TESTIMONY BEFORE THE UNITED STATES CONGRESS
ON BEHALF OF THE

NATIONAL FEDERATION OF INDEPENDENT BUSINESS

NFIB
The Voice of Small Business®

Statement for the Record of Elizabeth Milito, Esq.
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Before the
U.S. Senate Committee on the Judiciary

Hearing on: "The Impact of Lawsuit Abuse on American Small Businesses and Job Creators"

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National Federation of Independent Business (NFIB)
1201 F Street, NW Suite 200
Washington, DC 20004

Chairman Grassley and Ranking Member Feinstein,

On behalf of the National Federation of Independent Business (NFIB), I appreciate the opportunity to submit this testimony to the United States Senate Committee on the Judiciary as it considers the impact of lawsuit abuse on small businesses.

My name is Elizabeth Milito, and I am Senior Executive Counsel with the NFIB Small Business Legal Center. The NFIB Small Business Legal Center is a nonprofit, public interest law firm established to provide legal resources and be the voice for small businesses in the nation's courts through representation on issues of public interest affecting small businesses.

NFIB is the nation's leading small business association, representing members in Washington, D.C., and all 50 state capitals. Founded in 1943 as a nonprofit, nonpartisan organization, NFIB's mission is to promote and protect the right of its members to own, operate, and grow their businesses.

NFIB represents businesses nationwide, and its membership spans the spectrum of business operations, ranging from sole proprietor enterprises to firms with hundreds of employees. While there is no standard definition of a "small business" the typical NFIB member employs 10 people and reports gross sales of about $500,000 a year. The NFIB membership reflects American small business.

Although our country's judicial system deserves much admiration, small business owners staring down a lawsuit find it hard to stomach much praise for the courts. For small business owners, the threat and frequency of lawsuits[1] presents a dire situation since litigation costs are high and profit margins are thin. Three-quarters of all small business owners in America express concern about frivolous or unfair litigation.[2] Of those most concerned, six in ten say the fear of lawsuits makes them feel more constrained in making business decisions generally, and 54 percent say lawsuits, or the threat of lawsuits, forced them to make decisions they otherwise would not have made.[3]

While specific stories of lawsuit abuse vary from business to business, there is one reoccurring theme: this country's legal climate hinders economic growth and hurts job creation.

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[1] In its 2011 report, "U.S. Tort Cost Trends 2011 Update," at 3, Towers Watson found that the U.S. tort system cost $264.6 billion in 2010, which translated to $857 per person versus $820 per person in 2009. *See also* "2016 Litigation Trends Annual Survey," Norton Rose Fulbright (2016) (finding that between 2015 and 2016 an additional 6% of companies surveyed were sued).

[2] "Small Businesses: How the Threat of Litigation Impacts Their Operations," U.S. Chamber Institute for Legal Reform (2007).

[3] *Id.*

When it comes to lawsuits and small business, I like to highlight four things:

1. **Small businesses are easy targets for frivolous lawsuits.** Sophisticated attorneys do not usually sue NFIB members. Small businesses are more likely to be sued by lawyers who threaten cookie-cutter lawsuits that demand immediate settlement.

2. **Small businesses settle and avoid going to court.** When a conflict arises, small businesses, or the insurer on their behalf, will likely pay rather than fight a claim, whether there's a meritorious defense or not. Small businesses care about liability insurance rates and exorbitant legal fees because these costs directly impact their razor-thin margins, this means small businesses settle rather than fight.

3. **Small businesses pay more to fight frivolous claims.** Small businesses do not employ in-house counsel or keep attorneys on retainer. Fighting a legal claim costs a small business a disproportionate amount of time and money as compared to their larger counterparts.

4. **Small businesses support commonsense legal reform.** NFIB members support efforts to curb punitive damages, limit non-economic damages, forum shopping and other 'traditional' civil justice reform proposals. But more than anything, small business owners tend to be practical and logical and support reforms that get to the heart of small business litigation problems. For this reason, NFIB has championed the "Lawsuit Abuse Reduction Act," which focuses on tightening sanctions for frivolous lawsuits. NFIB believes LARA is the best proposed reform, to date, to rein in the "bottom feeders" that target small business.

1. Small Businesses are Easy Targets for Lawsuits

We would all like to think that attorneys comply with the highest ethical standards; unfortunately, that does not always happen. In my experience, this seems particularly true of a plaintiff's attorney who focuses on lower-dollar lawsuits – the type of suits that often target small businesses.

Of course, victims of injustice deserve their day in court. But lawsuit abuse victimizes small business defendants. And by lawsuit abuse, I am referring to those claims where a plaintiff's attorney asserts a flimsy claim to get some money, demands more money than is fair, or sues a business that had little or no involvement but might have money. In each instance, a small business must expend substantial resources to defend the business or risk the prospect of a default judgment.

