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When the Small Business Litigant cannot Afford to Lose (Or Win): Litigation Consequences for Small Businesses, Strategies for Managing Costs, and Recommendations for Courts and Policymakers

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**WHEN THE SMALL BUSINESS LITIGANT
CANNOT AFFORD TO LOSE (OR WIN):
LITIGATION CONSEQUENCES FOR SMALL
BUSINESSES, STRATEGIES FOR MANAGING COSTS,
AND RECOMMENDATIONS FOR COURTS
AND POLICYMAKERS**

Gregory J. Myers[†]

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I. INTRODUCTION

A small business cannot afford several months of litigation. A typical small business might have five to twenty employees and

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somewhere between \$500,000 and \$5 million in revenues.¹ This may sound like a lot of money, but after rent, debt service, payroll, and other expenses, the company's net income will be only a fraction of that amount—if it makes a profit at all.

In addition, while larger companies likely will have in-house legal counsel and staff, and a legal budget or reserve, as well as formalized information and technology systems, most companies² might not employ even one in-house attorney or a designee for handling legal disputes. A typical small business also might have undeveloped information systems and no one charged as a document custodian to regularly back up electronically stored information. Instead, the company's owners and executives will attempt to deal with outside counsel and handle discovery and other time-consuming and stressful litigation obligations, as best they can, in addition to their day-to-day business duties.

The hard costs of litigation weigh heavily against limited business revenues. Hiring a lawyer to evaluate a dispute and prepare a complaint or answer can consume many thousands of dollars in fees. Preparing and responding to written discovery can be even more expensive, especially if it is coupled with motion practice and multiple depositions, which (including preparation time, testimony, and transcript costs together) can cost between \$2000 to \$10,000 per witness. Even a limited expert witness can add tens of thousands of dollars in additional costs and fees. Responding to or bringing a summary judgment motion can often exceed \$40,000 in fees for a lawyer to brief and argue. These costly activities are only a partial list of costs and expenses that a litigant incurs—yet they could continue for six to twelve months or more before there is any prospect for settlement and before any trial.

As a result of these factors, almost any litigation scenario will

1. The Small Business Administration defines a small business as one that is independently owned and operated, is organized for profit, and is not dominant in its field. *See* 13 C.F.R. §§ 121.102, .105, .702 (2012). The limitations relating to the definition vary by industry. For example, in manufacturing, the maximum number of employees may range from 500 to 1500, depending on the type of product manufactured. *See id.* § 121.201. In services, the maximum allowed annual receipts may not exceed \$2.5 million to \$21.5 million. *See id.*

2. According to the Small Business Administration's small business profile for Minnesota through 2010, based on census data published in January 2012, Minnesota small businesses account for 97.9% of all businesses and employ 49.9% of the private workforce. U.S. SMALL BUS. ADMIN. OFFICE OF ADVOCACY, SMALL BUSINESS PROFILE: MINNESOTA 1-2 (2012), *available at* http://www.sba.gov/sites/default/files/mn11_0.pdf.

put almost every small business in long-term hardship or worse. The financial consequences not only threaten a small business's health but also interfere with operations, and can force key people within the business to shift substantial time and energy to the dispute, rather than running and building the company. In some scenarios, the inherent risks to the small business litigant are compounded by other factors.

This article will discuss two types of small business litigants: the new business and the business that is overmatched by virtue of its lesser resources or its financial dependence on its opponent. The article will then discuss the cost and distraction of litigation, including common features of litigation that prolong the process and make it more costly. Finally, this article will discuss potential approaches for lawyers to contain costs and for courts to promote alternative, less costly methods for resolving lawsuits.

II. DESCRIBING THE LANDSCAPE—IF YOU TAKE THE CLIENT AS YOU FIND IT, YOU OFTEN WILL FIND SMALL BUSINESSES IN A DISADVANTAGED SITUATION

A. *A Portrait: The New Business Hypothetical*

When a new business is formed, it is usually a significant personal and financial investment. The founders will typically take on debt and tap personal or family funds.

