

# BILLING FOR EDISCOVERY

How to Fully Recover Costs  
and Meet ABA Ethical Standards



BEST  
PRACTICE  
GUIDE

WRITTEN BY THE CLIENT SUCCESS TEAM AT NEXTPOINT

# **BILLING FOR EDISCOVERY**

## **HOW TO ETHICALLY PASS THROUGH EDISCOVERY COSTS TO CLIENTS**

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### **★ EXECUTIVE SUMMARY**

- Many lawyers mistakenly believe that they are ethically prohibited from earning a profit while passing through certain expenses incurred on behalf of clients
- Law firms routinely and unnecessarily reduce their profitability by absorbing technology costs as general overhead
- eDiscovery expenses incurred can reasonably be viewed as “in-house provision of services” similar to computer research or printing fees (Op. 93-379)
- It is ethically appropriate for an attorney to not only pass through costs but also realize a profit from the provision of in-house services like eDiscovery technology so long as these costs meet the ABA guidelines associated with proper disclosure and standards of reasonableness

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## ★ INTRODUCTION

eDiscovery software is indispensable in modern, internet-era civil litigation. Attorneys are under increasing pressure to invest in legal technology in order to provide effective counsel to their clients.

Additionally, in recent years the majority of state bars have modified their guidelines related to an attorney's duty of competence<sup>1</sup> to include not only substantive knowledge of the law but also competence in the use of legal technology.

As eDiscovery technology adoption increases, however, many law firms struggle with how to effectively and accurately pass these costs through to their clients. Attorneys mistakenly believe that passing these costs through would run afoul of ethics standards. As a result, a surprising number of firms grudgingly decide to absorb these client-specific expenses, thereby reducing the partnership's bottom line.

As a provider of cloud-based legal software and related services, our mission is two-fold:

1. To enable litigation teams to work more efficiently and effectively
2. To help law firms improve their profitability

The purpose of this article is to help managing partners, litigation attorneys, and finance professionals at law firms understand the relevant ABA rules and opinions governing client fees.

In short, the **ABA guidelines** provide sufficient latitude to bill clients for eDiscovery expenses while adhering to the ethical standards and principles governing the legal profession. There is no ethical prohibition from billing technology costs to end clients, just as there is no prohibition from passing through any cost incurred as a result of providing legal services such as court filing fees, messenger services, or copying cost.

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1. In 2012, the American Bar Association updated Model Rule of Professional Conduct 1.1 related to Duty of Competence as follows: "To maintain the requisite knowledge and skill, a lawyer should keep abreast of changes in the law and its practice, including the benefits and risks associated with relevant technology."

## ★ SURVEY OF THE RELEVANT ABA MODEL RULES AND FORMAL OPINIONS

The **ABA Model Rules of Professional Conduct** serve as guides for the ethics rules of most jurisdictions. To help clarify specific matters that the ABA deems of interest to the profession, the **Standing Committee on Ethics and Professional Responsibility** regularly submits opinions. These opinions are advisory in nature and not binding on any court.

Client fees are the lifeblood of the legal industry yet vulnerable to unethical behavior. As such, the Standing Committee has submitted a number of important opinions on an attorney's obligations related to billing clients.

## ★ THE REASONABLENESS STANDARD

[ABA Model Rule 1.5](#) on Fees establishes the core principle governing how attorneys may bill clients. Specifically, Model Rule 1.5 states:

*"A lawyer shall not make an agreement for, charge, or collect an unreasonable fee or an unreasonable amount for expenses."*

The "reasonableness standard" posited by Model Rule 1.5 is elegant in its simplicity. Either by design or inadvertent omission, it avoids providing specificity regarding what it deems "reasonable."

Model Rule 1.5 provides eight factors to consider when determining the reasonableness of a fee. Two of these factors are particularly relevant to the discussion regarding passing through eDiscovery technology expenses:

- "The time and labor required, the novelty and difficulty of the questions involved, and the skill requisite to perform the legal service properly"
- "The fee customarily charged in the locality for similar legal services."

There is no ethical prohibition from billing technology costs to end clients, just as there is no prohibition from passing through any cost incurred as a result of providing legal services.