One of the most prevalent forms of lawsuit abuse occurs when plaintiffs or their attorneys troll for cases. I refer to these cases as the "pay me now or I'll see you in court" scheme. A plaintiff, or an attorney, will travel from business to business, looking for violations of a law. In such cases, the plaintiff generally is not as concerned with correcting the problem as he or she is in extracting a settlement from the small business owner. In many instances the plaintiff's attorney will initiate the claim, not with a lawsuit, but with a "demand" letter. In my experience, plaintiffs and their attorneys find "demand" letters particularly attractive when they can file a claim against a small business owner for violating a state or federal statute.

The scenario works as follows: an attorney will send a one and a half to two-page letter alleging the small business violated a statute. The letter states that the business owner has an "opportunity" to make the whole case go away by paying a settlement fee up front. Time frames for paying the settlement fee are typically given. In some cases, there may even be an "escalation" clause, which raises the price the business must pay to settle the claim as time passes. So, a business might be able to settle for a mere $2,500 within 15 days, but if it waits 30 days, the settlement price "escalates" to $5,000. Legal action is deemed imminent if payment is not received.

In California, attorneys have been known to rake in several million dollars a year fleecing small business owners with these schemes. One attorney, Harpreet Brar, received hundreds of settlements of $1,000 or more from "mom and pop" stores throughout the state after suing them for minor violations of the state business code.[4] Mr. Brar sued many of these businesses for allegedly collecting "point-of-sale" device fees from his wife without proper disclosure signs.

[4] http://www.californiawagelaw.com/wage_law/2006/02/harbreet_brar_g.html.

Ann Kinner, who owns Seabreeze Books & Charts in Point Loma, CA is one such business owner and an NFIB member targeted by frivolous litigation. Kinner's store has been sued twice for Americans with Disabilities Act violations. She went to court to fight and won both lawsuits. But the defense cost her $10,000, money she could have used to hire a new employee. Kinner knows many businesses in her town subjected to identical claims. And most business owners, according to her, get the demand letter and fold because they cannot afford to hire a lawyer and defend the business. In Kinner's words, "the only people who win in these cases are the lawyers."

2. Small Businesses Settle and Avoid Going to Court

For the small business owner with 10 employees or less, the problem is the $5,000 and $10,000 settlements not the million-dollar verdicts since $5,000 paid to settle a case could eliminate about 10 percent of a business' annual profit. Regardless of the merits of the underlying claim, however, a business owner knows settlement will cost less than a court fight. While the targeted business saves money in the short term, these quick settlements encourage unscrupulous attorneys to continue shaking down small businesses with more lawsuits.

Calculating attorneys know that they can extort settlements from small businesses by threatening to sue. This is true of larger businesses to a certain extent as well; however, the typical small business operates on razor thin margins and maintains fewer assets and less insurance coverage than larger businesses.

Moreover, in trolling for cases, a plaintiff's attorney knows that small business owners do not have in-house counsels to inform them of their rights, write letters responding to allegations made against them, or provide legal advice. Without a standing army of attorneys ready to address legal problems, small business owners are more vulnerable to lawsuits, as they often delay seeking counsel—for financial reasons—until a lawsuit has already been filed. And in many cases the business simply lacks the resources needed to hire an attorney or the time and energy required to fight a lawsuit.

Additionally, small businesses cannot pass on to consumers the increased costs of liability insurance or pay large lawsuit awards without suffering losses.[5] Together these factors make small businesses particularly vulnerable targets for plaintiffs seeking to exact an easy settlement since refusal to settle might mean financial ruin for a business. Small business owners realize that the costs of fighting a legal battle often outweigh the benefit to mounting a defense. Indeed, at NFIB, on a near-daily basis, I speak with small business owners facing serious

[5] Damien M. Schiff and Luke A. Wake, *Leveling the Playing Field in David v. Goliath: Remedies to Agency Overreach*, 17 Tex. Rev. L. & Pol. 97, 98-99, 109-113 (2012) (discussing the financial difficulties facing small business owners when legal problems arise, and the financial disincentives against protecting their legal rights).

legal issues, who are nonetheless hesitant to seek out legal counsel because business owners know (and fear) what attorneys charge. The business owners also know that litigation is always a gamble, no matter how outlandish a lawsuit may appear.

Since there is no guarantee that, at the end of the fight, the defendant will prevail, small business owners often rationally opt to avoid the costs of litigation by agreeing to settle claims that they believe to be without merit. In short, the probable cost of litigation will exceed the benefit of winning in court.

