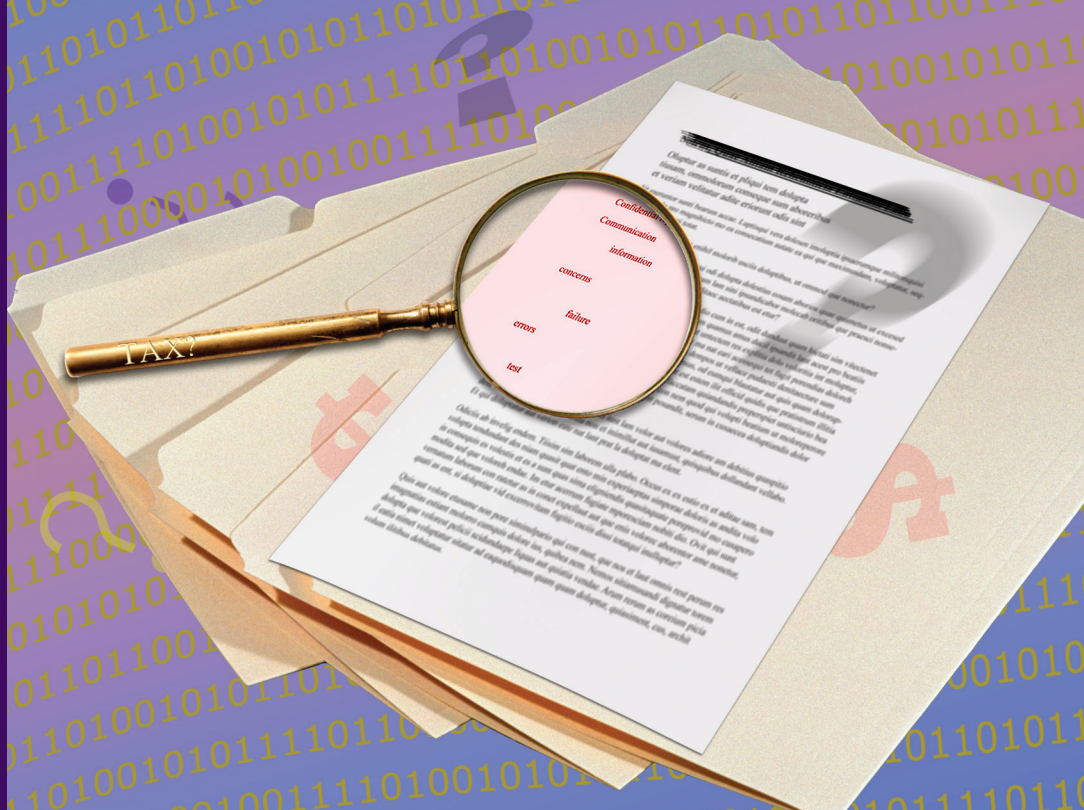
Getting Your E-Discovery Money Back

Taxation of Costs and Offer of Judgment

By Mark L. Austrian

A review of the predominant case law and recommendations for coping with this constantly changing landscape.



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Companies store virtually all of their information on massive and complex computer systems. Referred to as "electronically stored information" or "ESI," they can incur substantial costs collecting, processing, and producing this information. Courts have attempted to control these costs and to deter excessively expansive discovery demands by amending the Federal Rules of Civil Procedure in 2006 to require more detailed complaints before e-discovery can begin, creating new rules demanding attorney "cooperation" and "proportionality," and imposing cost shifting, sanctions, and protective orders. The final judicial arena where companies had hoped to deter plaintiffs with questionable claims from coercing large settlements was taxing e-discovery costs against losing parties. This appeared to be a promising approach until the Third Circuit issued the recent opinion in *Race Tires of America, Inc. v. Hoosier Racing Tire Corp.*, 2012 WL 887593 (3d Cir. 2012), which reduced reimbursable costs from $365,000 to $20,000 and on its face severely restricted reimbursement for e-discovery costs associated with hiring third-party vendors, and when the Federal Circuit produced an opinion in *In Re Ricoh Company, Ltd. Patent Litigation*, 661 F.3d 1361 (Fed. Cir. 2011), which limited e-discovery cost recovery because the parties previously had agreed to share these costs. An enormous divergence of opinion remains, however, on awarding e-discovery costs among the various federal courts of appeals and district courts, with outcomes that range from almost complete reimbursement to total denial. Partly for that reason, defendants seriously should consider recouping e-discovery costs in frivolous lawsuits by making Federal Rule of Civil Procedure 68 "offers of judgment." This article reviews the predominant case law on e-discovery taxable costs and suggests ways for companies to cope with this constantly changing landscape.

