

## Law Firm Cost Recovery is Here to Stay

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Cost recovery has always been a controversial area of law firm billing. Law firms incur tremendous administrative costs in servicing their clients, and yet clients are generally resistant, if not hostile, to the idea of these costs being billed back to them. Especially given the current economic crisis, law firms are having to justify their fees and costs more than ever before, so they need tools and data to help them demonstrate that their rates are fair and competitive.

In working with law firms since 1997, consultants Mattern & Associates noticed that there was no comprehensive source of unbiased information about what law firms were charging in the cost recovery arena. Also, there was no reliable information on what a "reasonable" billable percentage a firm should expect for certain items charged to their clients. Because of a lack of available data, law firm operations and executive directors had been making their own decisions about cost recovery, without knowing what other firms were charging. In early 2000, Mattern began collecting data from individual engagements and, starting in 2004, formalized the survey process. The information collected in the survey is added to the benchmark database that Mattern maintains for their clients' cost-recovery projects.

During the summer and fall of 2008, Mattern conducted its biannual cost-recovery survey for 2008. This survey of law firms focused specifically on the soft cost recovery aspect of their support services operation -- reprographics, facsimile, printing, scanning, overnight services and digital services (litigation support). Additional areas covered in the survey were legal research, telephone, word processing, catering and contract attorneys.

A total of 49 firms responded, ranging in size from a 50-attorney IP firm based in Boston to Jones Day with 2,171 attorneys worldwide. Geographically, every area of the country was represented with approximately 33 firms represented in the eastern United States and 28 with representation in the West. Thirty percent of the firms responding had an international presence.

From a cost recovery standpoint, the areas that law firms are predominately charging their clients for are:

| <b>Area</b>                                       | <b>Law Firms That Charge Their Clients (Percent)</b> |
|---|--|
| <b>Overnight Deliveries</b>                       | 98   |
| <b>Legal Research</b>                             | 97   |
| <b>Black and White Copies</b>                     | 93   |
| <b>Color Copies</b>                               | 89   |
| <b>Contract Attorneys and Legal Assistants</b>    | 84   |
| <b>Outgoing Facsimile</b>                         | 78   |
| <b>Digital Services (Litigation Support)</b>      | 74   |
| <b>Telephone Calls International and Domestic</b> | 68   |

### **COST RECOVERY 'RATES'**

Across the board, the "rates" that firms charge for the individual cost recovery areas have remained

relatively stable since 2006 with little, if any, increases or decreases. The most notable exceptions are as follows:

- there were slight increases in outgoing facsimile charges which rose from \$1.02 to \$1.17 per page;
- color photocopies increased from an average of \$.67 to \$.81 each;
- color prints increased from \$.64 to \$.78;
- black-and-white prints increased from an average of \$.16 to \$.18; and
- telephone rates decreased from an average of \$.15 per minute to \$.12.

#### **BILLABLE PERCENTAGE AND WRITE-OFFS**

As part of the survey, results were obtained for the following:

- billable percentage -- the percentage of total dollars/units divided by dollars/units billed to a valid client matter number;
- internal write-offs -- the dollars/units captured by a cost recovery system but being "written-off" prior to making it to a client invoice; and
- client write-offs -- the dollars/units captured by a time and billing system, billed to a client but not paid by the client.

| <b>Item</b>                                   | <b>Billable<br/>(Percent)</b> | <b>Internal<br/>Write-Offs<br/>(Percent)</b> | <b>Client<br/>Write-Offs<br/>(Percent)</b> |
|---|-------------------------------|--|--|
| <b>Overnight Services</b>                     | 68                            | 14   | 9  |
| <b>Legal Research</b>                         | 70                            | 26   | 16   |
| <b>Black and White Copies</b>                 | 64                            | 16   | 12   |
| <b>Color Copies</b>                           | 64                            | 16   | 12   |
| <b>Facsimile</b>                              | 70                            | 19   | 9  |
| <b>Telephone<br/>(Domestic/International)</b> | 66                            | 19   | 10   |

Billable percentages have remained relatively consistent since 2006. However, internal write-offs have increased across the items listed above. Based upon comments submitted in the survey, this increase is due to a surge in clients' reluctance to pay for these charges. It is a difficult area to quantify since data was not solicited on client write-offs in the 2006 survey.

#### **PRINT AND SCAN**

One of the more thoroughly discussed areas in the cost-recovery world today is the capture of print and scan. There is a sizable percentage of firms capturing print (as illustrated below -- 33 percent). This trend is more notable in firms with an international presence (interpreted as larger firms) of which 55 percent are currently charging for print.