Model Rule 1.5 explicitly states that communication and transparency are essential when it comes to billing:

*“The scope of the representation and the basis or rate of the fee and expenses for which the client will be responsible shall be communicated to the client, preferably in writing, before or within a reasonable time after commencing the representation....” Further, “any changes in the basis or rate of the fee or expenses shall also be communicated to the client.”*

Applying the guidance outlined in Model Rule 1.5 to the question of billing clients for eDiscovery expenses, it may be considered reasonable to bill clients if one can answer “yes” to the following questions:

- Is an investment in eDiscovery software required to perform document review and litigation services on behalf of my client’s matter?
- Are the proposed fees associated with the eDiscovery software consistent with what I would charge other clients for similar legal services?
- Can I communicate with my client the basis or rate of the expenses for eDiscovery software, either before or within a reasonable time after commencing representation?

## ★ CATEGORIZING PASS THROUGH COSTS

[ABA Formal Opinion 93-379: Billing for Professional Fees, Disbursements and Other Expenses](#) provides additional guidance for attorneys considering whether it is appropriate to bill clients for their respective eDiscovery expenses. Written in 1993, well before eDiscovery software and the emergence of cloud computing platforms became widely available, Op. 93-379 nonetheless provides greater clarity on how law firms can pass through these costs.

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**Op. 93-379 posits three categories of expenses:**

- General Overhead
- Disbursements
- In-House Provision of Services

**General Overhead:**

According to the Opinion, an expense that an attorney incurs in the course of maintaining his/her business is assumed to be covered within the professional fee and should not be billed separately to the client. To illustrate, the Opinion states that:

*“...the client should reasonably expect that the lawyer’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 lawyer is making for professional services.”*

General overhead items such as insurance, rent, or utilities benefit all of the firm’s clients equally. There is no accurate method by which to assign a proportion of these costs to individual clients. As such, the charges are assumed to be incorporated within the attorney’s legal fees.

In most cases **eDiscovery costs are not a cost of doing business** and should not be treated as general overhead. **eDiscovery costs are incurred to benefit specific clients on specific case matters.** There are numerous, accurate methods by which to allocate the relative benefit each client receives from the technology service.

Said differently, if a law firm is currently absorbing eDiscovery technology costs it is implicitly and unnecessarily treating these costs as general overhead.

Of course it is completely up to the discretion of the managing partners whether they want to reduce the partnership’s profits by assuming these costs. But it is neither necessary nor required.

### *Disbursements:*

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Op. 93-379 defines disbursements as “those actual payments of funds made by the lawyer on the client’s behalf.”

The Opinion goes on to illustrate with two examples: a lawyer hiring a court stenographer to transcribe a deposition, and a lawyer purchasing a plane ticket to Los Angeles for the client. In both instances, the Opinion states that “clients justifiably should expect” the attorney to pass through the exact amounts.

Consistent with the principles addressed in Model Rule 1.5, Op. 93-379 reinforces the importance of the attorney communicating to the client in advance that they should anticipate paying for these costs. Further, if a lawyer treats a pass through cost as a disbursement, the Opinion maintains that it “would be improper if the lawyer assessed a surcharge on these disbursements over and above the amount actually incurred.”

It has been our observation that law firms are most confident passing through eDiscovery costs as disbursements. When eDiscovery expenses are priced as a cost per Gigabyte fee — either at data ingestion or via a hosting model — attorneys are largely comfortable receiving the invoice from the eDiscovery vendor and passing it straight through to the client.

When the eDiscovery invoice comes in the form of a software subscription, however, a surprising number of law firms struggle with how to pass this expense through to clients in accordance with their understanding of the ABA’s ethics standards. If the eDiscovery platform is used for multiple clients, allocating the subscription cost complicates the decision further.

This has been a fundamental problem in eDiscovery pricing. Because disbursements are easier to justify, pricing and billing models have been structured around data size. However, with ever-increasing data volumes, this approach is directly responsible for the high costs of eDiscovery and prevents the market from benefiting from the rapidly falling costs of processing and storing data.



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### *In-house Provision of Services:*

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"Perhaps the most difficult issue," the authors of Op. 93-379 acknowledge, "is the handling of charges to clients for the provision of in-house services."

Examples cited include photocopying, computer research, on-site meals, deliveries, and other similar items. When such expenses are incurred on behalf of a client, "lawyers may pass on reasonable charges for these services."


