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1 **ARBITRATION ADVISORY**

2 **2020-0XB**

3 **HANDLING DISPUTES REGARDING COSTS**
4 **AND EXPENSES**

5 **Date**

6
7 Disclaimer Box

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9 **INTRODUCTION**

10 Business & Professions Code § 6200, et. seq., confers jurisdiction upon Mandatory Fee
11 Arbitration (MFA) arbitrators to consider and make awards regarding disputes over costs and
12 expenses billed to clients, in addition to disputes over fees. The purpose of this Advisory is to
13 provide guidance to MFA arbitrators regarding disputes over costs and expenses that may arise
14 from time to time in connection with MFA arbitrations.

15 **DISCUSSION**

16 **A. Key Authorities:**

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

20 **California Rules of Professional Conduct, Rule 1.5**

21 **Business and Professions Code §6148 (billing for costs in hourly fee cases)**

22 **Business and Professions Code §6147 (billing for costs in contingency cases)**

23 **San Diego County Bar Association Legal Ethics Opinion 2013-3**

24 **Los Angeles County Bar Association Formal Ethics Opinion 391**

25 **In addition, non-California ethics opinions that are cited below can provide**
26 **secondary guidance, but are not binding authority upon California practitioners. A.B.A.**
27 **Formal Opinion 93-379 (1993) Billing for Professional Fees, Disbursements and Other**
28 **Expenses provides a detailed discussion on costs which can be billed to a client and**
29 **difference between costs and attorney overhead expenses. The ABA's opinion was endorsed**
30 **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).

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

b. Statutory Requirements

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

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

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

c. Other General Considerations

It generally is held that in the absence of agreement to the contrary, an attorney may not charge a client for normal overhead expenses associated with properly maintaining, staffing and equipping an office, including the expense of maintaining a library. The reasoning is that 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 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. SDCBA Opinion 2013-3 at p. 4; ABA Formal Opinion 93-379 (1993); *see, also, In the Matter of Kroff* (1996) 3 Cal. State Bar Ct. Rptr. 838 (1998) [endorsing ABA Formal Opinion 93-379]; *In re Tom Carter Enterprises, Inc.*, 55 B.R. 548 (1985).

On the other hand, the attorney may recoup costs and expenses reasonably incurred in connection with the client’s matter for services performed in-house, such as photocopying, long distance telephone calls, **computer research**, special deliveries, secretarial overtime, and other similar services so long as the charge reasonably reflects the lawyer’s actual cost for the services rendered.” SDCBA Opinion 2013-3 at p. 5 (citing ABA Formal Opinion 93-179). With respect to items traditionally viewed as overhead items, the client’s reasonable expectation would normally be that such expenses will not be charged. Accordingly, unless the agreement is clear that such expenses will be charged, the attorney should not be able to recover them. Even when the agreement does clearly encompass such expenses, they remain subject to scrutiny for necessity, reasonableness and fairness, whether they are billed periodically to the client or

charged against the client's recovery under a contingent fee contract. *See, generally*, California Practice Guide on Professional Responsibility, The Rutter Group, 5:550-5:552.

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

C. Charges for Specific Costs and Expenses

Percentage of Fees Administrative Charges: One way some attorneys have sought to recoup costs incurred in the representation of a client without providing an itemized billing for costs is to charge the client an additional percentage amount, above the agreed upon fee, to reflect such costs. There is no direct California authority regarding the propriety of charging an administrative fee in lieu of itemized billing of in-house expenses. In *Matter of Kroff*, the State Bar Court noted that whether lawyers ethically may charge a flat periodic fee or lump sum to cover disbursements "is a matter of some controversy." The court stated that such charges may be valid if the client has given informed consent to arrangement and it does not result in an unreasonable charge to the client. Thus, any such agreement 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.

While no California ethics opinions has addressed the propriety of an administrative fee in lieu of an itemized bill for in-house costs and expenses, ethics opinions from other states are split on the issue. (*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]; Arizona State Bar Formal Ethics Opinion 94-10 [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]; *but see* Florida Bar Staff Opinion 30989 (2012) [a 4% administrative charge may not be imposed for each file even if it is disclosed in the client's contract as 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].)

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; 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."].)

152 **Travel and Parking:** Normally, where the engagement reasonably requires the attorney
153 to travel on behalf of the client in the course of the representation the client can reasonably
154 expect to be billed as a disbursement the reasonable amount of the airfare, taxicabs, meals while
155 traveling, parking and hotel room. ABA Formal Opinion 93-379 (1993). However, the general
156 rule of informed consent of the client applies. *But see, e.g., In re Tom Carter Enterprises, Inc.,*
157 *55 B.R. 548 (1985)* [parking is considered general overhead not recoverable from a bankruptcy
158 estate].

