House of Representatives
Committee on the Judiciary
Subcommittee on the Constitution and Civil Justice

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“Lawsuit Abuse Reduction Act of 2015”
Thank you, Mr. Chairman and distinguished Committee members for inviting me to provide testimony regarding the impact lawsuits, and particularly frivolous lawsuits, have on small business. My name is Elizabeth Milito and I serve as Senior Executive Counsel of the National Federation of Independent Business (NFIB) Small Business Legal Center. The NFIB Small Business Legal Center (NFIB 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.

The National Federation of Independent Business (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 350,000 member 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 is a reflection of American small business.

Although our country’s judicial system has much to be lauded, small business owners staring down a lawsuit find it hard to appreciate any praise of the courts. The United States is one of the most litigious nations in the world. How bad is it? It's bad. Four in five voters (78 percent) believe there are too many lawsuits in the U.S. More than 15 million lawsuits are filed every year. While some of these lawsuits have merit, many do not and these lawsuits are costing each and every one of us. And the news is particularly dire for small business owners, for whom the stakes are high and profit margins are razor thin.

Three-quarters of all small business owners in America are concerned they might be the target of a frivolous or unfair lawsuit. Of those who are most concerned, six in ten say the fear of lawsuits makes them feel more constrained in making

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2 Joseph Shade, The Oil & Gas Lease and ADR: A Marriage Made in Heaven Waiting to Happen, 30 Tulsa L.J. 599, 656 (1995) (“More than 15 million lawsuits are filed every year in the United States. Between 1964 and 1984 the per capita rate at which law suits were filed tripled.”) (citing Peter Lothenheim, Mediate, Don't Litigate 3 (1989)).

business decisions generally, and 54 percent say lawsuits or the threat of lawsuits forced them to make decisions they otherwise would not have made.\(^4\)

While specific stories of lawsuit abuse vary from business to business, there is one recurring theme: this country’s legal climate hinders economic growth and hurts job creation. Due to this, NFIB’s members and small business owners throughout the country are fed up with the inability to pass meaningful legal reforms. Therefore, NFIB applauds the Committee for holding this hearing in order to focus on the problem of lawsuit abuse.

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

1. **Small businesses are easy targets for lawsuits.** Sophisticated attorneys do not sue NFIB members. Small businesses are more likely to be sued by small-time lawyers who threaten cookie-cutter lawsuits that are expected to be settled immediately. Small businesses fear being sued more than actually having been sued.

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.

3. **Small businesses pay more to fight frivolous claims.** Small businesses care about liability insurance rates because these rates directly impact their razor thin margins. And fighting a legal claim costs small business owners a disproportionate amount of time and money as compared to their larger counterparts.

4. **Small businesses support commonsense legal reform like the “Lawsuit Abuse Reduction Act.”** Our 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. This is the best reform, to date, to rein in the “bottom feeders” that target small business.

\(^4\) Id.
1. Small Businesses are Easy Targets for Lawsuits

We would all like to think that attorneys comply with the highest ethical standards; unfortunately, that is not always the case. In my experience, this seems particularly true of plaintiffs’ attorneys who bring lower-dollar suits – the type of suits of which small businesses are generally the target.

One of the most prevalent forms of lawsuit abuse occurs when plaintiffs or their attorneys are merely trolling for cases. A plaintiff, or an attorney, will travel from business to business, looking for violations of a particular 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 particular 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 particular 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. Mr. Brar sued many of these businesses for allegedly collecting “point-of-sale” device fees from his wife without proper disclosure signs.

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 ADA violations. She went to court, fought 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.”

Of course, it is important to give victims of injustice their day in court. But lawsuit abuse victimizes those who are sued. And by lawsuit abuse, I am referring to those claims where a plaintiff’s attorney asserts a flimsy claim to get some money, to get more money than is fair, or sues a business that had little or no involvement but might have money. In all of these instances, small businesses must expend substantial resources to defend the business or risk the prospect of default judgments against them.

2. Small Businesses Settle and Avoid Going to Court

When a business is facing an abusive lawsuit, it is often far less expensive simply to settle the lawsuit rather than incur steep legal fees fighting it in court. 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.