Then, during the new business's early phases, the owners will work extra hours to build the business, and will plow their revenues back into the business. They will also face the vast array of start-up costs and have to pull together the physical financial and technological systems the business will need, including such things like:

- Office or business space
- Employees
- Taxes
- Vendors to handle accounting, payroll, and other services
- Legal costs
- Telephones, cell phones, and smart phones
- A website, business cards, brochures, mailings, and other marketing materials
- Computers, software, and Internet and related services
- Insurance

This could be any business—a consulting firm, an advertising firm, a salon. Even if the future looks bright and even if the business is growing fast and making a profit, could the business and its owners handle a lawsuit? Could they handle what it might do to their costs? To their busy schedules? To their reputation?

B. A Portrait Modified: The Dependent Small Business

It is easy to see that a small business would have a hard time absorbing any significant lawsuit. However, suppose the small business is also dependent on only a few clients—it is almost certain to be. One or two companies may give them significant repeat business, while other clients are harder to secure and less lucrative. What if a client does not pay or accuses the company of negligence or some other misconduct? Or, suppose the principals find themselves in a lawsuit concerning trade secrets or non-compete agreements relating to a previous employer.

Consider a business of professionals, such as lawyers, accountants, doctors, or chiropractors opening offices on their own. Each is dependent on clients, and sometimes one or two clients will account for a significant chunk of the firm's revenue.

For health professionals, their businesses can be even more dependent. A doctor or chiropractor's office will have many of the same features as a lawyer's or accountant's office, as well as significant information technology equipment, medical equipment, and so on. And, some health professionals are dependent on particular insurance payers—for example, Medicare/Medicaid or no-fault insurance companies. What happens if the insurer does not pay, citing a regulatory violation or questioning the services provided?

Or, suppose any business of any kind incurs a liability that it believes should be insured, but the insurer denies the claim. The claim might be some sort of water damage claim or other area of disputed coverage that is hard to sort out, or a workers' compensation or excess-risk exposure claim.

In such a situation, the legal risk might be closely related to the business risk. Business income will be lost, but the business has to pay legal fees—and wait and toil through the legal process—in order to try to recover the money.

Small businesses that depend on a small number of clients or a small number of payers may not be able to survive without the revenue. But can they afford litigation to secure their payment?

As summarized below, perhaps not. The fees and costs involved suggest that a small business will find it very difficult to survive any significant or lengthy litigation.

III. THE LITIGATION ROADMAP: JUSTICE DELAYED IS JUSTICE DENIED

Take any small business. Let's assume that a business is in litigation and the claims are significant, but that the business expects to prevail and even believes that a summary judgment motion will be appropriate. Let's also assume that the opponent is a capable litigant—a larger competitor, a larger business, or an insurer, any of which is willing and able to commit a significant amount of money to the litigation. The opponent may also see a competitive advantage to litigating against the small business.

Whether the matter is in Minnesota state or federal court, the timeline is relatively similar. The cost range is also comparable and discussed below. Each stage may also invite key decisions about motions and strategies; these costs are also comparable and are discussed below.

The starting point to any party's participation in litigation—the complaint or answer—is more than just preparing a document. For a complaint or an answer, an attorney will have to investigate the facts, research the law, and prepare the pleading. While straightforward matters (collection of an unpaid account, for example) might involve only a few hours of attorney work, more complicated or novel matters could involve scores of hours investigating facts and researching the law. The small business's executives and owners also will be charged with collecting documents, instituting a litigation hold, and meeting with its lawyers. The out-of-pocket costs may exceed \$20,000, but the operational costs to the company in terms of lost productivity and lost time is even more significant.

At that early stage, the small business may face a key decision. Suppose the business is a defendant and the claim against it is legally or factually suspect. Should it move for dismissal? Or suppose the business has sued for non-payment. Should it make an early motion for summary judgment? Suppose the business faces a motion for injunctive relief due to allegations that its executives violated a non-compete agreement or are exploiting trade secrets. Or suppose the small business has lost someone who is violating his covenant. In either case, can the business afford to sit idly by?