Although the percentage of firms has remained consistent since 2006, more firms are now capturing from local printers (increase from 38 percent to 50 percent) and multifunctional machines (increase from 75 percent to 86 percent). We attribute this increase to firms abandoning the first-set-exclusion mentality and charging for all prints produced.

| Item                          | Firms Capturing (Percent) | Billable (Percent) | Internal Write-Offs (Percent) | Client Write-Offs (Percent) |
|-------------------------------|---------------------------|--------------------|-------------------------------|-----------------------------|
| <b>Black and White Prints</b> | 33                        | 56                 | 12                            | 12                          |
| <b>Color Prints</b>           | 33                        | 39                 | 25                            | 35                          |
| <b>Scans</b>                  | 26                        | 66                 | 17                            | 5                           |

## HARDWARE

On the hardware front, [Equitrac](#) and [Control Systems](#) were the major players in 2006, with 100 percent of the placements between them. However, in 2008, it is clear that [Billback](#) has experienced significant growth at the expense of the other primary providers.

## ALTERNATIVE COST RECOVERY STRATEGIES

For the first time, we asked law firms about alternative strategies and/or the elimination of soft cost recovery. Thirty-three percent of firms responding have explored the elimination of soft cost recovery in the past year with smaller firms (firms < 249 attorneys) showing a stronger tendency to move in this direction. The alternative vehicles have included the following:

- adjusting fees to include these charges;
- adding a separate percentage to the hourly rates.

However, in the end, less than 2 percent of firms have eliminated cost recovery in one or more areas.

There are a number of conclusions that can be drawn from the survey results and subsequent comments. To interpret the results properly, one must first identify some behind-the-scenes trends in the support services arena that are driving some of the responses:

1. total output (print and copy) is expanding at a rate of 7 percent per year with the primary driver being the increase in printer output;
2. facsimile volume is decreasing and being supplanted by scanning; and
3. color output in law firms is no longer a marketing only necessity and is now being used throughout the firm.

## COST RECOVERY IS HERE TO STAY

The initial conclusion that can be drawn from the survey is that soft cost recovery is alive and well. Granted, a very small number of firms have abandoned the practice, but the overwhelming number of firms continue to maintain it and some are even expanding their billable revenue to encompass the capture of print, scan and digital services.

Based upon the shift in output from copies to prints, and the decrease in facsimile coupled with the explosion of scans, a firm is being forced to shift from the copy/fax cost-recovery model to a print/scan capture model. Failure to do so will mean declining cost-recovery revenue. The decrease in copy volume, which is the foundation of many firms' cost-recovery structure, is slowly disappearing, with the increase in print output replacing copy volume. Based upon our operational data, we estimate that once a firm networks its multifunctional devices, that firm will lose 30 percent of its "copy" volume to "print." Even though there is operational savings in shifting output from a printer to a multifunctional device, in most cases, the net savings will not be enough to offset the loss of cost-recovery revenue.

In summary, the support services which were built on the copy/fax model will no longer produce the volume necessary to support themselves. This issue, coupled with clients' increasing reluctance to pay for internal cost recovery charges, will lead to a rise in overhead burden for most firms.

Color output, both copy and print, will become more and more a part of firms' cost-recovery strategy. Many firms in the past have not billed separately for color, even though it is more expensive to produce. It is advisable to clearly define costs and establish separate billing codes for both color print and color output. Also keep watch on color scanning, this will be the next big cost-recovery item.

The third recommendation based upon the survey is that write-offs are an area to watch. With an increasing number of clients pushing back on internal soft cost recovery and many attorneys not wishing to anger clients, the write-offs of internal charges will only increase. In reviewing your overall cost-recovery model, care must be taken in evaluating individual areas to determine if they are in fact producing the projected revenue to cover their costs.

### **GOING FORWARD**

What does the Mattern cost recovery survey tell law firms? Soft cost recovery is here to stay. However, in order for it to continue to produce revenue and cover expenses the way it has in the past, additional items (print, scan, digital services, color output) must be added to the product mix. Failure to add these items will result in an inadequate cost recovery revenue stream that will not be able to cover support services costs. If you find your firm in this position, then steps must be taken to minimize the financial exposure of your support services operation. Also, increased diligence must be directed toward internal and external write-offs to continue to hold margins and evaluate individual services. Law firms that see these cost shifts and are nimble enough to react accordingly will be in a much better position to weather the storm of the recession, whereas firms that ignore the emergence of new trends and cost recovery opportunities may put themselves in a weaker position for success and profitability.

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