

CLEAN

ARBITRATION ADVISORY

2019-0XB

**HANDLING DISPUTES REGARDING COSTS
AND EXPENSES**

Date

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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.

DISCUSSION

A. General Considerations:

a. Contractual Interpretation

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

However, the lawyer's right to charge and collect for costs and expenses are evaluated based upon conditions foreseeable at the time they are made, must be explained fully to the client at the outset, must be fair and reasonable, and will be strictly construed against the attorney. *See, generally, Alderman v. Hamilton* (1988) 205 Cal.App.3d 1033; *Severson & Werson v. Bolinger* (1991) 235 Cal.App.3d 1569; *Cetenko v. United Calif. Bank* (1982) 30 Cal.3d 528. Where there is no contract, or where the contractual provisions for charging costs and expenses are unclear, the contract may be voidable at the option of the client pursuant to Business & Professions Code §§ 6147(b) and 6148 (b).

34 Fairness of the contractual provisions regarding costs and expenses generally will be
35 construed from a reasonable client's perspective. *Matter of Brockway* (Rev. Dept. 2006) 4 Cal.
36 State Bar Ct. Rptr. 944. Any lack of specificity will be construed strictly in light of such
37 reasonable expectations. *In re County of Orange* (1999) 241 B.R. 212; *Matter of Lindmark*
38 (Rev. Dept. 2004) 4 Cal. State Bar Ct. Rptr. 668.

39 Finally, even in the absence of a specific agreement as to costs and expenses in the
40 engagement contract, the attorney's fiduciary obligations to the client will include the handling
41 of and charging for costs and expenses such that the attorney's charges for costs and expenses
42 during the course of the representation also must be scrutinized for necessity, reasonableness and
43 fairness. *See, Gutierrez v. Girardi* (2011) 194 Cal.App.4th 925.

44 b. Other General Considerations

45 It generally is held that an attorney may not charge a client for normal overhead expenses
46 associated with properly maintaining, staffing and equipping an office, including the expense of
47 maintaining a library. On the other hand, the attorney may recoup non-overhead costs and
48 expenses reasonably incurred specifically in connection with the client's matter for services
49 performed in-house, such as photocopying projects specifically related to a client matter (as
50 opposed to, for instance, occasional photocopying of general correspondence or otherwise for the
51 convenience of the attorney, pleadings, etc.), special deliveries, special secretarial overtime
52 incurred due to the client's specific needs, and other similar services. Since the line between
53 recoverable costs and non-recoverable general overhead is an ever evolving one, whether items
54 such as photocopying, word processing, computer research charges, postage and messenger costs
55 are to be considered general overhead rather than costs are subject to the arbitrator's discretion
56 within these general guidelines, and within the overarching requirement that what the attorney
57 may claim as costs must be fully disclosed and explained to the client at the outset of the
58 relationship, and thereafter subject to scrutiny for necessity, reasonableness and fairness as they
59 are billed periodically to the client. *See, generally, California Practice Guide on Professional*
60 *Responsibility, The Rutter Group, 5:550-5:552.*

61 When charging for non-overhead costs and expenses, the charges must reasonably reflect
62 the attorney's actual cost for the services rendered or billed. The attorney may not add a profit
63 element on top of such actual cost, except where the client gives informed written consent to
64 such profit element. American Bar Association (ABA) Formal Opinion 93-379 (1993).

65 Initial disclosure of the basis for charges for costs and expenses, in addition to how fees
66 are to be calculated, fosters communication that will promote the attorney-client relationship.
67 The relationship similarly will be benefitted if the billing statements for services explicitly reflect
68 the basis for the charges so that the client understands how the fee bill was determined. ABA
69 Formal Opinion 93-379 (1993). In addition, billing statements reflecting non-overhead costs and
70 expenses must break down the charges by type, and otherwise provide the client the information
71 the client reasonably may need to understand the basis for the charges. *See Business &*
72 *Professions Code §6148(b).*

73 The question of whether a cost or expense may be incurred and charged to the client
74 generally is within the implied authority of the attorney, as an agent for the client, unless

specifically prohibited by the fee agreement. *See*, Civil Code section 2319 [“An agent has authority . . . to do everything necessary or proper and usual, in the ordinary course of business, for effecting the purpose of the agency.”]. Thus, absent specific client instructions not to incur a particular cost or expense, the arbitrator’s review will be only as to the necessity, reasonableness and fairness, or the possible unconscionability of the disputed cost or expense item.

