

HEADLINE: Proposed Arbitration Advisory Interim No. 2020-0XB (Handling Disputes Regarding Costs and Expenses)

SUBHEAD: The State Bar seeks public comment on Proposed Arbitration Advisory Interim No. 2020-0XB (Handling Disputes Regarding Costs and Expenses).

Deadline: February 22, 2021

Background

The State Bar Standing Committee on Professional Responsibility and Conduct (COPRAC) is charged with the task of issuing arbitration advisories providing guidance to fee arbitrators administering attorney-client fee disputes under the Mandatory Fee Arbitration Program. In accordance with State Bar policy and procedure, the Committee shall publish proposed arbitration advisories for public comment. (See, State Bar Board of Trustee Resolutions September 2018 and January 2020; see also, Board of Trustee Resolutions July 1979, December 2004, and November 2016.)

Discussion/Proposal

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.

Proposed Arbitration Advisory Interim No. 2020-0XB is intended to summarize existing law and to provide guidance to MFA arbitrators on disputes over costs and expenses that may arise from time to time in connection with MFA arbitrations.

At its October 23, 2020 meeting and in accordance with its Rules of Procedure, COPRAC tentatively approved Proposed Arbitration Advisory Interim No. 2020-0XB for a 90-day public comment distribution.

Any fiscal/personnel impact

None

Background material

Proposed Arbitration Advisory Interim No. 2020-0XB

Source

State Bar Standing Committee on Professional Responsibility and Conduct

Deadline

February 22, 2021

Direct comments to

Comments should be submitted using the [online Public Comment Form](#). The online form allows you to input your comments directly and can also be used to upload your comment letter and/or other attachments.

INTERIM ARBITRATION ADVISORY 2020-0XB
HANDLING DISPUTES REGARDING COSTS AND EXPENSES

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 Rule of Professional Conduct 1.5

Business and Professions Code section 6148 (billing for costs in hourly fee cases)

Business and Professions Code section 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. ABA Formal Opinion No. 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 the difference between costs and attorney overhead expenses. The ABA's opinion was endorsed by the State Bar Court in *In the Matter of Kroff* (Review Dept. 1998) 3 Cal. State Bar Ct. Rptr. 838.

B. General Considerations:

1. 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 [18 Cal.Rptr. 524]; *Baron v. Mare* (1975) 47 Cal.App.3d 304 [120 Cal.Rptr. 675].

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 [252 Cal.Rptr. 845]; *In re County of Orange* (C.D.Cal. 1999) 241 B.R. 212, 221 [4 Cal. Bankr. Ct. Rep. 117]. 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 [40 Cal.Rptr. 309] [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.)

In the Matter of Brockway (Review Dept. 2006) 4 Cal. State Bar Ct. Rptr. 944; see also *Severson & Werson v. Bolinger* (1991) 235 Cal.App.3d 1569 [1 Cal.Rptr.2d 531]. *In the Matter of Lindmark* (Review 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 No. 93-379 (1993); see also, Bus. & Prof. 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 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 to the necessity,

reasonableness and fairness, or the possible unconscionability of the disputed cost or expense item.

2. Statutory Requirements

Agreements to charge fees and costs in a non-contingent fee matter must comply with Business and Professions Code section 6148. Subsection (b) sets forth statutory requirements for what must be included in a bill and provides 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 and Professions Code section 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 and Professions Code sections 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.

3. 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 (*Rest.3d Law Governing Lawyers* § 38(3)(a); ABA Formal Opinion No. 93-379 (1993); San Diego County Bar Association Ethics Opinion No. 2013-3 at pp. 3-5.) 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 overhead costs 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. (San Diego County Bar Association Ethics Opinion No. 2013-3 at p. 4; ABA Formal Opinion No. 93-379 (1993); see, also, *In the Matter of Kroff* (1998) 3 Cal. State Bar Ct. Rptr. 838 [endorsing ABA Formal Opinion No. 93-379; *In re Tom Carter Enterprises, Inc.* (C.D.Cal. 1985) 55 B.R. 548.) Thus, with respect to items traditionally viewed as overhead, unless the agreement is clear that such expenses will be charged, the attorney should not be able to recover them. (San Diego County Bar Association Ethics Opinion No. 2013-3 at p. 5; *Rest.3d Law Governing Lawyers* § 38(3)(a).)