A motion for summary judgment or for dismissal could run between \$20,000 and \$40,000 (or more). Motions for temporary injunctive relief, from either side, require affidavits and legal research, but the fact that these motions are often made and heard within a matter of days tends to keep the total hours down—at least a little. The small business can choose to make or not make any of these motions and incur or not incur the costs and risks.

If the decision is to make the motion and the strategy is successful, the business will foreclose months of future legal costs in addition to winning the claim. But as every lawyer knows, confidence in the facts and the law can be misplaced. And if the small business's motion is denied, it has spent money it will not get back, and will never see an advantage. The process might even inflict its own harm, win or lose, if the court takes several months to decide the claim, and if all the while the business has to forego receiving its payment or incurs litigation costs or damage to its reputation in the meantime. Or, if the business can dismiss only one or two of several claims, such limited success might not reduce the magnitude of the case or the litigation activity or expense. The case will proceed to discovery.

The discovery process is usually crucial to proving up claims and defenses, but it also can be one of the most burdensome phases of litigation. For starters, the costs are significant. Preparing discovery requests and responses, particularly in matters involving multiple or complex claims and theories, can take dozens of attorney hours. To respond to discovery, there will be conferences between the company and the lawyer. It may require several meetings and discussions to address the litigation hold and document preservation. An electronic discovery vendor may be engaged to image hard drives and e-mail folders, hopefully with minimum disruption to the business. Of course, in a small business, the executives who are supposed to be running the business are also going to be charged with dealing with the lawyers, collecting documents, and doing other coordinating tasks.

Eventually, there will be depositions. Even a half-day deposition can cost much more than \$2,000, when preparation time, court reporter costs, and transcript costs are added to the time of taking the deposition. And for the small business, as always, the cost is multiplied by the distraction of the witness—often the owner and key executive—whose time and energy will be diverted, sometimes for several days.

Again in the discovery stage, especially in significant litigation, the small business litigant will want certain things—it will want the deadlines to be honored and it will want the documents and information it asks for in discovery to be produced. In order to do that, a party's attorney frequently needs to engage in time-consuming meet-and-confer sessions, followed by detailed letters and responses and, eventually, motion practice. To secure production of information or documents, a single motion to compel and the attendant process can easily exceed \$15,000.

When discovery is complete or nearly complete, the parties will almost always participate in a court-ordered dispute resolution process. The usual method in federal court is a settlement conference conducted by the magistrate judge assigned to the case. In state court, the parties will appear before an agreed-upon neutral who the parties will pay by the hour for his or her time preparing for and conducting the hearing. In either case, the lawyers will prepare a detailed pre-mediation submission that outlines the merits and weaknesses of each party's case, discuss any settlement proposals that have been exchanged and suggest an acceptable outcome. In all federal cases in Minnesota, each party must send a representative that has full and unlimited settlement authority, and in state matters, the corporate representative typically attends as well, or is at least available by phone for the duration of the mediation. Conferences can last an entire day or longer, ratcheting up the time and cost investment even further.

After all the process and expense, a case will go to trial, where the small business litigant will expect, finally, to secure a result—but is that expectation reasonable? And at what cost? Pretrial submissions in the form of exhibit lists, witness lists, and a trial memorandum are notoriously time-consuming. Courts typically will require that the parties produce binders of the exhibits and copies for the court, which can result in significant copying costs. Addressing objections and at least one and sometimes several motions in limine can further raise the expense. Witnesses need to be subpoenaed. Verdict forms and jury instructions need to be prepared. The lawyers need to prepare and often rehearse their direct examinations and cross-examinations. In larger matters, a party may conduct a trial before a mock jury or hire a jury consultant, either of which is a significant expense of time and money.