B. Charges for Specific Costs and Expenses

Percentage of Fees Administrative Charges: Such charges may be valid if fully explained to the client and agreed to in advance in writing, but should be scrutinized for unconscionability pursuant to California Rules of Professional Conduct (CRPC) Rule 1.5, such as where it can be established that the administrative charges are unduly high due to the size of the bill unrelated to the actual overhead consumed in support of the billed fees. *See, e.g.*, Va. LE Op. 1056 (1988) [approving a 4% overhead charge based upon the amount of the fee pursuant to a written fee agreement in matters not involving litigation]; *but, see*, Florida Bar Staff Opinion 30989 (2912) [a 4% administrative charge may not be imposed for each file even if it is disclosed in the client’s contract]. In addition, what services the client is to receive included in the charge must be fully explained to the client. *See*, ABA Model Rules 1.5, 7.1(a)(1); 8.4(c). Such charges also must be justifiable and not duplicative of the attorney’s general overhead factored into the attorney’s hourly rate or other method of compensation. Such charges must not be unconscionable.

Overhead: When a client has engaged an attorney to provide professional services for a fee (whether calculated on the basis of the number of hours expended, a flat fee, a contingent percentage of the amount recovered or otherwise) the reasonable expectation of the client would be that charges for general office overhead are included in the attorney’s hourly fee. Thus, in the absence of disclosure to the client in advance of the engagement to the contrary, the client should reasonably expect that the attorney’s cost in maintaining a library, securing malpractice insurance, renting of office space, purchasing utilities and the like would be subsumed within the charges the attorney is making for professional services. ABA Formal Opinion 93-379 (1993); *see, also, In the Matter of Kroff* (1996) 3 Cal. State Bar Ct. Rptr. 838 (1998) [failure to disclose actual costs and how they were determined in the fee agreement and in the attorney’s billing statements violates CRPC Rule 1.15].

In addition, general overhead is not recoverable from a bankruptcy estate. *See, In re Tom Carter Enterprises, Inc.*, 55 B.R. 548 (1985).

Travel and Parking: Normally, where the engagement reasonably requires the attorney to travel on behalf of the client in the course of the representation the client can reasonably expect to be billed as a disbursement the reasonable amount of the airfare, taxicabs, meals while traveling, parking and hotel room. ABA Formal Opinion 93-379 (1993). However, the general rule of informed consent of the client applies. *But see, e.g., In re Tom Carter Enterprises, Inc.*, 55 B.R. 548 (1985) [parking is considered general overhead not recoverable from a bankruptcy estate].

Luncheons: These are considered general overhead, and are not recoverable from a bankruptcy estate. *See, e.g., In re Tom Carter Enterprises, Inc.*, 55 B.R. 548 (1985); *see, also, In*

116 *re Maruko Inc.*, 160 B.R. 633 (1993); [in house luncheons among attorney staff alone are
117 considered overhead]. Where requested and approved by the client, such luncheon expenses
118 may be charged to the client.

119 *Secretarial*: Regular secretarial services are normally considered general overhead, and
120 are not recoverable from a bankruptcy estate. *See, e.g., In re Tom Carter Enterprises, Inc.*, 55
121 B.R. 548 (1985).

122 *Messenger Services*: Such charges may be billed where the needs of the matter or of the
123 client legitimately and reasonably require the service and where the client may agree in advance
124 to such charges. ABA Formal Opinion 93-379 (1993). However, such charges may not be
125 reasonable where the need for such delivery services arises from the attorney's procrastination or
126 inattention.