Taxable Costs

Federal Rule of Civil Procedure 54(d)(1) states that "[u]nless a federal statute, these rules, or court order provides otherwise, costs—other than attorney's fees—should be allowed to the prevailing party." However, Congress, in 28 U.S.C. §1920, specified the litigation expenses that could qualify as "taxable costs":

> A judge or clerk of any court of the United States may tax as costs, the following:
> (1) Fees of the clerk and marshal;
> (2) Fees for printed or electronically recorded transcripts necessarily obtained for use in the case;
> (3) Fees and disbursements for printing and witnesses;
> (4) Fees for exemplification and the costs of making copies of any materials where the copies are necessarily obtained for use in the case;
> (5) Docket fees under section 1923 of this title;
> (6) Compensation of court appointed experts, compensation of interpreters, and salaries, fees, expenses, and costs of special interpretation services under section 1828 of this title.

This statute, 28 U.S.C. §1920, was enacted during a period of time when most of the expenses in litigation other than professional fees included those expenses listed in the statute. Subsection (4) was amended in 2008 to replace "the costs of making copies of papers" with "the costs of making copies of any materials" in recognition of the importance of e-discovery.

E-Discovery Costs—The Basics

One of the basic problems that the courts have struggled with and that attorneys often have not helped them to tackle is understanding the technical steps and corresponding costs in the e-discovery process, what "e-discovery costs" should include, and how these costs fit within the statutory category of "copying" or "exemplification." As a result, terms such as "processing" are not well understood or described in the case law. Below is a brief and very rudimentary discussion of e-discovery procedures as they relate to the production of ESI. *See also The Sedona Conference Glossary: E-Discovery & Digital Information Management* (Sherry B. Harris *et al.* ed. 3rd ed. 2010) (discussing e-discovery terminology).

Production of Paper Documents

The Federal Rules of Civil Procedure allow litigants to produce documents stored in paper form in hard copy. A litigant clearly can recover photocopying costs. The basic problem with photocopying is that it leads to very high ancillary expenses. The only way to share this information is to make copies. Depending on the project, paralegals, law clerks, or attorneys must organize these paper documents physically for production. Afterward large sets of boxes, binders, and folders will reside in a "case room" that cost a great deal to review. This holds equally true for a receiving party as for a producing party.

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Paper documents can be scanned into an electronic format or PDF format and stored. These formats allow producers or receivers to store and to retrieve documents electronically, but they still require hands-on review; someone can't search them electronically. The cost to convert a document to a PDF file is similar to that of photocopying. Paper documents can also be converted to electronic form through optical character recognition (OCR). This is a branch of computer science that involves scanning the image of a document and converting the dark elements, text, and

graphics on the page to a bitmap. The OCR software reads the bitmap that the scanner created and puts it into a file format that the computer can process such as ASCII code. OCR systems include optical scanners for reading text and sophisticated software for analyzing images. Most OCR systems use a combination of hardware, specifically specialized circuit boards, and software to recognize characters. Advanced OCR systems can read text in a large variety of fonts, but they still have difficulty with handwritten text. The primary advantage of documents that have undergone OCR processing is that the information contained in this file can be inserted into an electronic review platform and searched by key words. One problem with converting paper documents to an OCR-based format, though, is that it is not 100 percent accurate. Scanning documents into an OCR format is not simply the same as "photocopying" a paper document.

The federal district courts also now encourage by rules and by decisions opposing parties to negotiate e-discovery agreements in the early stages of litigation.

Processing Information Stored in Electronic Form

Many different locations can house ESI, including servers, hard drives, and PDAs, to name a few. *See generally* Austrian & Krolewski, *Basic Steps in Ediscovery Continued: Knowing Where "Stuff" Is and Planning to Retain It*, Metropolitan Corporate Counsel (Jan. 2011). When litigation threatens, a corporation will most often issue a litigation hold to "freeze" ESI and prevent employees from intentionally or inadvertently deleting it. A corporation often retrieves this information from an archival storage facility—a server—and copies and transfers it to another container. For example, when an individual's computer hard drive contains ESI, a company may copy this drive, sometimes referred to as "imaging," and store the copy in another electronic container. A company will do this routinely to "preserve" the ESI so that in the future no one can claim that the company lost it. The "imaging" process is a technical one requiring technical experience and careful execution to preserve all of the metadata and to ensure that a company has authenticated information properly for trial purposes.

Similarly, a company must transfer e-mails contained on a central server from the server and convert it to a "PST" or similar format. A "PST" file is a Microsoft Outlook e-mail storage file containing individual e-mails in an MSG format, which is also specific to Microsoft. A PST file contains all of the ESI's metadata. However, someone cannot view much of this metadata in Microsoft Outlook. For instance, someone cannot view the metadata recording and time that someone created and changed something in a file. To reveal this information, a company must run it through a software program designed to extract text and selected metadata and to normalize it before the company eventually loads it into a review platform such as Concordance or Summation.

