

## Cost Recovery in 2018: An Evolving Internal and External Strategy

By Rob Mattern

It's now been 10 years since the economic crisis of 2008, and just under 10 years since we saw the greatest dip in demand for services experienced by the legal market. The market has stabilized since then, but growth has remained, year over year, flat. The Thomson Reuters 2018 Report on the State of the Legal Market shows this trend will continue as we see a market characterized by flat to sluggish growth, a continued decline in productivity, modest rate increases and the continued downward pressure on realization.

While over the past 10 years, firms have started to get a handle on their expenses, The State of the Legal Market Report notes a slight uptick in expenses overall for firms – and while this is likely a result of raising associates' pay, it does shine a light that firm's expenses are an area of evolving and necessary strategic thinking. What, if anything, are firms missing when it comes to strategically controlling expenses? Similarly, what, if anything, could firms be doing to improve recovery of costs? Are firms recovering for new areas of support? If so, how?

As we stated above, we at Mattern

& Associates think 2018 will show an increased focus on costs, as well as the applicable recovery of these costs. We also think that the data will continue to reveal that the greatest obstacle to an improved recovery strategy in 2018 as mostly "internal". The most recent decade – starting with the downturn of 2008 through today – shows on average a 20% decrease in billable actually billed. This means more attorneys every year are writing off billable costs before they reach the invoice. While the percentage of these charges have been paid by clients at relatively stable rates – in the high 80% range – for the same period.

This increase in internal write-offs has two sources: 1. billing attorneys are reluctant to invoice these costs – regardless of whether the client have refused to pay or not, and 2. some clients refuse to pay for any costs outside of fees except hard costs. Cli-

ents that understand and agree to a clear cost recovery strategy will pay.

We predict that in Mattern's upcoming 2018 Cost Recovery Survey the data will begin to show that this will be the first year that firms take their recovery strategy internal and get buy-in from the billing attorneys on recovering from clients that are willing to pay. There may be a softening of the traditional areas of recovery (copies, etc.), but this will be offset by a renewed aggressiveness for modern areas of recovery such as scans, prints, and litigation support/eDiscovery costs, storage, data rooms, closing books, hosting, coding, and more.

Here are some details to that prognosis, but first, a few definitions:

- **Billable percentage:** The percentage of an item charged to billable client matter number versus a non-billable (overhead) number.



- **Average percentage of billable actually billed:** The percentage of a billable item that is actually billed to a client.
- **Average percentage of what is actually billed that is paid:** The percentage of a billable items that is actually billed to a client and paid by the client.
- **Net realization:** The percentage of the billable that is actually billed and is paid by the client.

It is also necessary to define how firms handle clients that will not pay for soft cost recoveries. For the purpose of this article we are taking the position that firms are charging the applicable client matter number and writing these charges off in the pre-bill process. This is based on the fact that 84% of firms responding in 2016 survey took that position.

### **Black & White (B&W) and Color Copies**

In 2016, 92% of firms that responded to the survey were recovering black and white (B&W) copies, down from 98% in 2014 with color copies seeing a similar decrease. The net realization for both B&W and color also experienced similar decreases into the upper 30% range. The reason for this decrease is directly attributable to the decline in the average percentage of the “billable actually billed” which is the internal write-off of these charges.

Interestingly both B&W and color copies saw increases in the rates that firms were using to recover these costs.

### **Black & White (B&W) and Color Prints**

The percentage of firms recovering B&W and color prints increased from 2014 to 2016 and we predict that this trend will continue as B&W copy volume continues to erode and firms fight to protect recoveries to cover these costs. The same trends that we saw with B&W and color copies are apparent in the area of B&W print recovery with decreases in net realization attributable to increases in internal write-offs. Again, we see this trend continuing. Immune to this are color prints which saw a slight decrease in internal write-offs but otherwise remained strong as color becomes more of a norm in the workplace.

### **Scanning**

In 2016, approximately 37% of firms were recovering scans. We see this number increasing in 2018 as scanning increasingly becomes a staple of the legal workflow.

### **Legal Research**

In 2016 we predicted that legal research cost recovery would decrease; however, no one predicted how big of a decrease this area would incur with net realization decreasing by a third to 25% from 36% in 2014. Based on feedback and intermittent studies over the past two years, we are confirming the prediction we made in 2016 that the net realization of legal research will fall below 20% in 2018.

### **Litigation Support/eDiscovery**

The continued practice of not recovering costs for litigation support and data hosting is becoming untenable for firms. There are three issues surrounding this area of recovery:

- 1) Many firms have historically not recovered software and infrastruc-

ture/data storage costs and to try to shift that paradigm is difficult.

- 2) Many firms lack a strategy to recover these costs effectively, relying on the billable hours of the litigation support staff as a vehicle to recover all costs.
- 3) These areas are a mix of internal and external costs. Impacting and helping influence recovery is the projected growth of managed services in this area which creates a fixed cost vehicle to assist in the recovery of these costs. This recovery vehicle, along with the other benefits of managed services – reduction of risk and capital costs – makes this area ripe for continued growth and increasing recovery.

### **Hard Costs – Still the Way to Go**

As the survey has shown the past ten years, we predict hard costs will continue to be the most effective way to recover costs with net realization remaining in the mid 80% range.

### **The Continued Impact on Cost Recovery Vendors**

As the cost recovery climate changes in the legal arena, the service providers that sell their cost recovery systems can no longer count on the recovery of costs as their primary focus. With only 50% of firms recovering prints and slightly less recovering scans, and many firms looking to abandon cost recovery entirely, their focus have shifted to workflow which was only natural. This focus will only continue as copy volume continues to decline and the percentage of firms recovering levels off in the print and scan areas.

### **The “New Norm”**

Unless firms are willing to adopt to new realities of increasing client and internal pushback, diminishing copy volume, increasing print and scan volumes and the need to recover rising litigation and eDiscovery costs, they will fail to evolve their expense strategies to meet the demands of the new market.

Regardless of the direction a firm chooses to move, or not move, it will require an overall strategy to adopt to these “new norms.”



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