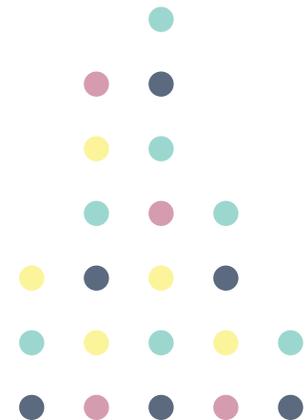


**WHITE PAPER**

# Cost Recovery and eDiscovery: Options for Law Firms

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## Overview

Law firm business models are under constant pressure from clients seeking greater accountability. Billable hours and pass-through fees are carefully examined, and alternative fee arrangements – in which firms are expected to absorb more of the everyday business costs associated with representing clients – are increasingly common. Clients are more likely to question charges that seem “unreasonable,” and firms are under pressure to accept certain expenses as “overhead” in exchange for being able to bill appropriate fees for their legal expertise.

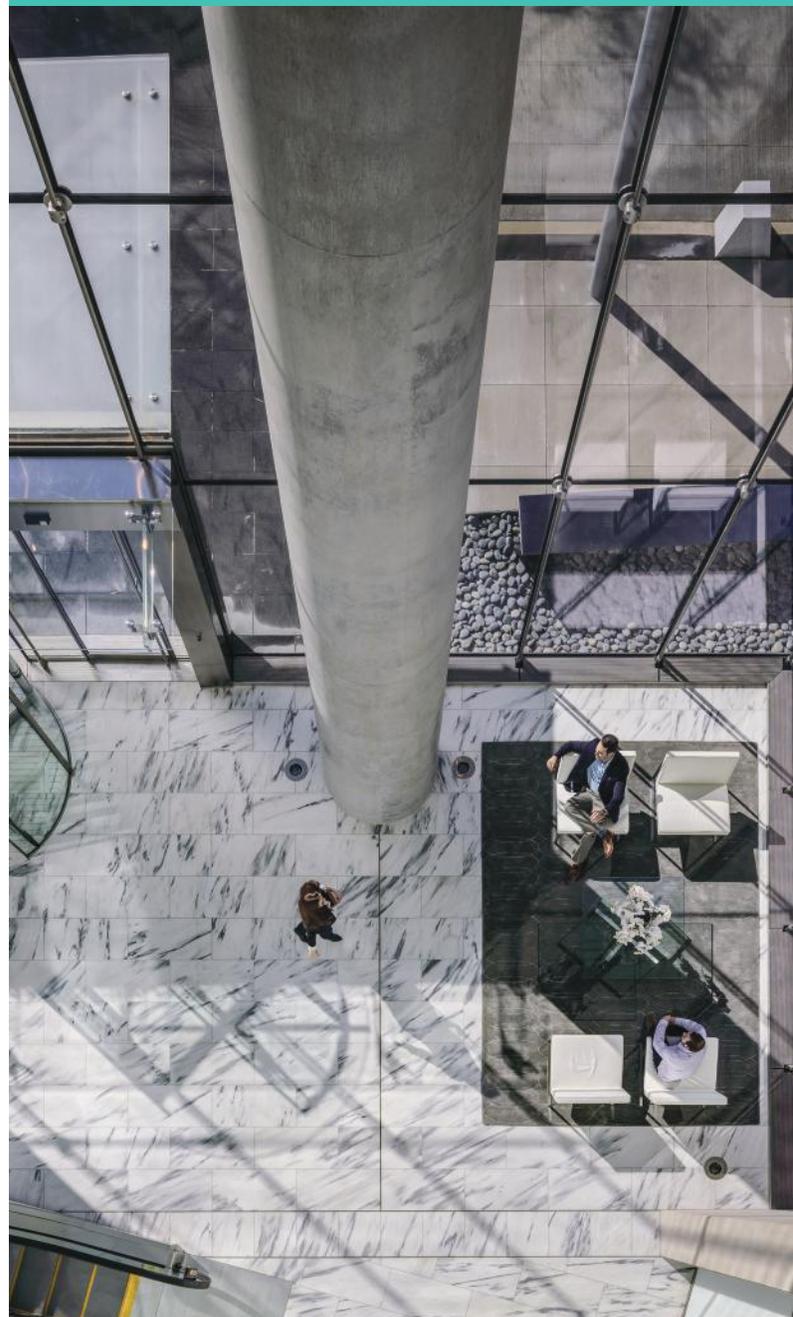
Many provisions that firms and clients generally agree on are easy to appreciate and understand. Telephone calls? Bill for the labor, but not the long distance. Writing a brief? Charge for the legal craft, not the word processing software license. Did inexperienced legal support staff take too long to write a brief? Write off the cost. Common sense rules the day.