Courts often refer to processing ESI from its "native format," which refers to the original application used to create it, into a TIFF format. TIFF, which stands for "tag image file format," is a flexible, adaptable file format for handling images and data within a single file. On one level, processing ESI into a TIFF simply creates a digital image of data very similar to a JPEG. But this image does not include metadata. This TIFF image is not searchable or "readable" and has no metadata associated with it. Converting ESI into a TIFF can also save the native file metadata during processing so that the TIFF image contains the native file metadata and becomes associated with that TIFF image. The process involves converting the native file metadata into "load files" that become associated within a computer with the TIFF image. This results in a "readable format" that a recipient can use to organize information in a variety of ways. In most instances when courts refer to a TIFF in the discovery context, they mean ESI that includes searchable metadata. Different review databases require certain load files. Converting ESI from its native format into a TIFF does not simply "copy" information from one place to another; it involves more processing. One party cannot produce useful information for another in a particular format such as a TIFF without undertaking this processing step. The advantage from a producing party's perspective of converting this information to a TIFF that has metadata before transferring it to a review platform is that in this format ESI is less expensive for attorneys to review. Many different copying processes exist for the types of ESI that are stored in many different ways and formats.

Review

In large, complex cases, the amount of ESI stored in the various locations and formats is enormous. The ESI generally will contain substantial amounts of duplicate documents, especially e-mails, and other patently useless information. This can amount to hundreds of thousands, if not millions of documents if a litigant actually printed hard copies. Thus parties may agree to various methods to reduce the amount of ESI that they must search and may take steps to limit the ESI that they will produce to information that is potentially relevant to a case by establishing data limits or consenting to limit searches to names of individuals or to key words.

Production

In 2006, as mentioned, the Federal Rules of Civil Procedure were amended to recognize the important differences between paper and electronic documents so that a party could specify the "form or forms" of the ESI that it wants produced. Fed. R. Civ. P. 34(b)(1)(C). Today, if a requesting party doesn't specify a form or format, the ESI-producing party must produce it either in a form in which that party ordinarily maintains the information, referred to as "native format" or "native files," or in a "reasonably usable form." Fed. R. Civ. P. 34(b)(2)(E). A requesting party may agree, and often will, produce ESI in a particular format that is fully searchable and has specific background information, generally meaning metadata, which will permit the receiving party to place the information in a review platform.

ESI in a TIFF format placed in a producing party's review platform is relatively inexpensive to produce to an opposing party in the same format along with required load files. If a producing party places the information in the review platform in its native file format first, then the producing party will have to process it into TIFF.

Processing information from paper into OCR, which again, stands for "optical character recognition," and then copying it or from native format into TIFF, can cost a lot. For example, in *In re Fast Memory Erase v. Spansion, Inc.*, 2010 WL 5093945 (N. D. Ga. 2011), the court awarded nearly $200,000 for creating TIFF and OCR images of documents responsive to the plaintiffs' discovery demands. These costs can include the costs associated with paying a third-party technician to make sure that this data processing is done properly and preserves all of the metadata. *See Jardin v. Datallegro, Inc. v. Stuart*, 2011 U.S. Dist. Lexis 117517 (S.D. Cal. 2011) (awarding costs associated with paying a third-party technician to perform duties limited to technical issues related to the physical production of information); *Tibble v. Edison International*, 2011 U.S. Dist. Lexis 94995 (C.D. Cal. 2011) (awarding services-related costs for electronic data recovery technicians).

In terms of the relative costs for the different processing and review steps, a recent study by the Rand Corporation identified eight very large companies that provided in-depth information about e-discovery production expenses. http://www.rand.org/content/dam/rand/pubs/monographs/2012/RAND_MG1208.pdf. The participants choose a minimum of five cases for which they produced data and electronic documents to another party in response to e-discovery requests. Rand received what it considered reliable e-discovery production cost data for 57 cases, including traditional lawsuits and regulatory investigations. For the study purposes "collection" consisted of locating potential sources of ESI following the receipt of a demand to produce electronic documents and data and gathering ESI for further use in the e-discovery process. "Processing" involved reducing the volume of collected ESI through automated processing techniques and modifying it, if necessary, to forms more suitable for review, analysis, and production. "Review" consisted of evaluating digital information to identify relevant and responsive documents to produce and privileged documents or confidential or sensitive information to withhold. In this study, collection, an area in which policymakers have focused intensely in the past, consumed about 8 percent of expenditures, processing costs consumed about 19 percent, and services of outside counsel amounted to 70 percent of these costs. In general, processing costs ranged from a low of 10 percent to a high of 40 percent of the total e-discovery costs.

Local and Appellate Court Rules

Rules proposed by the various federal circuit courts and federal district courts to manage e-discovery have taken different forms. At the appellate level, the Seventh Circuit Court of Appeals has instituted a pilot program stressing cooperation and proportionality. Its key features include the appointment by each party of a knowledgeable e-discovery liaison or manager and early processes for identifying and controlling the amount of ESI that litigants produce. The Federal Circuit has issued a "Model Order Regarding E-Discovery in Patent Cases," which places several limits on electronic discovery and proposes that the requesting party would bear the cost of discovery that ventured beyond those limits. These provisions encourage parties to conduct reasonable electronic discovery in patent infringement cases.