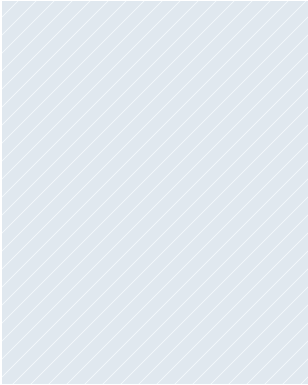
To illustrate what may be considered reasonable in the view of the ABA Committee, "the lawyer and the client may agree in advance that, for example, photocopying will be charged at \$.15 per page, or messenger services will be provided at \$5.00 per mile."

For the sake of argument, the exact cost of a photocopy may be more or less than \$.15 depending on the quality of the paper used, the cost of the printer, the hourly rate of the individual making the copy, etc. What's important here is that ABA guidance acknowledges that it is perfectly reasonable to establish rates for specific expense types.

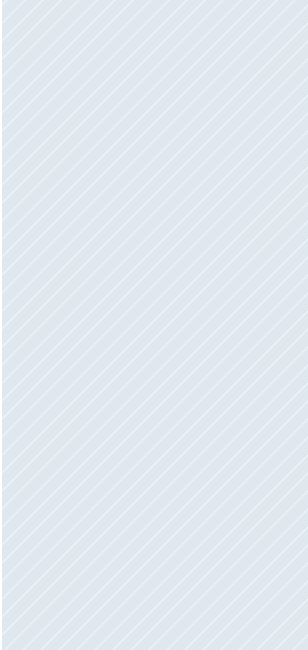

But how do law firms determine what's reasonable? In Op. 93-379, the Committee punts on specificity. They effectively say that it is beyond their scope as legal experts:

*"It is not appropriate...to opine on the various accounting issues as to how one calculates direct cost and what may or may not be included in allocated overhead. These are questions which properly should be reserved for our colleagues in the accounting profession. Rather, it is the responsibility of the Committee to explain the principles it draws from the mandate of Model Rule 1.5's injunction that fees be reasonable. Any reasonable calculation of direct costs as well as any reasonable allocation of related overhead should pass ethical muster."*

In the context of eDiscovery-related expenses, we believe one can reasonably read Op. 93-379 to state that so long as a law firm can establish a reasonable methodology for allocating expenses to the clients who benefit from these services, and these expenses are communicated to the client within a reasonable timeframe, it is perfectly consistent with the principles set forth in ABA Model Rule 1.5.



One can reasonably read Op. 93-379 to state that a law firm may charge for ediscovery services, with a sound methodology to allocate expenses to the clients who benefit from these services.





It is our contention that the ABA guidelines accommodate the pass through of subscription costs as an in-house delivery of services so long as they meet the reasonableness standard under Rule 1.5.

eDiscovery costs are much closer to messenger and copy costs than they are to utilities or malpractice insurance. Specifically, we believe a strong argument can be made that attorneys may classify software subscription expenses as In-house Provision of Services.

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### ★ ADDRESSING THE “PROFIT” QUESTION


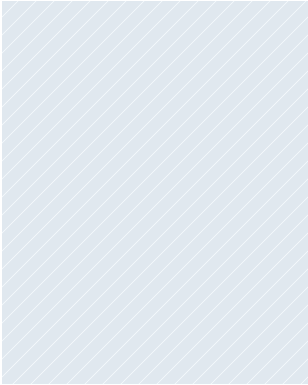
A review of the ABA standards clearly indicates that it is entirely appropriate to develop a reasonable methodology for allocating eDiscovery expenses to one’s clients so long as they align with the reasonableness standards set forth.

A common concern this approach raises, however, is whether a law firm can ethically “profit” from passing through third party services. Indeed, Op. 93-379 states:

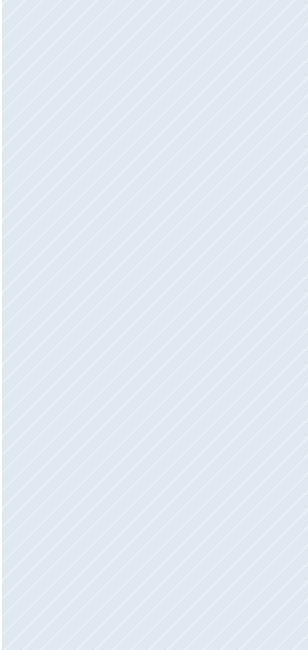

*“...in the absence of an agreement to the contrary, it is impermissible for a lawyer to create an additional source of profit for the law firm beyond that which is contained in the provision of professional services themselves. The lawyer’s stock in trade is the sale of legal services, not photocopy paper, tuna fish sandwiches, computer time or messenger services.”*

Virtually every attorney we speak with on this issue states that they don’t intend to earn a profit from charging back eDiscovery costs; their goal is to simply recover as much expense as they can.