But eDiscovery technology presents a different set of issues that require more careful consideration, especially in light of recent advances in technology that automate more and more complex processes and dramatically reduce the amount of skilled labor required to cull and review electronic documents and identify key evidence early in litigation. Today’s most effective eDiscovery technology – which is much more powerful and more fully integrated than it used to be, and incorporates recent innovations in areas like cloud computing and artificial intelligence – is no longer in the same category as ordinary business productivity tools.

Understandably, many firms struggle with how to appropriately, reasonably and ethically manage the costs of a modern, robust eDiscovery technology solution. More robust technology routinely saves clients money and produces better outcomes, but how can firms that provide these benefits ensure they cover their own costs?

In this white paper we will examine several cost recovery business models that have emerged in the wake of rising costs for eDiscovery technology.

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# The Status Quo: Absorbing eDiscovery Costs as Overhead

Traditionally, law firms have absorbed eDiscovery costs as a form of overhead. When eDiscovery technology was comparatively simple and inexpensive to own (think early versions of Concordance or Summation), this practice seemed reasonable enough. It conformed to similar practices regarding ordinary business expenses, such as absorbing the costs for computers for each attorney or for the software applications needed to support a client. Treating eDiscovery as overhead still represents the path of least resistance for many firms: “Our firm has always covered these costs for clients – we can’t change it now.”

However, because data volumes and complexity in litigation continues to increase rapidly, and because eDiscovery technology is now much more powerful and sophisticated, most firms can no longer afford the infrastructure and IT support required to implement and maintain the kind of eDiscovery practice that their clients have come to expect. While clients may demand advanced and effective solutions to manage electronic evidence, it is increasingly impractical to offer these solutions as a cost to be absorbed.

Defenders of the status quo may point out that charging for eDiscovery can be complicated. For one thing, the services tend to be more costly than other litigation-related fees such as court reporters, copy services or even offsite trial prep room. Also, accurately projecting costs early in the discovery process is difficult (although advances in technology like predictive analytics are dramatically reducing these uncertainties). The scale of an eDiscovery project can quickly increase with the discovery of new custodians and more potentially relevant data. Typically, a number of key variables are unknown at the outset of a case.

However, the value of effective eDiscovery technology for both firms and clients is increasingly apparent. And while effectively managing the data side of litigation may not at

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first glance seem like a core skill set in the legal profession, [Amendments to the ABA Model Rules of Professional Conduct made in 2012](#) are explicit in requiring that lawyers keep abreast of technological changes in the practice of law and consider the benefits and risks associated with relevant technology. This is now part of their ethical responsibility to provide competent representation.

Firms that feel obligated by “tradition” to resist cost recovery strategies in their eDiscovery practice run the risk of shortchanging clients in other ways – by charging inflated rates for other services, for example, or by failing to provide the most effective technology to address their clients’ litigation challenges.



# Ethical Considerations

Increasingly, firms may wish to charge their clients for eDiscovery, and because of its crucial role in litigation, many have determined it is appropriate to do so. But is it ethical?

According to the [ABA Model Rules of Professional Conduct 1.5\(a\)](#), a lawyer may not charge an unreasonable amount for litigation expenses. The reasonableness standard is based on a number of factors enumerated in Model Rule 1.5(a). Ethics Opinion 93-379 states that the reasonableness standards in 1.5(a) also apply to disbursements to third parties.

Individual firms will need to arrive at their own conclusions based on particulars of their own cost recovery plans, but ABA rules suggest that as long as eDiscovery and litigation support fees are reasonable and disclosed to the client at the outset of the attorney's legal engagement, law firms can recover fees for litigation support and bill eDiscovery services directly to their clients.