In trolling for cases, plaintiffs’ attorneys know that small business owners do not have in-house counsel 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—for that matter—the time and energy that may be required to fight a lawsuit. Small businesses also cannot pass on to consumers the increased costs of liability insurance or pay large lawsuit awards without suffering losses. These factors make small businesses particularly vulnerable targets for plaintiffs seeking to exact an easy settlement.

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, we must remember that the typical small business operates on razor-thin margins and maintains fewer assets and less insurance coverage than larger businesses. Small businesses simply cannot absorb the costs of a legal battle as easily as larger businesses—or for that matter the cost of paying damages if they should lose in the end.

This means that—in many cases—the small business owner may be risking financial ruin if the owner refuses to settle. And the plaintiffs’ bar knows that most small business owners realize that the costs of fighting a legal battle often outweigh the benefit to be had in mounting a defense. Indeed, at NFIB, on a near-daily basis, I speak with small business owners facing serious legal issues,

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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 be.

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. Indeed they will rationally decide to settle in cases where they realize that 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 in 2008 was $105.4 billion dollars. 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. It is not surprising that many small business owners “fear” getting sued, even if a suit is not filed.

Lawsuits - threatened or filed - impact small business owners. In eleven years at NFIB, I have heard 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 our 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. In the end, of course, time is money to a small business owner.

Settling a matter at the urging of their insurer can be particularly troublesome in the current system. In most cases, if there is any dispute of fact, the insurer will perform a cost-benefit analysis. If the case can be settled for $5,000, the insurer is likely to agree to the settlement because generally it is less expensive than litigating, even if the small business owner would ultimately prevail in the suit. This is often referred to as the “nuisance” value of a case, which plaintiffs’

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8 Id.

9 Id. at 7-8.

10 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. When you consider that many of these small businesses only net $40,000 - $60,000 a year, $5,000 paid to settle a case immediately eliminates about 10 percent of a business’ annual profit.
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 vast majority (9:1) of cases settle leaving small business owners dissatisfied because they want to fight these claims, but it ends up being significantly more costly even if they do prevail.\textsuperscript{11}

Once the suit is settled, however, the small business owner must pay higher business insurance premiums. Typically, it is the fact that the small business owner settled a case, for any amount, which drives insurance rates up; it does not matter if the business owner was ultimately held liable after a trial. 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.\textsuperscript{12}

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 in order to prove their innocence. They do not appreciate the negative image that a settlement 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.

Of course, for those small business owners who chose to stand on principle when they know they are in the right, there is no easy road. 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 Like the “Lawsuit Abuse Reduction Act”

Substantive reforms limiting tort liabilities or setting evidentiary and recovery standards would certainly help disincentive plaintiffs’ 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


\textsuperscript{12} “Tort Liability Costs for Small Businesses,” U.S. Chamber Institute for Legal Reform, 2010, at 11.
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. 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
4. the denials of factual contentions are warranted on the evidence or, . . . are reasonably based on a lack of information or belief.”

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.

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. In order to challenge a lawsuit as frivolous, a small business owner must pay a lawyer to draft a separate motion for sanctions that they cannot actually present to a court, but, due to the “safe harbor” provision, must first be sent 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 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. First, under

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14 Id. at 11(b).
15 Id. at 11(c)(1)(A).
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 take action. Second, Rule 11 discourages judges from imposing sanctions for the purpose of reimbursing 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.

Given 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, small business defendants are rationally discouraged from vindicating their rights. For these reasons, plaintiff attorneys have a perverse incentive to threaten or initiate a legal action, even when the plaintiff has only an outside chance of recovery in court. They know that the majority of cases settle, and that even outlandish claims sometimes “stick” in court. So why not move forward with questionable claims? Indeed, this perverse incentive is the root cause of 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, plaintiffs’ attorneys will inevitably weigh the benefits of pursuing a questionable claim as outweighing the risks.

Accordingly, we encourage passage of the “Lawsuit Abuse Reduction Act,” which will encourage plaintiffs, defendants, and attorneys on both sides to make prudent decisions and discourage cavalier and abusive positions in litigation. Public policy should encourage attorneys to prudently assess the viability of their clients’ potential claims before initiating a lawsuit or a fabricated defense.

**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.
We are hopeful that through your deliberations you can strike the appropriate balance to protect those who are truly harmed and the many unreported victims of our nation’s civil justice system – America’s small businesses.

Sincerely,

Elizabeth Milito, Esq.
NFIB Small Business Legal Center