3. Small Businesses Pay More to Fight Frivolous Claims

The costs of tort litigation are staggering, especially for small businesses. The tort liability price tag for small businesses has been estimated to exceed $100 billion dollars.[6] Small businesses shoulder a disproportionate percentage of the load when compared with all businesses. For example, small businesses pay 81 percent of liability costs but only bring in 22 percent of the total revenue.[7] It is not surprising that many small business owners "fear" getting sued, even if a suit is not filed.[8]

Lawsuits - threatened or filed - impact small business owners. I hear story after story of small business owners spending countless hours and sometimes significant sums of money to settle, defend, or work to prevent a lawsuit. And while NFIB members are loath to write a check to settle what they perceive to be a frivolous claim, they express as much, if not more, frustration with the time spent defending against a lawsuit. For a small business owner, time is money.

Doug Volpi, an NFIB member who owns a paint store in Southern California, provides a vivid illustration of how a frivolous lawsuit emotionally and financially taxes a small business owner. Mr. Volpi received a summons in the mail notifying him that his business, Frontier Paint, was a defendant in a multi-million-dollar asbestos lawsuit. The complaint alleged that the plaintiff suffered asbestos exposure in the 1960s and 1970s from use of a product called "Fixall." The manufacturer of Fixall has long since gone bankrupt leaving small businesses who allegedly sold the product holding the bag. Mr. Volpi bought his Southern California business in 1997 – over twenty years after the plaintiffs alleged exposure. Moreover, the plaintiff lived in San Francisco nowhere near the location of Mr. Volpi's Southern California store.

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[6] "Tort Liability Costs for Small Businesses," U.S. Chamber Institute for Legal Reform (2010) at 11.

[7] *Id.*

[8] *Id*. at 7-8.

Upon receipt of the summons, Mr. Volpi first panicked, then he went to work. According to Mr. Volpi, as soon as he read the papers he said to his wife "we're going to need to hire a lawyer." And they did. Then Mr. Volpi spent hours on-line researching the plaintiff's claims and discovered that the plaintiff's attorney's firm had a known reputation trolling for defendants. In Mr. Volpi's words this attorney "dropped a net, dragged it around, and pulled it up to see if there was any halibut." Thanks to the work of Mr. Volpi's attorney, Frontier Paint did not become halibut. But dismissal of Mr. Volpi's business from the lawsuit came at a significant cost to Frontier Paint. Mr. Volpi and his wife paid what was to them significant legal fees just to get their business removed from a complaint in which it should never have been named in the first place.

Mr. Volpi's story, unfortunately, is not unique. Class action cases are rife with stories like Frontier Paint's. In these cases, a plaintiff's attorney can use a shotgun approach naming hundreds of defendants in a lawsuit, therein making defendants responsible to prove their innocence. In many cases, plaintiffs name defendants by using vendor lists or even lists from the Yellow Pages of certain types of businesses (*e.g.*, auto supply stores, drugstores) operating in a particular jurisdiction.

Even when a business owner has insurance to cover costs, settlement by the insurer has pitfalls. In most cases, the insurer performs a cost-benefit analysis. If the matter will settle for $5,000, the insurer likely will settle. Litigating, even if the small business owner would ultimately prevail, would cost more. This is often referred to as the "nuisance" value of a case, which lawyers have grown particularly apt at calculating so that it is less expensive for either the insurer or small business to settle than to pay to defend a lawsuit. As a result, the majority (9:1) of cases settle leaving small business owners dissatisfied because they want to fight these claims.[9]

Once settled, however, the small business owner must pay higher business insurance premiums. Many small business owners understand this dynamic, and as a result, will settle claims without notifying their insurance carriers. As such, small businesses annually pay $35.6 billion out of pocket to settle these claims.[10]

But there are other costs as well; the time and energy wasted defending meritless claims and the damage to an innocent business's reputation which is not automatically remedied just because the court dismisses a lawsuit. Small business owners threatened with lawsuits often would prefer to fight to prove their innocence. They do not appreciate the negative image that a settlement

[9] NFIB National Small Business Poll, "Liability," William J. Dennis, Jr., NFIB Research Foundation Series Editor, Vol. 2, Issue 2 (2002) at 1.

[10] "Tort Liability Costs for Small Businesses," U.S. Chamber Institute for Legal Reform (2010) at 11.

bestows on them or on their business. Settling a meritless case causes the business to look guilty, and some prospective customers cannot be easily convinced otherwise. Yet, unfortunately, the reality is that small business owners often have no choice but to settle, accept their losses and try to move on when threatened with a lawsuit.

Business owners who chose to stand on principle to protect their reputation likely face a long, expensive, and emotionally draining fight. To vindicate their rights, they must prove their innocence in court. Business owners, like Ms. Kinner, almost universally state that defending a meritless suit occupies their daily attention and costs them many sleepless nights.

