

TESTIMONY BEFORE THE UNITED STATES CONGRESS  
ON BEHALF OF THE  
NATIONAL FEDERATION OF INDEPENDENT BUSINESS

**NFIB**  
The Voice of Small Business.®

**House of Representatives Committee on the Judiciary  
Subcommittee on the Constitution**

on the date of

March 11, 2011

on the subject of

H.R. 966 “the Lawsuit Abuse Reduction Act”

Thank you, Mr. Chairman and distinguished Committee members for inviting me to provide testimony regarding the tremendous negative effects lawsuits, and particularly the fear of lawsuits, are having on the millions of small business owners in America today. 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 about 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 federal policy makers often view the business community as a monolithic enterprise, it is not. Small business owners have many priorities and often limited resources. Being a small business owner means, more times than not, you are responsible for everything – NFIB members, and hundreds of thousands of small businesses across the country, do not have human resource specialists, compliance officers, or attorneys on staff. For small business owners, even the threat of a lawsuit can mean significant time away from their business – time that could be better spent growing their enterprise and employing more people.

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. In many instances, a plaintiff's attorney will just take a client at his word, performing little, if any, research regarding the validity of the plaintiff's claim. As a result, small business owners must take time and resources out of their business to prove they are not liable for whatever "wrong" was theoretically committed. As one small business owner recently remarked to me, "What happened to the idea that in this country you are innocent until proven guilty?"

Although that mantra refers to a defendant's rights in our criminal justice system, problems with our civil justice system can no longer be ignored. It is incumbent

upon the attorney representing a plaintiff to get the facts straight **before** sending a threatening letter or filing a lawsuit, not after the letter is sent or the lawsuit is filed. Sadly, due in large part to the ineffectiveness of Rule 11 in its current form, we have a legal system in which many plaintiffs' attorneys waste resources and place a significant drain on the economy by making the small business owner do the plaintiff's attorney's homework. It often is up to the small business owner to prove no culpability in cases where a few hours of research, at most, would lead the attorney for the plaintiff to conclude that the lawsuit is unjustified.

The NFIB Legal Center applauds the Committee for holding this hearing in order to focus on the problem of frivolous lawsuits.

### **Frivolous Lawsuits Create a Climate of Fear for America's Small Businesses**

A few years ago, the national media focused much attention on the outlandish \$65 million lawsuit filed against a District of Columbia dry cleaner for a missing pair of pants. As outrageous as the facts of this suit are, it is not outrageous that the defendant is a small business. The fact is that NFIB members, and the millions of small businesses across the country, are prime targets for these types of suits because they do not have the resources to defend against them. Small businesses cannot pass on to consumers the costs of liability insurance or pay large lawsuit awards without suffering losses.

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.<sup>1</sup> 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.<sup>2</sup> It is not surprising that many small business owners "fear" getting sued, even if a suit is not filed.<sup>3</sup> That possibility – the fear of lawsuits – is supported by an NFIB Research Foundation National Small Business Poll, which found that about half of small business owners surveyed either were "very concerned" or "somewhat concerned" about the possibility of being sued.<sup>4</sup> The primary reasons small business owners fear lawsuits are: (1) their industry is vulnerable to suits; (2) they are often dragged into suits in which they have little or no responsibility; and (3) suits occur frequently.<sup>5</sup>

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<sup>1</sup> "Tort Liability Costs for Small Businesses," U.S. Chamber Institute for Legal Reform, 2010, at 11.

<sup>2</sup> *Id.*

<sup>3</sup> *Id.* at 7-8.

<sup>4</sup> NFIB National Small Business Poll, "Liability," William J. Dennis, Jr., NFIB Research Foundation Series Editor, Vol. 2, Issue 2 (2002).

<sup>5</sup> *Id.* at 1.

## **The Impact of Frivolous Lawsuits on Small Business**

Make no mistake about it – lawsuits (threatened or filed) impact small business owners. In my seven 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,<sup>6</sup> 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.

Small business is the target of so many of these frivolous suits because trial lawyers understand that a small business owner is more likely than a large corporation to settle a case rather than litigate. 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. They do not have the resources needed to hire an attorney nor the time to spend away from their business fighting many of these small claim lawsuits. And often they do not have the power to decide whether or not to settle a case – the insurer makes that decision.

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’ lawyers have grown particularly apt at calculating so that it is less expensive for either the insurer or small business 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.<sup>7</sup>

Once the suit is settled, 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. Not surprisingly, NFIB research has shown that the majority of small employers believe that the biggest problem with business insurance today is cost.<sup>8</sup> Many

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<sup>6</sup> 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.