Each day at trial can involve two or more lawyers working twelve to eighteen hours a day, plus paralegal support, and possibly legal support in the office to work on trial motions and other matters. The small business litigant's owner or principal representative will often attend trial every day, while he or she and maybe several employees are pulled from their tasks to come to court and (usually after a long wait) testify.

But a trial is not always the end of the line. There are often post-trial motions and if a party intends an appeal in state court, it must motion for a new trial in order to preserve certain objections.³

Even a party that is victorious at trial may need to enforce its judgment, and may incur additional costs and delay in the process. The losing party often appeals, and if both parties lose in part, there may be cross-appeals. An appeal to the Minnesota Court of Appeals or the Eighth Circuit typically takes nine to twelve months to play out, accompanied by substantial briefing and oral argument. An appeal involving any measure of significant or complex issues is likely a \$25,000 proposition at a minimum (not counting any briefing related to a petition for review by the Minnesota Supreme Court or for certiorari to the United States Supreme Court).

Given the expense and plodding progression described above, it goes without saying that any remand for additional proceedings would likely be unwelcome, at least from a cost perspective. Faced with these costs, the small business may realize too late that its primary liability may not be its opponent, but rather its obligations to its own attorney and the other burdens of litigation.

3. Motions for a new trial in state court are made pursuant to Rule 59 of the Minnesota Rules of Civil Procedure. In Minnesota state courts, "It has long been the general rule that matters such as trial procedure, evidentiary rulings and jury instructions are subject to appellate review only if there has been a motion for a new trial in which such matters have been assigned as error." *Sauter v. Wasemiller*, 389 N.W.2d 200, 201 (Minn. 1986); *see also* *Alpha Real Estate Co. v. Delta Dental*, 664 N.W.2d 303, 309–10 (Minn. 2003) (distinguishing between substantive questions of law that do not require a new trial motion and "matters such as trial procedure, evidentiary rulings and jury instructions" that do require such a motion). The federal counterpart, Rule 59 of the Federal Rules of Civil Procedure, does not require a motion for new trial:

The settled rule in federal courts, contrary to that in many states, is that a party may assert on appeal any question that has been properly raised in the trial court. Parties are not required to make a motion for a new trial challenging the supposed errors as a prerequisite to appeal.

11 CHARLES ALAN WRIGHT ET AL., *FEDERAL PRACTICE AND PROCEDURE: CIVIL* § 2818, at 186 (2d ed. 1995).

IV. THE LAWYER'S CHALLENGE: GETTING A RESULT OTHER THAN DEATH BY ATTRITION

Any business owners, once they are sued or decide they want to bring suit, will likely sit down with their lawyer and explain why they are right and why they expect to win—they may even tell their lawyer to do “whatever it takes” to win. The lawyer may even agree, but he or she will do them a disservice by just discussing the merits. The discussion should include all the fees and costs and a thorough primer on all the distractions of time and stress involved in litigation. Once the business owners see this reality, they and their lawyer should focus on an approach that might lead to an early or efficient resolution.

In that regard, even if the lawyer has tamped down the company's expectations, the lawyer faces two fronts: managing the client's financial commitment to the litigation and managing the litigation to its best result.

A. *Approaches to the Attorney-Client Financial Relationship*

An attorney who is sensitive to the client's financial concerns can immediately take some steps to minimize cost. He can reduce the hourly fee. He can staff tasks with non-billing paralegals or secretaries or use lower-rate associates. But such approaches lack imagination and are inherently limited because most lawyers, understandably, are unwilling to reduce their fees significantly or already reduce their bills for other reasons. These approaches also leave the client in the dark about how much the representation may ultimately cost and foreclose the client's ability to plan.