4. Small Businesses Support Common Sense Legal Reform

Substantive reforms limiting tort liabilities or setting evidentiary and recovery standards would certainly help disincentive attorneys from taking brash and cavalier legal positions. But, in crafting solutions here, we must acknowledge the practical circumstances of the small business owner threatened with protracted legal battle. Regardless of whether the plaintiff's claims are meritorious, the small business defendant faces a difficult—and often impossible—dilemma. Settle or risk everything. For this reason, NFIB has championed the "Lawsuit Abuse Reduction Act," which focuses on tightening sanctions for frivolous lawsuits. This is the best reform, to date, to rein in the "bottom feeders" that target small business.

LARA would put teeth back into the federal Civil Procedure Rule 11. Rule 11 sets forth requirements that attorneys must meet when bringing a lawsuit and *permits* judges to sanction attorneys if they do not meet those conditions. Specifically, Rule 11 requires every pleading to be signed by at least one attorney.[11] It also states that when an attorney files a pleading, motion, or other paper with a court he or she is "certifying that to the best of the person's knowledge, information, and belief, formed after an inquiry reasonable under the circumstances [that:]

(1) it is not being presented for an improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation;
(2) the claims, defenses, . . . are warranted by existing law or by a nonfrivolous argument for [a change] of existing law or the establishment of new law;
(3) the allegations and other factual contentions have evidentiary support or, . . . are likely to have evidentiary support after a reasonable opportunity for further investigation or discovery; and

[11] Fed. R. Civ. P. 11(a).

(4) the denials of factual contentions are warranted on the evidence or, . . . are reasonably based on a lack of information or belief."[12]

Importantly, it also provides attorneys with a 21-day window to withdraw a frivolous lawsuit after opposing counsel provides notice of intent to file a motion for sanctions. This is commonly referred to as Rule 11's "safe harbor" provision.[13]

Rule 11, in its current form, is the product of revisions made in 1993. These revisions rendered it nothing more than a "toothless tiger." The current rule places small businesses that are hit with a frivolous lawsuit in a lose-lose situation. To challenge a lawsuit as frivolous, a small business owner must pay a lawyer to draft a separate motion for sanctions that they cannot present to a court, but, due to the "safe harbor" provision, must first send to the plaintiff's attorney. This expense is in addition to filing an answer to the complaint.

If the plaintiff's attorney withdraws the frivolous complaint within 21 days, then the small business that went through the time and expense of defending against it has no opportunity to be made whole. A judge will never consider the issue.

If, on the other hand, the plaintiff's attorney proceeds with the frivolous lawsuit, despite notice that the small business will seek Rule 11 sanctions, then the small business still has very little chance at recovery for two reasons:

(1) under current Rule 11, even if a judge finds a lawsuit is indeed frivolous, imposition of sanctions, in any form or amount, is entirely discretionary. There is no assurance that a judge will act; and
(2) Rule 11 discourages judges from imposing sanctions to reimburse a defendant for the costs of a frivolous lawsuit by limiting sanctions "to what suffices to deter repetition of the conduct or comparable conduct by others similarly situated." As a result, unscrupulous attorneys, out to make a quick buck, know that the odds of being sanctioned under Rule 11 are remote. They receive something more like a "get out of jail free" card when they bring frivolous lawsuits.

LARA would remedy this and other problems by eliminating the "safe harbor" provision, making Rule 11 sanctions mandatory when an attorney or other party files a lawsuit before making a reasonable inquiry, and removing language that discourages judges from awarding reasonable attorneys' fees and costs to compensate small businesses that are victims of frivolous lawsuits. And, importantly, LARA makes it fair to both sides since the sanctions would also apply to frivolous defenses raised by small business owners.

[12] *Id.* at 11(b).

[13] *Id*. at 11(c)(1)(A).

The tremendous costs of litigation, and the inevitable risk that a plaintiff might prevail if the case goes before a sympathetic jury or an errant judge, discourage small business defendants from vindicating their rights. This provides plaintiff attorneys a perverse incentive to threaten or initiate a legal action, even when the plaintiff has only an outside chance of recovery in court. The attorneys know most of cases settle and that even outlandish claims sometimes "stick" in court. So why not move forward with questionable claims? Indeed, this perverse incentive fuels litigation abuse. And it remains a nationwide problem both in terms of the economic impact it has on business and in terms of the culture of fear that it fosters in the business community. So long as this remains true, unscrupulous attorneys will inevitably weigh the benefits of pursuing a questionable claim as outweighing the risks.

Accordingly, NFIB supports reform efforts that encourage plaintiff attorneys to make prudent decisions before threatening to sue and that discourage plaintiff and defense attorneys from taking cavalier and abusive positions in litigation.

Conclusion

Lawsuits hurt small business owners, new business formation, and job creation. The cost of lawsuits for small businesses can prove disastrous, if not fatal, and threaten the growth of our nation's economy by hurting a very important segment of that economy, America's small businesses. On behalf of America's small business owners, I thank this Committee for holding this hearing and providing us with a forum to tell our story.

Sincerely,

Elizabeth Milito, Esq.
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