The federal district courts also now encourage by rules and by decisions opposing parties to negotiate e-discovery agreements in the early stages of litigation. As many as 40 federal district courts have developed and implemented specific rules or initiatives governing and, in many instances limiting, initial e-discovery. For example, the U.S. District Court for the Southern District of New York has created a pilot program that includes detailed suggestions for managing complex cases. The pilot program requires litigants to include people who are competent to discuss information technology issues related to e-discovery in an initial pre-trial conference and other e-discovery conferences, to complete an initial pretrial conference "checklist" with a fairly extensive list of discussion issues, and to present the checklist to the court through a joint electronic discovery submission. The U.S. District Court for the Western District of Pennsylvania has adopted a "Special Master's Protocol" under which the litigants select a special master from a list of attorneys with expertise in mediation and technology to hold hearings and issue orders pertaining to e-discovery. The default standard of the U.S. District Court for the District of Delaware has several key components that prescribe the e-discovery process and the information sharing that must occur between opposing counsels. Notably, rule 26(f) of the new "default standard" compels the parties to engage in substantive dialog around various aspects of the e-discovery process that they will undertake. The default standard also requires the parties to have exchanged specific lists of information before holding the rule 26(f) conference.

Many of these federal district court procedures stress the need to implement cost-saving measures by agreement. For example the U.S. District Court for the Southern District of New York pilot project asks the parties to respond in the joint electronic discovery submission whether they have reached agreements on the scope of production, the form of production, and the cost of production, including the cost of retrieving ESI, cost shifting or cost sharing, and the use of cost-saving measures such as using common e-discovery vendors or shared repositories. Executing e-discovery agreements under these rules does not impact on the ultimate costs taxing. *See* Thomas Y. Allman, *Local E-Discovery Rules in Federal Courts: Helpful Guidance or Confusing Proliferation*, (Sedona Conf. Mar. 15, 2011).

Federal District Court Decisions

In general, the federal district courts have held that a losing party has the burden to demonstrate why a court should not award costs to the winner, and a court reviews an award of costs on an appeal for abuse of discretion. However, whether a particular expense falls within the purview of section 1920 as a permissible tax in the first place depends on what the applicable statute allows, which a court determines by a de novo review. *See Summit Tech., Inc. v. Nidek Co.*, 435 F.3d 1371 (Fed. Cir. 2006). In many federal court districts, such as the Southern District of New York, taxation of ESI costs seldom arises since the local rules severely limit taxation of copying costs to

documents actually used for a trial. *See* S.D.N.Y. Civ. R. 54.1 (5).

Until recently, federal district courts developed most of the law concerning the taxation of costs and categorizing recoverable costs. Some courts have restricted taxable costs to those simply associated with electronically scanning paper documents to producing them to opposing counsel. These courts generally would not tax costs associated with OCR processing of information stored solely in an electronic format. These courts would tax only the costs associated with copying that information as currently stored into another file without any type of processing and producing it to the opposing party. These courts view the necessary procedures basically as the equivalent of reproducing paper documents. *See*, *e.g.*, *BDT Products, Inc. v. Lexmark International, Inc.*, 405 F.3d 415 (6th Cir. 2005); *Brown v. McGraw-Hill Co., Inc.*, 526 F. Supp. 2d 950 (N.D. Iowa 2007). The district courts in the Eastern District of Virginia have uniformly maintained this very restrictive view of taxable costs. In *Mann v. Heckler & Koch Defense Inc.*, the court refused to award costs for anything more than burning electronic documents onto a CD. 2011 WL 1599580, at *7 (E.D. Va. 2011) ("It strikes the Court as clear that, when starting with an electronic document, the process of burning the document onto a CD to turn over in discovery is 'copying.'"). In *Fells v. Virginia Dept. of Transp.*, the court refused to tax costs for "creating" searchable documents viewing it as something different than copying. 605 F. Supp. 2d 740 (E.D. Va. 2009). And in *Francisco v. Verizon South, Inc.*, the court refused to award costs for converting e-mails into TIFF-readable form. 272 F.R.D. 436, 446 (E.D. Va. 2011) ("The technique may be *comparable* to scanning and copying, but it is not identical to the process of scanning and copying."). The Fourth Circuit has yet to articulate views on these issues.

In *Tomlinson v. El Paso Corp.*, the court refused to award the cost of creating a secure website to allow access by the plaintiffs to the defendants' software program so that the plaintiffs could review the information. 2011 U.S. Dist. LEXIS 63818 (D. Colo. 2011).

Further up the e-discovery cost spectrum, many federal district courts have recognized that "copying" can also include formatting information to create usable format such as TIFF. Thus, they have awarded the costs of converting electronic documents from their existing formats into TIFF or OCR images, which make the information more easily searchable. *In re Fast Memory Erase v. Spansion, Inc.*, 2010 WL 5093945 (N.D. Tex. 2011).