But what do the ABA standards deem ethical should a law firm develop an allocation methodology that results in recovering more money than they spent on the technology? And if a modest profit is a potential result of establishing



If a modest profit is a potential result of establishing a fixed fee cost allocation, does this prohibit attorneys from passing through eDiscovery costs?



a fixed fee cost allocation, does this prohibit attorneys from passing through eDiscovery costs?

The ABA Standing Committee on Ethics and Professional Responsibility provides guidance on this matter in two separate formal opinions. Written in 2000, [Formal Opinion No. 00-420, Surcharge to Client for Use of a Contract Lawyer](#), concludes that:

*"Subject to the Rule 1.5(a) mandate that 'a lawyers fee shall be reasonable,' a lawyer may under the Model Rules, add a surcharge on amounts paid to a contract lawyer when services provided by the contract lawyer are billed as legal services."*

Op. 00-420 goes on to state:

*"...if the costs associated with contracting counsel's services are billed as an expense, they should not be greater than the actual cost incurred... unless there has been a specific agreement with the client otherwise."*

In other words, the ABA guidelines indicate that it is entirely acceptable for an attorney to realize a profit. Indeed, the Committee writes in Op. 00-420 that when an attorney bills contract lawyer services as legal services (i.e. not as a disbursement):

*"...it is implicit in Formal Opinion 93-379 that profit from providing legal services is expected and appropriate, as long as the total fee is reasonable."*

Written in 2008, [ABA Formal Opinion 08-451: Lawyer's Obligations When Outsourcing Legal and Nonlegal Support Services](#) takes this concept one step further by addressing "non-legal support services."

After reinforcing the conclusion of Op. 00-420 that "a law firm that engaged a contract lawyer could add a surcharge to the cost paid by the billing lawyer

A thorough reading of the ABA guidelines should mitigate any concerns law firms may have with applying an appropriate and reasonable fee for eDiscovery technology.

provided the total charge represented a reasonable fee” and complied with the requirements of Rule 1.5, Op. 08-451 goes on to state:

*“...the analysis is no different for other outsourced legal services.”*

To the extent that a law firm believes it appropriate and reasonable to categorize eDiscovery technology and related services and “non-legal support services,” a thorough reading of the relevant ABA guidelines should mitigate any concerns the law firm may have with applying a reasonable fee for the use of eDiscovery software so long as the approach adheres to the principles set forth in Rule 1.5.

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## **CONCLUSION**

The subject of billing clients for any non-legal fees that attorneys incur on behalf of clients is, in the words of the ABA Committee in Op. 93-379 “fraught with tension.”

Attorneys are rightly concerned with adhering to the ethical standards set forth by the ABA. However, it is entirely appropriate and within the ethical standards set forth by the ABA for attorneys to pass eDiscovery expenses through to the clients who benefit from these services. Doing so is not only acceptable, it will result in more profits for the partnership.

## ABOUT NEXTPOINT

Nextpoint is smart software that automates ediscovery projects for legal teams of every size. The highly secure, cloud-based solution lets your team begin document review in minutes with powerful data analytics tools, a user-friendly interface and collaborative access from anywhere. Innovative trial-prep features will exceed your expectations of what smart ediscovery software can do.

Founded as a litigation support company in 2001, Nextpoint introduced the world's first cloud-based litigation software a few years later. Since then, we've continued to innovate and expand to serve law firms, corporations and government agencies of all sizes. In 2013, Nextpoint was awarded U.S. Patent number 8,447,731 for our management of electronic data in the cloud, specific to litigation processes.

### ★ STOP PAYING FOR EDISCOVERY DATA

Nextpoint gives users **free, unlimited data uploads, processing, hosting, OCR, imaging and productions.** As you face increasing pressure to control costs, Nextpoint empowers users to easily process, analyze, review, produce and present data, affordably and predictably.

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