<sup>7</sup> NFIB National Small Business Poll, “Liability,” William J. Dennis, Jr., NFIB Research Foundation Series Editor, Vol. 2, Issue 2 (2002) at 1.

<sup>8</sup> NFIB National Small Business Poll, “Business Insurance,” William J. Dennis, Jr., NFIB Research Foundation Series Editor, Vol. 2, Issue 7 (2002).

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.<sup>9</sup>

In addition to the financial costs of settling a case, there are incalculable psychological costs. 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 can not be easily convinced otherwise.

Of course, it is important to give victims of injustice their day in court. However, it is also important to remember that frivolous lawsuits victimize those who are sued. Small businesses that are wrongfully sued must expend substantial resources to defend meritless claims or must risk the prospect of default judgments against them. 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 claim is successfully defended or dismissed.

NFIB members to whom I have spoken almost universally state that defending these meritless suits occupies their daily attention and costs them many sleepless nights. Some mention that the hassle of dealing with these frivolous suits make them question why they remain in business when they can simply work for someone else and avoid such harassment. Often times these suits take years to resolve. NFIB members cannot recoup this time and the damage to their businesses' reputation and goodwill cannot be easily repaired. So while plaintiffs' rights should be protected, so should the rights of innocent defendants – justice demands it.

### **Frivolous Lawsuits Come in Many Shapes and Sizes**

Frivolous lawsuits take different forms, and I will highlight several types of suits that have been brought to my attention. I place these suits into four categories – “Pay me now or I’ll see you in court”; “Let’s not let the law get in our way”; “Somebody has to pay, and it might as well be you”; and “Yellow Page lawsuits.”

#### **“Pay me now or I’ll see you in court”**

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

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<sup>9</sup> “Tort Liability Costs for Small Businesses,” U.S. Chamber Institute for Legal Reform, 2010, at 11.

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. 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.

Also in California, three lawyers working for the Trevor Law Group, a Beverly Hills law firm, made small fortunes shaking down thousands of small business owners. Specifically, the law firm targeted more than 2,000 auto-repair shops in California for "unfair business practices." These attorneys, like Mr. Brar, used broad consumer protection statutes (which have subsequently been invalidated) to go after those people considered most likely to settle – our nation's small business owners.

### **"Let's not let the law get in our way"**

While most attorneys adhere to the ethical standards to which they have sworn to uphold, there are instances where attorneys fall short and fail to research the validity of the plaintiff's claim and may even fail to review the statute that they allege the defendant violated.

An example involves NFIB member Michael Saunders, who has been inundated for over a year by letters demanding that his company repay invoices to a now bankrupt company. The letters threaten legal action if the invoices are not repaid. The bankruptcy code only allows the trustee to recover payments made within 90 days of a company filing for bankruptcy. However, many of these invoices were for work done by Mr. Saunders's company years before the company went bankrupt. Other invoices are for work done after the company emerged from bankruptcy protection.

The attorneys for the trustee were kind enough to offer Mr. Saunders's company a discount for paying by a certain date. Mr. Saunders's company, however, had no obligation to repay the invoices. Since the payments made by Mr. Saunders's company were not within the statutory period, the demands were totally improper. If the attorneys making the demands even did a simple inspection, they would have discovered that demanding repayment in these instances was wrong. The attorneys either did not check, or did not care to abide by the law. It is a common tactic of bankruptcy trustees to make demands of so-called "preference payments" even if the payments in question do not meet the statutory definition. It is either illegal scheming or at the very least lazy lawyering.

Even though the demands were improper, that was not the end of the story. Mr. Saunders still had to respond to the demands because if he did not then default judgments would be entered against him. So he had to expend substantial legal fees to dispense with completely meritless claims. In fact, he claims that his legal expenses are essentially what the letters demanded he repay.

**"Somebody has to pay, and it might as well be you"**

These frivolous suits are the type in which the plaintiff may have been harmed, but is suing the wrong person. For example, Bob Carnathan, an NFIB member, owns Smith Staple and Supply Co., a small nail and staple fastening business located in Harrisburg, Pennsylvania. Mr. Carnathan's business leases space in a strip mall. After a snowstorm, one of the tenants in the complex was walking across the parking lot when he slipped and fell on the icy pavement injuring his back and head. The medical bills from his injury totaled a little over \$3,000. The man sued every tenant in the complex, as well as the landlord and the developer, for \$1.75 million. Mr. Carnathan was sued even though he was not at fault because his rent included maintenance on the facilities and grounds.