The broadest interpretations of section 1920(4) have issued from federal district court cases involving large e-discovery costs, considerable e-discovery disputes, or both. Thus, in *Lockheed Martin Idaho Technologies Company*, the court awarded $4.6 million for creating a computer database:

> Turning to the first category, the litigation database was necessary due to the extreme complexity of this case and the millions of documents that had to be organized. While the creation of the database is expensive, it is not unreasonably so, and it saved immense time for counsel who otherwise would have to sift through the documents by hand. Given these circumstances, the Court finds that these costs are recoverable under §1920(4).

2006 WL 2095876, at *3 (D. Idaho 2006). The court, however, did not analyze the statute or why the specific statutory language covered creation of the database.

In the Seventh Circuit, the district courts have construed *Hecker v. Deere & Co.*, 556 F.3d 575 (7th Cir. 2009), as providing broad authority to tax broad, necessary e-discovery costs such as key word searching, de-duplication, and filtering. In *Promote Innovation LLC v. Roche Diagnostics Corp.*, for example, the court concluded that

> the Seventh Circuit has ruled that district courts have the discretion to allow the recovery of costs for electronic discovery. *See*, *e.g.*, *Hecker v. Deere & Co.*, 556 F.3d 575, 591 (7th Cir.2009) (ruling the district court did not abuse its discretion by allowing the Defendant to recover costs from converting computer data into a readable format); *Cefalu v. Village of Elk Grove*, 211 F.3d 416, 428 (7th Cir. 2000) ("[w]e find no limits in the term exemplification that would… preclude [a court] from compensating a party… for computer-based, multimedia displays."). In sum, Promote [the party contesting costs] did not prove that using the electronic discovery process described above was unnecessary for Roche to prepare for litigation.

2011 WL 3490005, at *2 (S.D. Ind. 2011).

In *CBT Flint Partners, LLC v. Return Path, Inc.*, the plaintiff requested the production of 1.4 million electronic documents, and after an ensuing "really nasty" discovery dispute the court required the plaintiff and its counsel to pay e-discovery-related costs. 676 F. Supp. 2d 1376 (N.D. Ga. 2009), *vacated*, 654 F.3d 1353 (Fed. Cir. 2011). The defendant had retained a computer consultant to help collect, search, and produce electronic documents, and the defendant sought to recover $243,453 in associated fees. Again, without discussing the rationale in detail, the district court recognized that the courts had divided opinions on awarding e-discovery costs but nonetheless awarded these costs:

> The services are certainly necessary in the electronic age. The enormous burden and expense of electronic discovery are well known. Taxation of these costs will encourage litigants to exercise restraint in burdening the opposing party with the huge cost of unlimited demands for electronic discovery. The objection to taxation as costs of the ediscovery consultant's fees is overruled and denied.

Id. at 1381.

The Federal Circuit Court reversed the lower court's summary judgment grant to the defendant on an appeal so the Federal Circuit did not reach the issue of costs.

In *In re Aspartame Antitrust Litigation*, 817 F. Supp. 2d 608 (E.D. Pa. 2011), the court also noted that the discovery process had "gone awry." In that case the court issued a detailed case management order requiring the parties to produce ESI in specific formats, TIFF with specified load files, or native files, to which the parties had previously agreed, that permitted key word searching. This information was collected in a database created and administered by a third-party vendor. The court stated that courts have discretion to award costs within the statutory categories and proceeded to rule that the costs incurred in creating an e-discovery database to process the information was "necessary" rather than merely convenient for the counsel. This decision was effectively overruled by the Third Circuit in *Race Tires* discussed below.

Courts of Appeals Decisions

In re Ricoh Company, Ltd. Patent Litigation, 661 F.3d 1361 (Fed. Cir. 2011), applying Ninth Circuit law, was the first appellate court decision to analyze taxing e-discovery costs. In that case the parties agreed to have a third-party vendor take the defendant's e-mails, convert them to an appropriate format, and add them to a computer database. The Federal Circuit concluded that if the parties either agree or must of necessity use certain electronic techniques to make information available in a certain electronic format, then a court can tax the associated fees as costs. In this case, the plaintiffs requested e-mails and other documents from the defendant's customers. The litigants disagreed substantially on the form of production. The plaintiffs objected to all of the formats proposed by the defendant—hard copy, TIFF, or viewing them directly from the defendant's internal database in the defendant's office—and demanded that the defendant produce all e-mails in native format. The court issued a case management scheduling order that specified how the parties would carry out the e-discovery processing, which included formatting and load data instructions. The plaintiffs had suggested retaining a third-party vendor to process the e-mails and to provide a database accessible to both parties, the costs of which the parties would split evenly. The defendant represented that it did not use the database to review, filter, search, annotate, or otherwise process documents. The database was used solely as a "means of document production" to produce the documents in their native formats for the plaintiffs' benefit. After receiving a favorable summary judgment, the defendant submitted a bill of costs that included its share of the cost to pay the third-party vendor in the amount of $234,702. The Federal Circuit agreed that these qualified as taxable costs:

> Here, the district court did not abuse its discretion in concluding that, absent a contrary agreement such as we conclude existed in this case, costs associated with Stratify [the third party vendor] were taxable because "the Stratify database was used as a means of document production in this case." Taxation Order, slip op. at 13.

