

**ARBITRATION ADVISORY**

**2020-0XB**

**HANDLING DISPUTES REGARDING COSTS  
AND EXPENSES**

**Date**

Disclaimer Box

**INTRODUCTION**

California Business and Professions Code sections 6200-6206 confers jurisdiction upon Mandatory Fee Arbitration (MFA) arbitrators to consider and make awards concerning disputes over fees, costs, or both, that are charged to a client in connection with professional services rendered by an attorney. The purpose of an arbitration advisory is to provide guidance to MFA arbitrators regarding disputes or issues that may arise in connection with MFA arbitrations.

This arbitration advisory is intended to summarize existing law and to provide guidance to Mandatory Fee Arbitration arbitrators on disputes over costs and expenses that may arise from time to time in connection with MFA arbitrations.

**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.

## **B. General Considerations:**

### **a. Contractual Interpretation**

The right of an attorney to charge a client for costs and expenses generally is a matter of contract, express or implied. Consequently, the arbitrator should first look to the written fee agreement, if one exists, to determine the parties’ agreement 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.

Provisions governing the lawyer’s right to charge and collect for fees, 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 and must be fair and reasonable. *See, generally, Alderman v. Hamilton* (1988) 205 Cal.App.3d 1033; *In re County of Orange* (1999) 241 B.R. 212, 221. As the State Bar Court has explained:

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

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

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

Even in the absence of a specific agreement as to costs and expenses in the fee agreement, or a formal written fee agreement, the attorney has the implied authority to handle and charge for costs and expenses that are necessary, reasonable, and fair. *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

71 to the necessity, reasonableness and fairness, or the possible unconscionability of the disputed  
72 cost or expense item.

73           b.       Statutory Requirements

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

78           Agreements in contingent fee cases are governed by Business & Professions Code  
79 §6147. Subsection (a)(2) provides that the agreement shall include “A statement as to how  
80 disbursements and costs incurred in connection with the prosecution or settlement of the claim  
81 will affect the contingency fee and the client’s recovery.”

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

85           c.       Other General Considerations

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

104           On the other hand, “the attorney may recoup costs and expenses reasonably incurred in  
105 connection with the client’s matter for services performed in house, such as photocopying, long  
106 distance telephone calls, computer research, special deliveries, secretarial overtime, and other  
107 similar services so long as the charge reasonably reflects the lawyer’s actual cost for the services  
108 rendered.” (SDCBA Opinion 2013-3 at p. 5 (citing ABA Formal Opinion 93-179).) As  
109 discussed more particularly below, recoverable in-house costs and expenses include items such  
110 as photocopying, postage and messenger costs, long-distance phone charges, travel and parking,

computer research charges. 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. 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. (*Matter of Kroff, supra* at 13.) 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.”.)

**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), See also, Code of Civil Procedure §1033.5(C) [travel expenses to attend depositions as an allowable item of costs in litigation]; . 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].

**Business luncheons and meals:** 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 re Maruko Inc.*, 160 B.R. 633 (1993); [in house luncheons among attorney staff alone are considered overhead]. Where requested and approved by the client, such luncheon expenses may be charged to the client. However, meal expenses incurred while traveling for depositions, out-of-town travel on a case may be a proper cost charged to the client. (ABA Formal Opinion 93-379, p.7; *Howard v. American National Fire Ins. Co.* (2010) 187 Cal.App. 4<sup>th</sup> 498, 541 [analyzing recovery of meal expenses as an item of recoverable costs under Code of Civil Procedure §1033.5]; but see, *Gorman v. Tassajara Development Corp.* (2009) 178 Cal.App.4<sup>th</sup> 44, 72 [distinguishing between local meal expenses and meals incurred while traveling].)

**Secretarial and staff:** Regular secretarial services are normally 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). However, if secretarial overtime was incurred because of an emergency or time exigency related to the client’s case, then such costs may be billed to the client as a cost. (SDCBA 2013-3 pp. 7-8.) Other staff overtime is also generally considered part of general attorney overhead, except where actions of the client or the nature of the case may require extraordinary overtime.

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

**Computer Assisted Legal Research (CALR):** Billing for CALR is not a settled issue as courts are split on whether some portion of electronic research expenses should be considered overhead costs that are not charged to the client. (See, e.g., *Cairns v. Franklin Mint Co. (C.D. Cal 2000)* 115 F.Supp.2d 1185, 1189.) There is a school of thought that holds that CALR is overhead, particularly as is the case more and more where the attorney’s “library” is predominately electronic and the attorney or law firm has a fixed-fee contract with the service provider. Another school of thought holds that CALR is billable to the client; and, such charges specifically 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). In SDCBA 2013-

3, the Committee, applying ABA Formal Opinion 93-379 as endorsed by the State Bar Court in *Kroff*, concluded that an attorney could legitimately charge a client the actual direct cost of CALR.

In light of developing law in this area, at a minimum, the arbitrator should first confirm whether such charges have been agreed to by the client in advance. The next area of inquiry will be the reasonableness of the charge. If the charge is based on the firm's actual cost, it may be billed to the client as a cost in connection with the representation. Some providers offer "pro-forma" invoices for such charges, but these are not usually the actual amount charged to the firm relative to each client. Thus, where such charges are passed along to the client, the arbitrator should inquire as to the methodology used to assure that the charges were reasonably allocated among all clients using such services for the month or other billing period. Again, the arbitrator should determine whether the client knowingly and voluntarily agreed to pay any profit, markup or extra charge 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 may want to consider retaining an 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:** Long-distance telephone charges incurred in a client's case have generally been considered a cost which can be charged to the client, as opposed to an overhead expense, especially if the fact that an attorney will charge the cost of long-distance calls is included in the fee agreement. (*See*, ABA Formal Opinion 93-379 (1993); SDCBA Legal Ethics Opinion 2013-3.) However, given the current state of telephonic communication through cell phones or internet phone services (VoIP), long distance calls may not be considered reasonably necessary 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); *Ojeda v. Sharo Cabrillo Hospital* (1992) 8 Cal.App.4<sup>th</sup> 1, 8 [“Traditionally, the costs associated with a lawsuit have included items such as transcript, filing, service and jury fees and hourly compensation paid to experts who serve as witnesses or consultants.”].)

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

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

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