After two years of endless meetings and conference calls, Mr. Carnathan learned that his business was released from the lawsuit. He says that there is no compensation for the time that he was forced to spend away from his business to fight this unfair lawsuit. Mr. Carnathan firmly believes that "the smaller your business, the more you are impacted when a frivolous lawsuit lands on your doorstep."

NFIB member Hugh Froedge's 11-year fight against a personal injury claim also highlights the frustration of small business owners. Froedge's business was named in a personal injury lawsuit after the plaintiff was found trapped between the machine he was working with and a belt conveyer sold by Mr. Foedge's company. Mr. Froedge's business was sued along with a number of other companies in a case that alleged \$7 million in damages. There was no evidence that Mr. Froedge's belt conveyer caused the plaintiff's injuries and, in fact, OSHA held the plaintiff's employer responsible. Mr. Froedge could also prove that the

plaintiff's employer had rewired the other machine and disregarded important workplace safety measures. However, all of the other entities named in the lawsuit went bankrupt, leaving Mr. Froedge's business as the only defendant.

The lawsuit took 11 years to resolve. In the end, Mr. Froedge's insurance company decided to settle the matter, even though Mr. Froedge believed he was not culpable and would have preferred to fight. In fact, his mother wanted to sell everything to fight this case. However, the insurance company made the decision for them.

### **"Yellow Page Lawsuits"**

These lawsuits are more commonly found in class action cases. In these cases, hundreds of defendants are named in a lawsuit, and it is their responsibility to prove that they are not culpable. 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.

Unfortunately, NFIB Member Lou Baribeau, knows these tactics all too well. Mr. Baribeau's company manufactures water tanks. Water tanks are rated depending on what pressure they are designed to handle. A company bought one of Mr. Baribeau's tanks from a reseller. That tank, while in perfect working order, was not designed to work under the pressure that the company was going to put on it. Additionally, the government inspector did not make sure that the system was up to code and passed it. Tragically, yet not surprisingly, the system malfunctioned and a maintenance person was badly injured.

Mr. Baribeau's company was sued as part of a class action. Mr. Baribeau was sued simply because his water tank was involved, regardless of whether the water tank was the reason the accident occurred. As he put it, "innocence has nothing to do with it." The case went on for a year, and legal expenses forced the parties to settle. Mr. Baribeau was forced to pay \$5,000 just to make it go away.

Another NFIB member has been targeted in asbestos litigation. The family-owned commercial construction business, which was founded over 40 years ago, has been named in over 10 asbestos lawsuits. According to the member, his company has been targeted in recent years as many asbestos manufacturers have gone bankrupt leaving a void of solvent defendants. As a result, attorneys are now trolling for construction firms that existed in the 1960s and that are still in existence, and preferably with deep pockets, today.

The NFIB member, who wishes to remain anonymous for fear publicity surrounding his company's involvement in asbestos litigation will cause more attorneys to target the business, has never been sued by an employee – all suits

have been filed by individuals who allege that the NFIB member company was one of potentially dozens of subcontractors on a particular job site where the plaintiff worked and was allegedly exposed to an asbestos product. In several instances, it was later shown the plaintiff could never have worked at a site alongside the NFIB member, such as when exposure allegedly occurred at a marine construction site or before the company even existed. Still, to get dismissed from these cases the NFIB member spends thousands of dollars in attorney's fees and discovery costs.

### **Solutions for Small Business**

These stories demonstrate that lawsuit abuse is alive and well in the United States, and small businesses are too often the victims. It is for this reason that legislation is sorely needed to reform our nation's civil justice system. H.R. 966, recently introduced by Representative Lamar Smith, will help eliminate many of the types of suits I have described or, at the very least, provide a fair opportunity for small-business victims of frivolous lawsuits to receive reimbursement of their legal costs.

H.R. 966 would put teeth back into 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.<sup>10</sup> 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."<sup>11</sup>

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.<sup>12</sup>

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<sup>10</sup> Fed. R. Civ. P. 11(a).

<sup>11</sup> *Id.* at 11(b).

<sup>12</sup> *Id.* at 11(c)(1)(A).

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 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.

H.R. 966 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.

## **Conclusion**

Frivolous 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. We must work together to find and implement solutions that will stop this wasteful trend. 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

# CORE VALUES

We believe deeply that:

Small business is essential to America.

Free enterprise is essential to the start-up and expansion of small business.

Small business is threatened by government intervention.

An informed, educated, concerned, and involved public  
is the ultimate safeguard for small business.

Members determine the public policy positions of the organization.

Our employees and members, collectively and individually, determine the success of  
the NFIB's endeavors, and each person has a valued contribution to make.

Honesty, integrity, and respect for human and spiritual values are important  
in all aspects of life, and are essential to a sustaining work environment.

## **NFIB**

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