Id. at 1365.

The next significant appellate decision discussing costs for data conversion was *Race Tires of America, Inc. v. Hoosier Racing Tire Corp.*, 2012 WL 887593 (3d Cir. 2012). The case management order issued by the district court required that unless ESI in native format was necessary for file review the parties would produce ESI in TIFF along with the various load files needed by the review platform and others as OCR, which would allow the parties to analyze them properly. Each party retained separate vendors to assist with the ESI production. The case management order also instructed the parties to attempt to agree on key word search terms. Some of the OCR and the TIFF conversions were completed in-house in one of the party's law firms. The district court affirmed the clerk's taxation of the electronic discovery vendor charges but disallowed the conversion costs completed by the law firm. The district court did not attempt to analyze the discrete functions performed by the third-party vendor.

The Third Circuit first noted that the filed bills of cost were "notable for their lack of specificity as to the services actually performed." *Race Tires*, at *20. This is an all too common problem. The Third Circuit commented that the district court did not differentiate between the third-party vendor costs associated with hard drive imaging, data processing, keyword searching, and file format conversion. Often the bill of costs referred to "processing" listing thousands of dollars of charges without specifying which activities these referred to.

The Third Circuit recognized that district court decisions had split on how to tax costs associated with third party vendors. The court then explained the statutory history and previous court decisions interpreting section 1920(4) in detail and noted that the section reflected an overall public policy that sought to reduce the threat of liability for expenses because that threat tended to discourage lawsuits. Section 1920 provides a court with *discretionary* authority to award costs. As discussed below, this differs from the purpose of Federal Rule of Civil Procedure 68 (offers of judgment), which intends to encourage settlements and is *mandatory*.

The Third Circuit first determined that only converting native files to TIFF files and scanning documents to create digital duplicates was "generally recognized as… 'making copies of material.'" *Race Tires*, at *8. The case management order referred to a TIFF file accompanied by associated metadata or load files. Presumably, since the Third Circuit cited *Heckler v. Deere & Co.*, its ruling encompasses the costs of processing ESI into TIFF with associated metadata. *Id.* at *7 (citing *Heckler v. Deere & Co.*, 556 F.3d 575, 591 (7th Cir. 2009), and quoting as follows: "converting computer data into a readable format in response to plaintiff's discovery requests… are recoverable under 28 U.C. §1920"). This is further supported by the citation to *In re Fast Memory Erase v. Spansion, Inc.*, 2010 WL 5093945 (N. D. Ga. 2011), in which the court awarded $197,737 for TIFF and OCR conversion, which most certainly had to include the cost of preliminary processing to transfer the metadata along with the TIFF image. *Race Tires*, at *11.

The court did not explain why these processes were the equivalent of "copying." The court rejected the analysis of a number of district courts under which those courts had awarded vendor costs because the vendors performed functions that neither attorneys nor paralegals performed on the grounds that the decisions were "untethered from the statutory mooring." *Race Tires*, at *10. In short, the Third Circuit interpreted "copying" narrowly.

Significantly, the Third Circuit did not explain which steps constituted "converting" native files or paper documents into the ESI production format. As noted above, converting native files or paper documents into ESI must involve numerous steps. The Third Circuit didn't explain why "conversion" amounted to the electronic equivalent of photocopying. Instead, the Third Circuit simply concluded that courts could not consider "processing" to convert ESI into TIFF a taxable cost.

> It may be that extensive processing of ESI is essential to make a comprehensive and intelligible production. Hard drives may need to be imaged, the imaged drives may need to be searched to identify relevant files, relevant files may need to be screened for privileged or otherwise protected information, file formats may need to be converted, and ultimately files may need to be transferred

> to different media for production. But that does not mean that the services leading up to the actual production constitute "making copies."

Race Tires, at *10.

One of the basic problems that the Third Circuit wrestled with was how to view "processing" hard documents and "copying paper" and the contemporary equivalent, "processing" ESI, for production. Strictly speaking, "processing" a paper document to convert it into ESI and "processing" ESI to convert it into TIFF is not "copying," but these conversion processing steps are necessary so that one party can transmit useful information to another. Courts should consider "conversion" the distinguishing characteristic, and courts should consider the steps necessary to transmit information between parties the essential steps, rather than the steps taken to reduce the quantity of information transferred such as searching and culling. It thus remains to be seen whether additional types of costs, if properly delineated and tied to TIFF conversion and scanning will be categorized as taxable costs when properly presented to the courts.

***In re Ricoh** Company, Ltd. Patent Litigation…* was the first appellate court decision to analyze taxing e-discovery costs.