159 **Luncheons:** These are are considered general overhead, and are not recoverable from a
160 bankruptcy estate. *See, e.g., In re Tom Carter Enterprises, Inc., 55 B.R. 548 (1985); see, also, In*
161 *re Maruko Inc., 160 B.R. 633 (1993);* [in house luncheons among attorney staff alone are
162 considered overhead]. Where requested and approved by the client, such luncheon expenses
163 may be charged to the client.

164 **Secretarial:** Regular secretarial services are normally considered general overhead, and
165 are not recoverable from a bankruptcy estate. *See, e.g., In re Tom Carter Enterprises, Inc., 55*
166 *B.R. 548 (1985).* [There is a good discussion of secretarial overtime in ABA 93-379 and
167 SDCBA 2013-3. Should it be included?]

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

173 **Overtime:** Staff overtime generally is considered part of general attorney overhead,
174 except where actions of the client or the nature of the case may require extraordinary overtime
175 and where the client agrees in advance to such charges. ABA and SDCBA do not appear to
176 require advance consent to necessary overtime. Am I misreading?]

177 **Computer Assisted Legal Research (CALR):** Billing for CALR is not a settled issue.
178 There is a school of thought that holds that CALR is overhead, particularly as is the case more
179 and more where the attorney's "library" is predominately electronic. Another school of thought
180 holds that CALR is billable to the client; and, such charges specifically have been found to be
181 recoverable from a bankruptcy estate. *See, In re Maruko Inc., 160 B.R. 633 (1993); In re Tom*
182 *Carter Enterprises, Inc., 55 B.R. 548 (1985).* **BOTH SAN DIEGO AND THE ABA PERMIT**
183 **CHARGES FOR ELECTRONIC RESEARCH AT COST—SHOULDN'T THEY BE CITED?]**
184 In light of this uncertainty, at a minimum, the arbitrator should first confirm whether such
185 charges have been agreed to by the client in advance. The next area of inquiry will be the
186 reasonableness of the charge. **If the charge is based on the firm's actual cost, it is acceptable.**
187 Some providers offer "pro-forma" invoices for such charges, but these are not usually the actual
188 amount charged to the firm relative to each client. Thus, where such charges are passed along to
189 the client, the arbitrator should inquire as to the methodology used to assure that the charges
190 were reasonably allocated among all clients using such services for the month or other billing
191 period. Again, the arbitrator should determine whether the client knowingly and voluntarily
192 agreed to pay any premium [what does premium mean in this context—do we mean profit or
193 markup?] charged for CALR. Finally, the arbitrator should consider the mathematical

unfairness, if any, where, for example, the attorney pays \$1,000 per month for the services and one client is the only client using the service for the month. Under such circumstances, charging the client the full \$1,000 for a small amount of CALR may be improper and potentially unconscionable.

Photocopying: Discrete or large photocopying projects specific to a client's representation may generally be charged to the client, especially where there is some extraordinary need for such services, including pleadings, document productions, etc., and where the client agrees in advance. Thus, the attorney and the client may agree in advance that, for example, photocopying will be charged at \$.15 per page. However, the question arises what may be charged to the client, in the absence of a specific agreement to the contrary, when the client has simply been told that costs for these items will be charged to the client. Under those circumstances the attorney is obliged to charge the client no more than the direct cost associated with the service (i.e., the actual cost of making a copy on the photocopy machine) plus a reasonable allocation of 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. [Is there authority for this.]

Long Distance Calls: Given the current state of telephonic communication, long distance calls are more likely to be considered 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. [I don't understand this. If the agreement says that the firm can recoup expenses for long distance calls relating to the client's matter, why can't it do so?]

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. [Does the agreement have to list process service specifically?]

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). [Again, does there have to be an express agreement? What about hourly fees paid to retained experts?]

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. [What are discretionary costs? And how does this relate to the lawyer's implied authority.]

My recollection is that there is authority about temporary legal personnel and paralegals, too.]

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CONCLUSION

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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 the foregoing guidelines of what the arbitrator may consider when the client may dispute the attorney's charges for costs and expenses.

Main document changes and comments

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|------------------------|------------------|-----------------------|
| Page 1: Comment [KEB1] | Kenneth E. Bacon | 2/18/2020 10:31:00 AM |
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I'm not sure of the page as the copy of the opinion on Westlaw does not have pages.

