

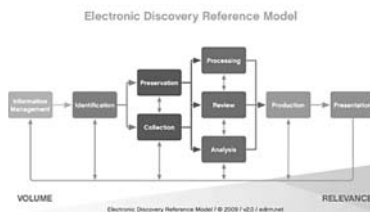
E-Discovery Cost and Benefits

Legal discovery can impact your organization in significant ways. The direct costs of expert assistance add up quickly. The indirect costs of disruption impair the focus on the business mission. A key consideration is where to position your organization in the spectrum from an ad hoc largely outsourced solution to a purely in-house enterprise solution.

To help the discussion, I will use the Electronic Discovery Reference

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providers. Here is the model they use:



Beginning with a large volume of raw information, the goal of the process is to present relevant information responsive to the discovery request. Any of the elements shown may be performed in-house or outsourced. Typically, the likelihood of outsourcing increases from left to right. For example, an organization may adequately manage its information assets in-house but look to outside experts to produce and present trial exhibits.

Because they lack sufficient resources to develop in-house enterprise solutions and/or receive infrequent discovery requests, smaller organizations may look to turnkey outsourcing. However, many organizations are deciding to bring e-discovery in-house. This strategy provides substantial tangible benefits. Direct cost-savings accrue year-by-year. Rigorous policy implementation and directed technology investments diminish business disruption and reduce legal risk in future years. As litigation exposure increases, costs are far better contained.

In either case, organizations must develop document retention policies that preserve essential internal information assets (enterprise content) while minimizing retention of information that serves no business purpose. Studies have found that 84 percent of information stored and archived by organizations actually has no business or legal utility whatsoever. The implications for discovery of information in legal disputes, in particular electronic information (e-discovery), are profound. In one antitrust case that I discussed with a colleague, out of 20 million documents reviewed and produced, only several hundred exhibits were eventually introduced as exhibits in court. This ratio of 100,000 to 1 provides clear evidence that organizations are not strategically managing information assets toward specific business goals.

In deciding on a more effective information management solution, an organization must weigh the costs and benefits of outsourced discovery

processes vs. in-house discovery processes. This article provides a structure for legal and technology stakeholders to anticipate and quantify e-discovery costs and benefits. By balancing the trade-offs in the legal, technology and business domains, organizations can identify e-discovery solution pathways that make migration toward a comprehensive in-house information management system both feasible and worthwhile.

Organizations today accumulate unimaginable amounts of information. Although partly driven by external factors (e.g., regulatory oversight and legal demands), the major contributor is internal: ineffective management of electronic information, exacerbated by the declining cost of information storage. Attempts by information technology (IT) departments to impose storage limitations meet strong resistance. In most cases, IT departments have simply accommodated the explosive increase and excessive retention of information. The crux of the problem: Organizations retain information not because they expect to use it, but because there is no compelling reason to discard it.

A growing external demand today is e-discovery. In-house counsel is responsible for compliance with discovery obligations and must have knowledge and familiarity with the nature and location of electronically stored information, relevant computer systems and applications, document retention schedules, policies, practices and enforcement, and any need for suspension or modification thereof and the search, storage and retrieval capabilities of the organization and the attendant costs. The courts expect counsel to confer in good faith early and often throughout litigation disputes, and to cooperatively reach agreement or identify e-discovery issues for the court. Such issues may include the form of production of electronically stored information; cost allocation; protection of privileged, private and confidential information; and other issues relevant to searching, preserving and producing electronically stored information. An organization's decision to direct either in-house or third-party resources to perform these tasks directly impacts the total cost of discovery, which can reach millions of dollars in large and complex cases.

The EDRM is a diagram of the key functional stages in e-discovery.

They may be grouped into these six phases:

Information Management - from initial creation of electronically stored information to its final disposition.

Identification - locating potentially relevant sources of electronically stored information and determining their scope.

Preservation - ensuring that electronically stored information is protected against inappropriate alteration or destruction; gathering electronically stored information for further processing.

Processing - Review, Analysis - reducing the volume of electronically stored information and converting it, if necessary, to more suitable forms; evaluating electronically stored information for relevance and privilege as well as for content and context.