127 *Overtime*: Staff overtime generally is considered part of general attorney overhead,
128 except where actions of the client or the nature of the case may require extraordinary overtime
129 and where the client agrees in advance to such charges.

130 *Computer Assisted Legal Research (CALR)*: Billing for CALR is not a settled issue.
131 There is a school of thought that holds that CALR is overhead, particularly as is the case more
132 and more where the attorney's "library" is predominately electronic. Another school of thought
133 holds that CALR is billable to the client; and, such charges specifically have been found to be
134 recoverable from a bankruptcy estate. *See, In re Maruko Inc.*, 160 B.R. 633 (1993); *In re Tom*
135 *Carter Enterprises, Inc.*, 55 B.R. 548 (1985). In light of this uncertainty, at a minimum, the
136 arbitrator should first confirm whether such charges have been agreed to by the client in advance.
137 The next area of inquiry will be the reasonableness of the charge. Some providers offer "pro-
138 forma" invoices for such charges, but these are not usually the actual charged to the firm relative
139 to each client. Thus, where such charges are passed along to the client, the arbitrator should
140 inquire as to the methodology used to assure that the charges were reasonably allocated among
141 all clients using such services for the month or other billing period. Again, the arbitrator should
142 determine whether the client knowingly and voluntarily agreed to pay any premium charged for
143 CALR. Finally, the arbitrator should consider the mathematical unfairness, if any, where, for
144 example, the attorney pays \$1,000 per month for the services and one client is the only client
145 using the service for the month. Under such circumstances, charging the client the full \$1,000
146 for a small amount of CALR may be improper and potentially unconscionable.

147 *Photocopying*: Generally, charges for occasional or convenience photocopying are
148 considered part of general overhead. On the other hand, discrete or large photocopying projects
149 may be charged to the client, especially where there is some extraordinary need for such
150 services, including pleadings, document productions, etc., and where the client agrees in
151 advance. Thus, the attorney and the client may agree in advance that, for example, photocopying
152 will be charged at \$.15 per page. However, the question arises what may be charged to the
153 client, in the absence of a specific agreement to the contrary, when the client has simply been
154 told that costs for these items will be charged to the client. Under those circumstances the
155 attorney is obliged to charge the client no more than the direct cost associated with the service
156 (i.e., the actual cost of making a copy on the photocopy machine) plus a reasonable allocation of
157 overhead expenses directly associated with the provision of the service (e.g., a fair percentage of

the salary of a photocopy machine operator). *See*, ABA Formal Opinion 93-379 (1993); SDCBA Legal Ethics Opinion 2013-3. On the other hand, where a large photocopying project may be completed by an outside provider at a page rate less than the general page rate agreed upon by the attorney and client at the outset of the representation, the attorney should retain the outside service (subject to client confidentiality safeguards) to complete the project and bill the client only for the actual cost of the project charged by the outside provider.

Long Distance Calls: Given the current state of telephonic communication, it is the opinion of the Committee that long distance calls are part of general overhead and should not be billed as separate expenses. An exception would be where the call charge is for an attorney's out-of-contract call (such as international calls may be) or part of a video conference or involving multiple parties where the attorney will be billed in addition to the attorney's general telephone cost.

Process Service: It is appropriate to bill the client for such charges where provided by an outside service. *See, e.g., In re Tom Carter Enterprises, Inc.*, 55 B.R. 548 (1985). Where such service is provided by in-house employees, the charge to the client should be no more than the reasonable cost to the attorney measured by a reasonable percentage of the employee's overall salary.

Witness Fees: These fees are expenses that properly may be charged to the client. *See, e.g., In re Tom Carter Enterprises, Inc.*, 55 B.R. 548 (1985).

Filing & Other Court Fees: Filing fees and other court charges including mandatory e-filing charges are recoverable as costs. Discretionary court costs require the agreement of the client.

CONCLUSION

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