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| Page 2: Comment [KEB2] | Kenneth E. Bacon | 2/14/2020 11:45:00 AM |
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I'm not sure what In Re County of Orange adds. That is a bankruptcy case which essentially cited the Alderman case regarding the rules for interpreting fee agreements

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| Page 2: Comment [KEB3] | Kenneth E. Bacon | 2/18/2020 11:13:00 AM |
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The case held that an attorney's fiduciary obligations to client apply to costs, even in the absence of a fee agreement. The court specifically stated that in light of the fiduciary obligations, the attorneys did not have carte blanche with respect to costs deducted from the settlement. I think implicit in the holding that attorneys have fiduciary obligations regarding costs is that they should be scrutinized for necessity and reasonableness, especially where there is not fee agreement so the attorney is limited to quantum meruit. I don't know if there is better authority for this, but eh *Gutierrez* case is cited in the Rutter Group Professional Responsibility Guide [5:596]

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| Page 3: Comment [KEB4] | Kenneth E. Bacon | 2/18/2020 11:23:00 AM |
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I think that is a correct statement. The Rutter Group Professional Responsibility Guide cites to *Cooley v. Miller & Lux* (1909) 156 Cal. 510. 525-526 for the proposition that absent a contrary agreement, a client is bound to repay attorney for "all outlays made by him in the payment of the expenses of carrying on the litigation."

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| Page 4: Comment [S5] | Steve | 11/19/2019 3:15:00 PM |
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Doesn't matter of Kroff expressly state that such agreements are lawful in California, at p. 13? Or am I over-reading it?

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| Page 5: Comment [S6] | Steve | 11/19/2019 3:18:00 PM |
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What does this phrase mean? Does the retention agreement expressly have to state that the lawyer will charge travel expenses?

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| Page 5: Comment [KEB7] | Kenneth E. Bacon | 2/18/2020 11:32:00 AM |
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I believe the fee agreement should specify what travel costs will be billed to the client

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| Page 5: Comment [KEB8] | Kenneth E. Bacon | 2/18/2020 11:45:00 AM |
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Those opinions included computer research amongst a list of "in-house services" necessary for the lawyer's representation of a client, but they did not extensively discuss or analyze computer research as a cost item. Nowadays, a Westlaw or Lexis account is akin to maintaining a physical library, which is an overhead item.

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| Page 5: Comment [KEB9] | Kenneth E. Bacon | 2/18/2020 11:49:00 AM |
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I don't think that is necessarily correct. Billing a client a portion of the actual subscription cost (i.e., the attorney's actual cost) is like billing for maintaining a library. I think that's overhead and should not be billed to the client.

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| Page 6: Comment [KEB10] | Kenneth E. Bacon | 2/18/2020 1:08:00 PM |
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Here is what was in the draft advisory before Joel's edit:

Computer Assisted Research: Such charges have been found to be recoverable from a bankruptcy estate. See, *In re Maruko Inc.*, 160 B.R. 633 (1993); *In re Tom Carter Enterprises, Inc.*, 55 B.R. 548 (1985). However, it is the opinion of the Committee that, since these cases were decided, computer assisted research has become much more commonplace and, in many cases, represent the attorney's only library resource. Accordingly, absent some extraordinary need for computer assisted research, a full explanation of how the charge was calculated and a demonstration of the reasonableness of the charge, it should be considered as general overhead not appropriately billed to the client.

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| Page 6: Comment [KEB11] | Kenneth E. Bacon | 2/18/2020 1:41:00 PM |
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I don't agree with should, too strong. More accurate to say "may"

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| Page 6: Comment [KEB12] | Kenneth E. Bacon | 2/18/2020 1:44:00 PM |
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Nowadays long distance fees not really an actual charge given the free long distance service on cell phones and other plans.

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| Page 6: Comment [KEB13] | Kenneth E. Bacon | 2/18/2020 1:46:00 PM |
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That would be the better practice

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| Page 6: Comment [KEB14] | Kenneth E. Bacon | 2/18/2020 1:47:00 PM |
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Once again, that is a best practice but not required. Witness fees are considered allowable costs per C.C.P. §1033.5

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| Page 6: Comment [KEB15] | Kenneth E. Bacon | 2/18/2020 1:49:00 PM |
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I'm not sure what this meant. That sentence appears to be something Joel added in his last draft. It could mean fees to make copies or something of that nature, but it may be best to just delete that sentence.