Production - delivering electronically stored information to others in appropriate forms and using appropriate delivery mechanisms; and **Presentation** - displaying electronically stored information before audiences (at depositions, hearings, trials, etc.).

The first three phases are normally within the scope of an organization's IT capabilities. However, consultative services may be necessary in more complex cases. The last three phases are more likely to require outsourcing for two reasons: the scope of the effort may overwhelm in-house resources and the complexity of the discovery request may demand specialized search, analysis and presentation services.

Your organization must determine the most cost-effective work plan for each e-discovery request. The preferred work plan will depend on the nature and scope of the e-discovery request and the year-to-year pattern of discovery requests your organization anticipates. A blended solution

(partly in-house and partly outsourced) may prove desirable in many instances, but I must emphasize that comprehensive in-house information management (Phase 1) establishes the best foundation for a successful e-discovery response: lowering costs and meeting compliance requirements on the first try.

To illuminate the e-discovery cost drivers, we will examine three inter-related cost domains: legal, technology and business. An organization's legal department is the focal point for e-discovery requests and will normally oversee any outsourced efforts. The IT department not only manages the organization's enterprise content but can furnish specialized expertise and tools to identify and retrieve relevant documents. The organization's business mission will inevitably incur indirect costs because of the disruptive nature of e-discovery requests.

Ninety percent of U.S. corporations are engaged in some type of litigation. This suggests that e-discovery is an ongoing process for companies - not a one-time event. Indeed, there are at least 20,000 compliance requirements worldwide and about 10,000 regulations that impact data management in the United States alone. A single hard drive can easily contain up to 1.5 million pages of data and one corporate backup tape can contain 4 million pages of data. To put this in context, one can store more documents on a ten-square-inch hard drive than can be kept as hard copies in an entire story of a building. The task of looking for one document among all active and archived files often becomes overwhelming and expensive, as more documents = more time = more dollars.

Cost estimating relationships usually rely on a "sizing" parameter. For electronically stored information, a measure of storage capacity is frequently used: a gigabyte (GB) or 10 bytes (characters) of data. IT managers can readily furnish the storage space in GB utilized by a set of document files. For Microsoft Word documents, the page equivalence is about 65,000 pages/GB. However, page equivalence is very much application dependent.

Although costs depend on a variety of factors, the following list highlights important elements needed to estimate an organization's costs of discovery: Preservation of documents under legal requirements to retain evidence for pending or anticipated litigation and/or regulatory inquiries, or to prove or defend a claim; retrieving and processing documents for litigation, including documents which have been retained longer than records retention policies require; information restoration and collection tasks measured in gigabytes GB of storage space; average volume of information per discovery request measured in GB per request; and document review burden for a range of analytical needs measured in labor resources per GB.

An in-depth analysis of these elements will allow an organization to estimate the range of actual processing and legal costs when outsourcing the task of responding to a discovery request. The costs can reach unexpectedly high levels. One major Fortune 500 corporation found that an average litigation discovery request produced 100 - 150 GB of information.



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Regulators Pounce on Franchisors

The California Department of Corporations threw the book at two affiliated franchisors and their executives earlier this year. Play N Trade Franchise, Inc., a video game retailer, and Yakety Yak Wireless, Inc., a retailer of cell phones, accessories and wireless services, for multiple violations of California's Franchise Investment Law. The Department accused the operators of not telling new franchisees that Yakety Yak and Play N Trade were affiliates; they had initially sold Yakety Yak franchises without registering the offering with the state; they had been sued by a former marketing director of both companies who accused the operators of running a "house of cards"; they had recently terminated three area developers; and they had repeatedly sold franchises at discounted fees without informing later prospects about the negotiated sales, a disclosure duty peculiar to California.

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the operators of running a "house of cards"; they had recently terminated three area developers; and they had repeatedly sold franchises at discounted fees without informing later prospects about the negotiated sales, a disclosure duty peculiar to California.



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The most remarkable aspect of these regulatory actions is the punishment. According to public records, the compounding of multiple omissions by the same operators inflicting two different franchise systems justified very fine lines (for which the franchisor's principals were potentially personally liable), revocation of each franchisor's right to sell franchises in California, and a demand that the operators offer all of their franchisees the chance to rescind their franchise agreement and receive their franchise fees and entire investment back even if the franchisee had not relied on a disclosure document suffering from all of the defects.