## Cost Recovery for eDiscovery

Asking clients for reasonable compensation for eDiscovery-related expenses is beginning to make sense to many law firms. As they confront dramatic increases in the scope and technical complexity of discovery practice, the tradition of assigning the associated costs to overhead is becoming increasingly obsolete. In today's litigation landscape, eDiscovery is expensive and the value of fast, accurate and

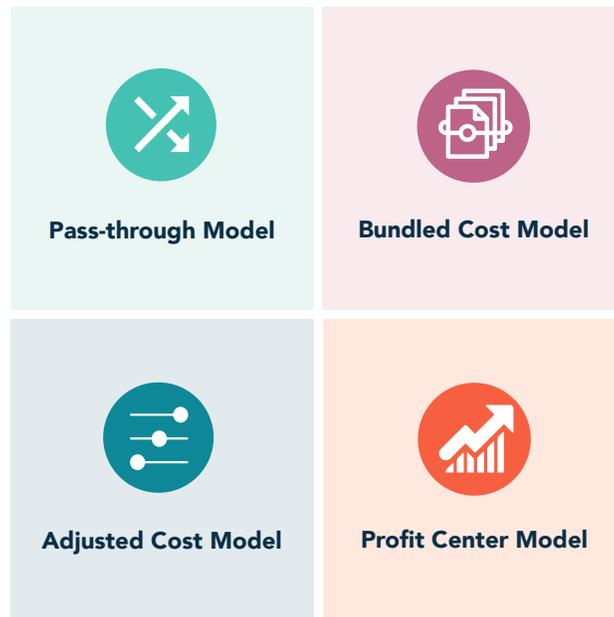
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efficient eDiscovery in litigation is hard to dispute. Many firms are debating whether they need to take a more strategic approach to cost recovery.

But how do firms quantify the value of eDiscovery in specific matters and convince clients that paying for it is not only fair but in their best interests? What kinds of cost recovery models should firms consider using to recoup these expenses?

There are four basic cost recovery models currently in use: the pass-through model, the bundled costs model, the adjusted cost model and the profit center model. The model(s) a particular firm chooses to adopt will depend on a number of factors, including the firm's overall business strategy, the specific practice areas it covers and the nature of its client base, as well as the eDiscovery technologies and vendors the firm uses. Firm culture and the client preferences will also play a crucial role in determining the most appropriate cost recovery model.

1. In [Formal Opinion 93-379](#), the ABA Committee on Ethics and Professional Responsibility stated: "In the absence of an agreement to the contrary, it is impermissible for a lawyer to create an additional source of profit for the law firm beyond that which is contained in the provision of professional services themselves. The lawyer's stock in trade is the sale of legal services, not photocopy paper, tuna fish sandwiches, computer time, or messenger services."
2. Comment to ABA Model Rule 1.5: "A lawyer may seek reimbursement for the cost of services performed in-house ... either by charging a reasonable amount to which the client has agreed in advance or by charging an amount that reasonably reflects the cost incurred by the lawyer."
3. ABA Formal Op. 93-379: "The lawyer may recoup 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."



## Pass-through Model

The pass-through model for cost recovery is currently the dominant model in the industry. In this model, the law firm “passes through” all costs incurred for eDiscovery directly to its clients for each case or transaction without marking up any of these costs. Firms also typically charge for project management support, and some firms may also choose to charge fees to cover the coordination involved in arranging any third-party services. Transparency is a primary benefit and the fundamental goal of this model.

For the pass-through model to function effectively and be acceptable to clients, the firm must be able to accurately itemize – and explain, if the client requests it – all eDiscovery-related costs on its invoices. In some cases, depending on the relationship between firm and client, firms using the pass-through model may be able to simplify invoices to some extent by grouping expenses into broad categories without detailed itemization.

Firms using the pass-through model have a responsibility – sometimes requiring considerable energy and effort on the part of staff – to ensure that the vendor charges they are passing on to clients are reasonable by market standards, and they should be prepared to defend specific charges according to this criterion. When vendors make mistakes,

overcharge or fail to meet their own obligations, firms may face find themselves negotiating adjustments not only on their own behalf, but also on behalf of their clients.

## Bundled Cost Model

In the bundled cost model, a law firm typically engages an outside vendor to provide a SaaS or on-premise solution for eDiscovery services, and the firm bills its clients for these services by marking up the per-gigabyte data hosting charges they pay. Markups are designed to cover the internal costs, including legal support labor, associated with the firm’s discovery practice. Under this arrangement firms may bill separately for internal project management support time, or they may increase the markup and include project management costs in the “bundle.”