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.” (San Diego County Bar Association Ethics Opinion No. 2013-3 at p. 5 (citing ABA Formal Opinion No. 93-179).) As discussed more particularly below, recoverable in-house costs and expenses include items such 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, Tuft et al., Cal. Practice Guide: Professional Responsibility (The Rutter Group 2017) Ch. 5-E, § 5:550-5:552 [citing several opinions on this topic].

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 No. 93-379 (1993). See also *In the Matter of Kroff* (1998) 3 Cal. State Bar Ct. Rptr. 838; and the San Diego County Bar Association Ethics Opinion No. 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 *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. (*In the Matter of Kroff, supra*, at 13.) Thus, any such agreement should be scrutinized for unconscionability pursuant to California Rule of Professional Conduct 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 No. 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 No. 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* (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 No. 93-379 (1993); see also, Code of Civil Procedure section 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.* (C.D.Cal. 1985) 55 B.R. 548 [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.* (C.D.Cal. 1985) 55 B.R. 548; see also, *In re Maruko Inc.* (S.D.Cal. 1993) 160 B.R. 633; [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 No. 93-379 at p. 7; *Howard v. American National Fire Ins. Co.* (2010) 187 Cal.App.4th 498, 541 [analyzing recovery of meal expenses as an item of recoverable costs under Code of Civil Procedure section 1033.5]; but see, *Gorman v. Tassajara Development Corp.* (2009) 178 Cal.App.4th 44, 72 [100 Cal.Rptr.3d 152] [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.* (C.D.Cal. 1985) 55 B.R. 548. 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. (San Diego County Bar Association Ethics Opinion No. 2013-3 at 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. San Diego County Bar Association Ethics Opinion No. 2013-3; ABA Formal Opinion No. 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.* (S.D.Cal. 1993) 160 B.R. 633; *In re Tom Carter Enterprises, Inc.* (C.D.Cal. 1985) 55 B.R. 548. In San Diego County Bar Association Ethics Opinion No. 2013-3, the Committee, applying ABA Formal Opinion No. 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: The attorney and the client may agree in advance that, for example, photocopying will be charged at \$0.15 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 No. 93-379 (1993); San Diego County Bar Association Ethics Opinion No. 2013-3. Discrete or large photocopying projects specific to a client's representation may generally be charged to the client, especially where there is some need for such services and where the client agrees in advance. 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 No. 93-379 (1993); San Diego County Bar Association Ethics Opinion No. 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.* (C.D.Cal. 1985) 55 B.R. 548. 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.* (C.D.Cal. 1985) 55 B.R. 548; *Ojeda v. Sharp Cabrillo Hospital* (1992) 8 Cal.App.4th 1, 8 [10 Cal.Rptr.2d 230] ["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 to the foregoing guidelines of what the arbitrator may consider when the client may dispute the attorney's charges for costs and expenses.

From: [Carol M Langford](#)
To: [Difuntorum, Randall](#); [Tuft, Andrew](#)
Subject: Arbitration Advisory 2020-OXB
Date: Thursday, November 19, 2020 3:13:09 PM

CAUTION: This email originated from outside of the organization. Do not click links or open attachments unless you recognize the sender and know the content is safe.

I cannot figure out how to comment on this Opinion. My comment is simple: it appears to allow a lawyer to charge for HVAC (heating and air conditioning) and legal malpractice insurance and the like as a sort of admin fee if the client consents.

What?? That will not make the public enamoured with lawyers. We sell professional services, not HVAC.

Filing fees, etc. are fine. But this clearly refers to things that are office overhead, like rent.

Can you pass this along for me?

--

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From: [Carol M Langford](#)
To: [Difuntorum, Randall](#); [Tuft, Andrew](#)
Subject: Fee Arb Opinion
Date: Saturday, November 21, 2020 6:08:29 PM

CAUTION: This email originated from outside of the organization. Do not click links or open attachments unless you recognize the sender and know the content is safe.

FYI if you allow the fee arb draft Opinion to be published with the part in it - the way it is written - on admin/rent, and HVAC, you will suffer. Or the Bar will. It is one thing if a rich client who wants overtime is willing to pay. It is another fir the poor schmuk in Stockton who feels stuck paying because all middle and low range clients think they have to pay. This I know for sure.

Clients should NOT have to pay for a lawyer's rent. That is so "Let them eat cake" in this day and age.

Sent from my iPhone