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Impact of Litigation on Small Business

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Purpose

Litigation costs, unlike other costs of doing business, are seldom estimated on an annual basis. This research attempts to shed light on how small business fares under the constraint of litigation and calculates annual litigation costs.

Overall Findings

- Litigation is costly to small business owners both in time and money.
- It modifies the way they do business.
- Litigation causes emotional hardship within small firms.

Highlights

- The impact of litigation on businesses goes well beyond the purely financial impact of legal fees and damages. Most small business owners are invested personally in their businesses; litigation causes not just financial loss, but also substantial emotional hardship, and often changes the tone of the business.
- Many of the small businesses surveyed tried to settle their case prior to trial, but with mixed results. Those surveyed explained that the main reason why settlement failed was that the opposing party refused to meet and negotiate, preferring to go to court. Small business owners indicated they would go to great lengths to stay out of court, which was their major motivation for settlement; an indication that there is a hidden cost to the threat of litigation.

- Financial impacts were mentioned by most study participants. Legal costs for actual litigation ranged from \$3,000 to \$150,000 with approximately one-third of those providing a response under \$10,000. Small business owners felt they had to "recoup" these losses by cutting operating expenses, acquiring new customers or expanding their services to existing customers. Raising prices was not an option, as it would put them at a competitive disadvantage.

- Most companies used business assets to pay the damages. However, in the case of employee complaints, insurance covered some of the damages. Owners mentioned that the payment of damages nearly put them out of business, which affected them for a long period of time as they worked to rebuild the business and recoup their losses.

- Small business owners who were surveyed became more wary of employees and customers as a result of their litigation experience.

Scope and Methodology

This study was conducted with the help of a survey (OMB # 3245-0345). The researchers used the annual reports Judicial Business of the U.S. Courts, and Federal Court Management Statistics, as they provide useful data on district court caseloads, but do not identify the types of defendants. For example, the reports state that in U.S. District Courts in 2001 there were 302,104 cases filed, 295,308 cases terminated, and 297,265 cases pending with some cases straddling between 2000 and 2001. They also report that the median time from filing to disposition in civil cases was 8.7 months, and from filing to trial was 21.6 months. The research team made use of a micro data set on individual case filings to determine the number of lawsuits filed that involved small businesses.

The research team used the PACER (Public Access to Court Electronic Records) system to create a data set of individually filed cases to determine the number and nature of lawsuits involving small businesses. Data on cases filed in U.S. District Courts during the 12-month period, July 2002 through June 2003, was obtained from the PACER system. Members of the research team then determined whether the lawsuit appeared to involve a business as plaintiff or defendant via telephone books, individual business web sites, anywho.com, and directoriesUSA.com. This sample of cases was also used to select

a subsample of businesses to contact for a telephone interview.

This report was peer-reviewed consistent with Advocacy's data quality guidelines. More information on this process can be obtained by contacting the Director of Economic Research at advocacy@sba.gov or (202) 205-6533.

Ordering Information

The full text of this report and summaries of other studies performed under contract with the U.S. Small Business Administration's Office of Advocacy are available on the Internet at www.sba.gov/advo/research.

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