Finally, the Third Circuit distinguished *Ricoh* in a footnote. *Race Tires*, at *14, n. 11. The Third Circuit held that since the parties had agreed to share the costs of the vendor to create a review database, this converted the costs in connection with the creation of the database into a taxable cost. This distinction makes little sense. Either the cost associated with creating a database as a vehicle to produce ESI is a taxable cost or it is not. Whether the parties agreed to share the database should not determine whether or not a court can tax the associated cost. However, the Third Circuit decision in *Race Tires* reinforces that parties need to know the law in their particular circuit before formally agreeing to share costs so that they understand how an agreement can impact recoverable costs.

Impact of Agreements Between the Parties

In *Ricoh*, the Federal Circuit also examined whether agreeing to cost sharing during the discovery process precludes a court from taxing those expenses when a case concludes. Frequently in complex litigation the parties will execute agreements to share e-discovery costs associated with things such as creating a joint database or creating specific production formats, and the courts encourage this. In the jurisdictions that view these types of expenses as taxable costs, parties will need to consider and educate courts whether executing a cost-sharing agreement at the beginning of the litigation will preclude the prevailing party from recovering its share of the expenses as a taxable cost.

In *Ricoh*, the district court held that having an agreement to share e-discovery costs did not automatically prohibit a court from taxing those costs. The district court cited *Thabault v. Chait*, 2009 U.S. Dist. Lexis 576 (D.N.J. 2009), in which the court held that agreeing to split daily transcripts did not affect the taxability of these costs. On the appeal in *Ricoh*, the Federal Circuit reversed the district court holding. The Federal Circuit held that a court could not tax the cost of the shared database since the parties had agreed to share the costs of the database, and this agreement controlled. The Federal Circuit based the decision on the idea that since the parties could agree to increase the scope of expenses covered by section 1920, they could also limit them. The Federal Circuit, however, did not refer to any evidence that the agreement between the parties included an agreement on taxable costs, or that the parties had even discussed taxable costs. The only authority that the Federal Circuit cited in the *Ricoh* decision was *Thomas v. Duralite*, 524 F.2d 577, 590 (3d Cir. 1975), in which, as in *Ricoh*, the parties had not discussed taxable costs or whether or not the cost-sharing agreement covered taxable costs.

The Federal Circuit distinguished *Saunders v. Washington Metropolitan Area Transit Authority*, 505 F.2d 331 (D.C. Cir. 1974), which held that a preexisting agreement between the parties to share the cost of an appendix did *not* exclude that cost as a cost that a court could tax. *Ricoh*, at 1366 n.1. This was a very questionable distinction since both the producer of the e-discovery and the creator of the appendix both share responsibility initially for paying the cost without an agreement to the contrary.

The court in *United States v. U.S. Training Ctr., Inc.*, 2011 U.S. Dist. Lexis 144233 (E.D. Va. Dec. 8, 2011), reached the same result stating that it didn't need to address whether or not a court could tax electronic discovery costs because the parties' joint discovery report specified that each party would bear its own electronic production expense.

These decisions fly in the face of the current trends in the law that encourage cooperation and e-discovery agreements. At least, after *Ricoh*, parties must deal with taxable costs carefully in agreements to share e-discovery expenses.

Documenting Costs

In the heat of battle, attorneys and paralegals often can have difficulty keeping detailed records of the reasons for incurring e-discovery expenses, identifying the clearly recoverable costs, and insisting that third party vendors do the same. They should, though, for two reasons. First, a court must be able to segregate clearly recoverable costs from those that may not be clearly recoverable. Second, a court needs to have sufficient documentation to determine that costs were "reasonable and necessary." *See generally* Bennett, *Are E-Discovery Costs Recoverable by a Prevailing Party?* 20 Alb. L.J. Sci. & Tech. 537 (2010). The court's admonition in *Prashant Rawal v. United Air Lines, Inc.*, No. 07 C 5561, 2012 WL 581146 (N.D. Ill. Feb. 22, 2012), sustaining an objection to potentially recoverable costs instructs:

> It is possible that some of the electronic processing costs were incurred simply for the "electronic scanning of documents," which are recoverable. *Brown*, 526 F. Supp. 2d at 959. But because United does not separate those costs from the unrecoverable costs associated with creating a searchable database, it has failed to carry its "burden of demonstrating the amount of its recoverable costs." *Telular*

Corp. v. Mentor Graphics Corp., 2006 WL 1722375, at *1 (N.D. Ill. June 16, 2006). Rawal's objection to United's request for $14,997.50 in electronic processing costs therefore is sustained.

Id. at * 6. *See also Francisco v. Verizon South, Inc.*, F.R.D. 436, 272 F.R.D. 436 (E.D. Va. 2011) (denying certain costs for a lack of document support); *Loomis v. Exelon Corp.*, 2010 U.S. Dist. Lexis 24405 (N.D. Ill. 2010) (denying reimbursement of electronic discovery costs to successful defendants because the defendants did not describe the costs in sufficient detail to allow the court to determine whether or not the costs were reasonable and necessary).