For the client, the cost of this arrangement is considerably higher than it would be for the cost of data storage alone, but they no longer have to pay separately for the labor of legal support staff, and the invoices they receive are likely to be much simpler and easier to understand than invoices in a pass-through model. Bundling tends to minimize potential haggling, after the invoice is delivered, over costs that may seem exorbitant to clients. Also, costs for eDiscovery are more predictable for clients, and may end up being lower overall.

For the firm, this arrangement is attractive because they are much less likely to have to defend charges or write off costs for work that isn't done efficiently. The client is less likely to complain because costs are more predictable, and invoices are simpler and therefore easier to explain to the client.

Bundling can be handled in a variety of ways depending on a number of factors. For example, it could take the form of:

- A flat litigation support fee – say, \$10,000 per month to cover everything related to eDiscovery, including labor, data hosting and technology)
- A per custodian fee, such as \$X per custodian per month
- A simple upfront fee – say, \$X per gigabyte as ingested, with no other fees
- A simple per-document fee

While all of these variations on the bundling model for cost recovery have been tried at one time or another, the per-gigabyte approach is probably the most common, presumably because it aligns desired outcomes with a readily measurable metric that makes sense to clients. For example, the per-custodian fee may seem attractive for its simplicity, but it may end up incentivizing clients to withhold potentially useful custodians to save money. Likewise, a per-document fee could incentivize firms to review documents they don't actually need to review. A per-gigabyte fee is also imperfect, but for many clients it is the most prudent option among various bundling alternatives.

As with all cost recovery models, it is imperative that law firms embrace transparency in their bundling agreements with clients, so clients know exactly what services are included or excluded in the "bundled" rate and the markup for data hosting is based on prevailing market rates and proportional to the actual cost of the associated services they are providing.

### Adjusted Cost Model

The adjusted cost model for eDiscovery cost recovery focuses primarily on charges for data hosting and technology. Like the bundling model, the adjusted cost model involves marking up the fees firms pay to vendors for these services. (In this case, the markup is not designed to cover associated costs like support staff or project management, which are billed separately or absorbed.) Essentially, in this model law firms purchase eDiscovery services from vendors at a "wholesale" price and then sell those services to their clients at a "retail" price.

While it would be unethical for firms to simply mark up ordinary hosting and technology costs without adding value, in the adjusted cost model firms are purchasing those services in bulk and independently of individual clients. For example, a firm might negotiate "wholesale" rates from a vendor by committing to purchasing a minimum amount of data hosting capacity over a designated period of time. The firm is obligated to pay for this capacity whether they end up using it or not, and they therefore assume the risk of buying more capacity than they can actually use.

To make this arrangement work, firms must be able to make accurate projections regarding the hosting requirements of upcoming legal matters. The "retail" fees they charge clients for these services must also be in line with prevailing market per-gigabyte rates. On the other hand, if a firm makes accurate projections and uses the purchased hosting and technology services efficiently, it can offer clients a favorable and consistent rate and perhaps lower overall costs, and the firm itself may end up benefiting financially from the economy of scale inherent in this model.



## Profit Center Model

As our discussion of the adjusted cost model implies, firms have developed expertise in projecting costs, identifying potential process improvements, implementing technology-enabled efficiencies and effectively exploiting economies of scale may actually be able to transform their eDiscovery practice into a profit center. In fact, any of the aforementioned cost recovery models could be adapted to a profit center approach by firms that have a good understanding of their actual costs and workflows, and manage discovery efficiently.

Transitioning to a cloud-based eDiscovery platform could be an important factor in helping firms meet these objectives, as could targeted use of advanced technologies like data analytics, machine learning and natural language processing. The key imperatives for firms pursuing the profit center model – or any cost recovery model, for that matter – in an ethical and sustainable way are 1) to be fully transparent with clients, 2) to charge clients at rates that are reasonable or favorable vis-à-vis the marketplace, and 3) to ensure there is precedent in the industry for the approach they have embraced.