It is difficult to recall any other California enforcement case, or any federal or state enforcement proceeding for that matter, in which such a stiff penalty was meted out for disclosure violations not involving illegal earnings claims, unregistered franchise sales, or more serious allegations of fraud. The orders could cripple the remains of the Yakety Yak and Play N Trade franchise programs thereby punishing those franchisees that might prefer not just to continue operating under the brand, but to see their chain grow.

While one may question if the punishment imposed by California's regulators appropriately fits the crime, no one should question the authority of California's regulators to bust franchisors and their principals for not complying with disclosure requirements even when omissions or deficiencies involve something less than active fraud.

Unlike other private consensual business arrangements, franchisees are highly regulated relationships. Franchise sales in the United States are subject to federal and state regulation. Depending on where the parties reside, do business or, in some states, where the offer or acceptance is directed to or from, a single franchise sale may be regulated by more than one jurisdiction.

California's franchise sales law, enacted in 1970, was the first of its kind to require franchisors to make detailed pre-sale disclosures and register with a state agency before offering or selling franchises in the

state. The federal franchise sales law, originally adopted in 1978 and overhauled in 2007, regulates franchise sales in all 50 states, including wholly intra-state transactions, by requiring pre-sale disclosure, but not registration with the federal agency. Fourteen states have franchise sales laws modeled after California's, although, overall, little regulatory uniformity exists. Besides regulating franchise sales, many states also restrict the conditions under which a franchise may be terminated or not renewed and some states dictate substantive terms for the franchise relationship. Importantly, a franchisee cannot waive statutory protections even if it wants to.

Non-franchise competitors of franchise companies operate without comparable legal entanglements. Consequently, manufacturers, product suppliers and trademark licensors often explore possible structural alternatives that will enable them to accomplish their distribution goals using independent contractors without tripping the statutory definition of a franchise. Many times, a distribution program cannot be restructured without sacrificing critical business goals. Ignoring the law or taking calculated risks can backfire as enforcement actions in California and elsewhere will attest.

Most franchisors intend to comply with federal and state disclosure and registration obligations. However, with all of the technicalities involved, it is easy for even the best-intended franchisor to slip up.

Franchise sales laws are strict liability consumer protection statutes, which render a franchisor's excuse for noncompliance immaterial. Violations carry significant penalties even if the franchisor's operators had no knowledge of, or intent to violate, the law. Franchise regulators can freeze assets, order restitution, issue cease-and-desist



orders, ban violators from selling franchises, and recover substantial penalties without having to prove that the franchisee relied on defective disclosures. Regulators can prosecute a franchise sales violation as a felony and, just like federal securities laws, hold the franchisor's key management jointly and severally personally liable for a company's willful violations.

Additionally, franchise sales violations can give rise to civil liability. In addition to damages, under state franchise sales laws an injured franchisee can rescind the franchise contract and get their entire investment back if by showing the violation was willful. Willful requires nothing more than proof that the franchise seller intended to commit the act or make the omission referred to; it does not require knowledge of the law or intent to violate the law, injure another, or acquire any advantage. Consequently, even franchisees who admit they never read the disclosure document may rescind a franchise transaction. Finally, the franchise seller's attorney who drafts a defective disclosure document may be liable to injured franchisees who can sue for malpractice.

Most franchisors intend to comply with federal and state disclosure and registration obligations. However, with all of the technicalities involved, it is easy for even the best-intended franchisor to slip up. Highly detailed disclosure rules require current information about a broad swath of topics ranging from background about the franchisor, its parents and certain affiliates, to the conditions and terms of franchise fees, costs, sourcing restrictions, territorial rights, the franchisor's support obligations, franchisee statistics, and a summary of key terms in the franchise agreement. As the program evolves, inconsistencies between the disclosure document and the franchisor's actual program can easily creep up especially when company turnovers leave compliance duties to someone with little institutional memory. Franchise sales violations may also arise when disclosure documents are not furnished within prescribed delivery periods, sales close after a franchisor's registration lapses, or brokers engage in discussions with prospects, but are not registered as the company's franchise sales agent. An examination of a hundred different disclosure documents might very well reveal some number with multiple disclosure mistakes.