ethics**  
236 **Opinion 2013-3.) However,** given the current state of telephonic communication through cell  
237 phones or internet phone services (VoIP), long distance calls could be considered part of general  
238 overhead which should not be billed as separate expenses. An exception would be where the call

239 charge is for an attorney's out-of-contract call (such as international calls may be) or part of a  
240 video conference or involving multiple parties where the attorney will be billed in addition to the  
241 attorney's general telephone cost. However, [Sarah: Might not necessarily be true. If its  
242 included in the atty's contract, may not necessarily be true that you cant charge for it.] [I don't  
243 understand this. If the agreement says that the firm can recoup expenses for long distance calls  
244 relating to the client's matter, why can't it do so?]

245 *Process Service:* It is appropriate to bill the client for such charges where provided by an  
246 outside service. *See, e.g., In re Tom Carter Enterprises, Inc.*, 55 B.R. 548 (1985). Where such  
247 service is provided by in-house employees, the charge to the client should be no more that the  
248 reasonable cost to the attorney measured by a reasonable percentage of the employee's overall  
249 salary. [Does the agreement have to list process service specifically?]

250 *Witness Fees:* These fees are expenses that properly may be charged to the client. (*See,*  
251 *e.g., In re Tom Carter Enterprises, Inc.*, 55 B.R. 548 (1985); *Ojeda v. Sharo Cabrillo Hospital*  
252 (1992) 8 Cal.App.4<sup>th</sup> 1, 8 [“Traditionally, the costs associated with a lawsuit have included items  
253 such as transcript, filing, service and jury fees and hourly compensation paid to experts who  
254 serve as witnesses or consultants.”].)

255 In the context of Mandatory Fee Arbitration proceedings, disputes regarding witness fees  
256 typically relate to the cost of expert witnesses. Clients are often surprised by the amount of  
257 expert fees incurred in their case. The client's responsibility for potential expert witness fees as  
258 a cost incurred in a case are often set forth in the fee agreement. Thus, an arbitrator should first  
259 review the provisions of the fee agreement where there is a dispute regarding expert witness fees  
260 charged to the client. If the fee agreement does not include a provision regarding expert witness  
261 fees, in litigation matters the hiring of experts is usually within the attorney's implied authority  
262 and may be billed to the client.

263 *Filing & Other Court Fees:* Filing fees and other court charges including mandatory e-  
264 filing charges are recoverable as costs. Discretionary court costs may require the agreement of  
265 the client, but an attorney generally has broad implied authority to incur costs which are  
266 reasonably necessary to the client's case. For example, many courts no longer provide a court  
267 reporter for law and motion hearings or other matters so an attorney must specifically request  
268 and pay for reporter expenses. While a client may dispute the necessity of this type of  
269 discretionary expense, if it is reasonably necessary to the client's case such expenses are likely  
270 within the scope of an attorney's implied authority.

## 271 CONCLUSION

272 The reasonableness, fairness or unconscionability of an attorney's charges for costs and  
273 expenses can never be a matter of exact mathematical calculation. Rather, the attorney's charges  
274 for costs and expenses should be evaluated pursuant to the fee agreement, and also examined for  
275 necessity, reasonableness, disclosure, method of calculation and the reasonable expectations of  
276 the client. Such examination also should include reference the foregoing guidelines of what the  
277 arbitrator may consider when the client may dispute the attorney's charges for costs and  
278 expenses.