## How eDiscovery Vendors can Help

Everyone knows you get what you pay for. But first, most of us want to know what we are paying for and why. Law firms and attorneys should demand that their eDiscovery partner provide the best in legal technology AND provide full transparency of the services rendered so they can, in turn, directly recover these costs from their clients. An eDiscovery partner like Casepoint that works with their law firm clients to educate and provide full transparency of the best in technology to its clients can make a big difference in transitioning to a cost recovery model. The law firm wins by recouping fees they are already paying for, and the client wins by receiving the most progressive, efficient and cost-effective legal representation.



## Getting Buy-In

Transitioning to a more strategic approach to recovering costs for eDiscovery can be a challenge, especially if the law firm has never billed its clients for these services. Senior attorneys are likely to object, “We’ve never billed for eDiscovery or litigation support. If we start now, our client will take their business elsewhere!”

In many firms, there is a cultural bias in which the eDiscovery practice group is perceived as performing a supporting role, augmenting the more “substantive” work of subject matter practice groups (such as construction or real estate or antitrust), rather than functioning as another line of business in the organization that adds value and impacts outcomes. Attorneys in subject matter practice groups may fear that charging for eDiscovery will undermine their relationships with clients. Overcoming these and other objections will require careful communication and advocacy should be led by an internal “champion,” such as a CIO, CFO, litigation support manager and/or a senior attorney who has intimate familiarity with the details of eDiscovery.

There is also an increasingly obsolete perception that conducting eDiscovery is primarily a matter of “software” analogous to business productivity applications. In reality, it is increasingly difficult for firms to afford the technological infrastructure to fulfill industry-standard eDiscovery obligations with the requisite computing power and advanced capabilities that today’s data-intensive legal matters demand.

Law firm leadership and attorneys need to be educated – not only to enhance their own understanding, but also so they can in turn make a case to clients for moving beyond the “overhead” model, which can obscure important details of the eDiscovery process. Firms must demonstrate that the cost recovery fee arrangement they are proposing is more transparent and provides better accountability, and in making the case they should emphasize client business objectives that implementing the right technology can address, like speed, accuracy, cost-efficiency, economies of scale and better legal outcomes.

Advocates of cost recovery will need to carefully analyze which of the models best fits their firm’s organizational structure, client base and firm culture, and then develop a strategic cost recovery plan that includes a detailed cost-benefit analysis based on data from actual legal matters the firm has already litigated. Among other things, that will mean itemizing each of the actual costs subsumed under the “overhead” category. It may also entail identifying tradeoffs that the firm is forced to make to compensate for uncovered expenses in the overhead model, such as deciding against deployment of predictive coding in a matter that clearly calls for it.



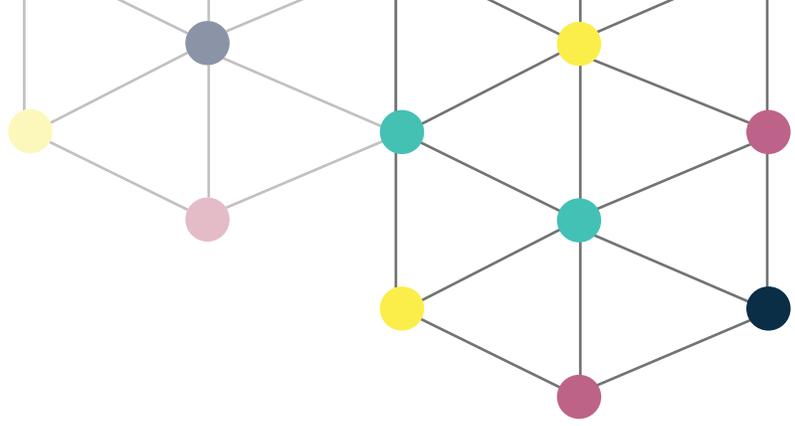
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## Conclusion

Litigation in the twenty-first century is increasingly data-driven, and simply absorbing the cost of implementing advanced technologies that enable dramatic new efficiencies – and better legal outcomes – is not sustainable. In the long run, treating eDiscovery costs as overhead is not only likely to be detrimental to a firm's bottom line, but also may risk degrading the level of service it provides to clients.

Corporate clients are already receptive to the business case for improvements in efficiency and cost-effectiveness. Law departments are under increasing pressure within their own organization to be more efficient and accountable in everything they do. A well-designed cost recovery plan that is ethical, transparent and based on reasonable market-level rates for eDiscovery services has the potential to benefit both firms and their clients and solidify those relationships over time.





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