The Third Circuit in *Race Tracks* stated, without much explanation, that "it is possible to tax only the costs incurred for the physical preparation of ESI produced in discovery." This may not be as easy as that court believed. Most vendors do not segregate the costs associated with the various physical discovery production steps in invoices. Nor, as comparing the *Race Track* and *In re Ricoh* cases and the district court cases makes evident, do courts agree on the types of expenses that invoices supporting bills of costs should segregate. So attorneys and paralegals need to make this effort.

Cost Shifting and Protective Orders

The Federal Rules of Civil Procedure permit cost shifting under a variety of circumstances. However, if a party makes an unduly burdensome request for information, the responding party must raise the issue during the litigation: a court cannot award the associated expense as a taxable cost. *Committee Concerning Community Improvement v. City of Modesto*, 2007 U.S. Dist. Lexis 94328 (E.D. Cal. 2007) (denying costs of set up fees, online review, and technical time of a provider that synthesized and uploaded over a million e-mail documents for document production because the burdensomeness of the denied costs should have been raised in a motion for a protective order on the basis of Fed. R. Civ. P. 26(b)(2)(B)).

Offer of Judgment

Federal Rule of Civil Procedure 68(a), offer of judgment, specifies that before a trial "a party defending against a claim may serve on the opposing party an offer to allow judgment on specified terms, with the costs then accrued." Federal Rule of Civil Procedure 68(d) continues, "If the judgment that the offeree finally obtains is not more favorable that the unaccepted offer, the offeree *must* pay the costs incurred after the offer was made." (emphasis added). This rule is unilateral in that it provides relief only to a defendant. Thus, unlike Federal Rule of Civil Procedure 54(d)(1), a plaintiff making a settlement offer that a defendant rejects would not receive relief. One critical difference between the two rules is that courts have discretion to award costs under Federal Rule of Civil Procedure 54(d)(1), while Federal Rule of Civil Procedure 68 generally makes taxing costs mandatory.

Federal Rule of Civil Procedure 68 doesn't define the "costs" that it covers. Some have suggested that Federal Rule of Civil Procedure 68 "costs" only include the taxable costs covered by 28 U.S.C. §1920. This view, however, was rejected in *Marek v. Chesny*, 473 U.S. 1 (1985). In that case the plaintiff brought a civil rights action under 42 U.S.C. §1983, which permits a plaintiff to recover attorney's fees. The plaintiff rejected a Federal Rule of Civil Procedure 68 offer of judgment and eventually received a judgment award that amounted to less than that originally offered. The plaintiff contended that "costs" under Federal Rule of Civil Procedure 68 should include only those specified in section 1920. The defendant argued that since the substantive statute included attorney's fees as "costs," Federal Rule of Civil Procedure 68 "costs" included attorney's fees, which required the court to shift the plaintiff's attorney's fees back to the plaintiff. The Supreme Court agreed. *Marek*, 473 U.S. at 9 ("all costs properly awarded in an action are to be considered within the scope of Rule 68 'costs'"). This, the Supreme Court believed, encouraged settlements. Justice Brennan argued that the federal rules advisory committee intended "costs" in Federal Rule of Civil Procedure 68 to include only the section 1920 taxable costs awarded to prevailing parties by Federal Rule of Civil Procedure 54(d). *Marek*, 473 U.S. at 18–20 (Brennan, J., dissenting). *See also* Robert G. Bone, *'To encourage Settlement': Rule, 68, Offers of Judgment and the History of the Federal Rules of Civil Procedure*, 102 NW. L. Rev, 1561 (2008) (discussing Fed. R. Civ. P. 68 generally).

Thus, whether courts should limit the e-discovery "costs" covered by Federal Rule of Civil Procedure 68 to those covered in section 1920 when an applicable statute doesn't define "costs" remains unanswered. I do not know of any cases after *Marek* applying the definition of "cost" in section 1920 to Federal Rule of Civil Procedure 68. Thus, given the uncertainty, it would appear that making an offer of judgment very early in litigation before e-discovery effectively starts may permit the offering party to recover all of its e-discovery costs if, when the litigation concludes, the requesting party does not receive a more favorable result. Although I haven't identified specific cases in which defendants requested e-discovery costs under Federal Rule of Civil Procedure 68, it appears worth considering.

Conclusion

Based on the existing case law, I make the following recommendations, all calling for implementation early in litigation. A defense attorney needs to

- Know the law of the litigation jurisdiction.
- Consider a Federal Rule of Civil Procedure 68 offer of judgment.
- Ensure that the company, outside counsel, and e-discovery vendors keep detailed records of the particular e-discovery tasks that they performed and segregate those most closely to the concept of "copying."
- Consider whether and how an e-discovery agreement will impact taxable costs.
- Educate a court on the complexities and costs of e-discovery from the beginning.
- Consider using protective orders to limit discovery or shift costs.
- Think carefully about a case management order. Courts seem to view costs incurred satisfying requirements included in a case management order more recoverable as necessary to the copying process than costs associated with activities that a case management order doesn't include.