In recent years, particularly with the recession beginning in 2008, much attention has been given to alternative billing arrangements for legal work.⁴ For example, some law firms have moved at least in part to flat-rate pricing for particular tasks. Others have abandoned the billable hour in favor of monthly rates. The profession likely has moved toward greater disclosure by lawyers to their clients, and clients applying greater scrutiny to the legal bills they receive. Much of this discussion, however, has concerned larger clients of larger firms where the negotiating

4. See, e.g., Jennifer Smith, *Watch Out, Billable Hour: Alternative Fee Arrangements Continue to Grow*, WALL ST. J. LAW BLOG (Apr. 9, 2012, 11:22 AM), <http://blogs.wsj.com/law/2012/04/09/watch-out-billable-hour-alternative-fee-arrangements-continue-to-grow>.

power and price predictability might be easier to evaluate. It is not so clear cut for the smaller firm and smaller business facing a one-shot lawsuit that might instantly have become its largest liability due to legal fees alone.

Certain approaches might be best suited to easing the pain for the business while also securing for the lawyer a good return for the time invested. For example:

A hybrid fee. As an alternative to a straight contingent fee arrangement, the lawyer and client (particularly a plaintiff) could agree that the lawyer would perform all of the work for a discounted hourly rate (say, 75% of retail rates), but then would recover a percentage of the dollars recovered. Perhaps the percentage could be applied only if the lawyer's recovery exceeds the cost of litigation by a certain level. Such an arrangement builds in a motivation to litigate efficiently and to resolve the litigation quickly if possible.

Waiving part of the fee. Every lawyer has experienced the case where the first few weeks are inefficient while the lawyer attempts to review documents, interview witnesses, review or learn the law, and research particular issues. In a sense, that describes the learning curve in almost every representation. When the lawyer knows this will be a factor and that the litigation will be long, it might make sense to forego the entirety of the first stages of the representation by waiving the first \$5000 or \$10,000 in fees. Alternatively, the lawyer could create a fee arrangement where a middle portion of the fee is waived. For example, the attorney could bill for the first \$30,000, but then waive the next \$10,000 in fees. This might give the client some relief while the activity is spiking, but not be too large a discount for the lawyer. It also might be timed to set up natural windows for resolving the case—meaning, the “fee holiday” could be scheduled around a mediation so that the client is reminded that the costs resume if the matter is not resolved.

A capped arrangement. Some matters might be well suited for capped or flat-rate work. For example, particular tasks that are certain can be capped at a fixed amount—say, no more than a certain amount for an answer or a motion. Alternatively, the attorney could agree to bill for all costs and fees, but provide that no matter how much activity there is in a given month, the attorney will not bill more than a certain amount, say, no more than a certain amount in fees per month, plus all costs, or whatever makes

sense. Such arrangements will allow the small business to plan and budget for the litigation and not face mounting bills that are higher than expected and which are sure to demoralize a litigant trying to keep a small business running. While the lawyer runs the risk of incurring fees in excess of the monthly cap, the presence of such a limit might also encourage a better-planned sequence of litigation.

B. Beyond the Lawyer's Control—Or Is It? Efficient Litigation, and Challenges Posed by the Opponent, the Court, and the Small Business Client

There is no question that litigation activity can be overwhelming if it at all resembles the roadmap described above. Two other features can also add to the cost and the frustration for a small business client.

First, the opponent's tactics can drive up costs. For example, an opponent could fail to participate in discovery in good faith, or fail to locate and produce documents. Litigants sometimes ignore deadlines by serving tardy discovery, tardy motions, or tardy expert reports. The simple solution would be to hold the violating party accountable, but courts might be reluctant to do so. And it does not matter. The cost of noncompliance is almost always borne, at least in part, by the innocent party. When faced with noncompliance, the innocent party will almost always have to bring a motion to force compliance, adjust the party's approach to account for tardy disclosure, or respond in some other way to the unanticipated conduct. An award of fees may encourage compliance, but it is a limited remedy to the innocent party.

There is no silver bullet to avoiding such circumstances, just some best practices. For example, in federal court, all parties can save time and expense by spending extra time and effort at the Rule 16 conference to spell out exactly the scope of discovery, the litigation hold requirements, and the methods for producing electronically stored (and other) information. While Minnesota state courts do not feature a similar process, an early letter laying out the expectations or an agreement on these matters can at least clarify the process and make any remedy easier to secure. A party concerned about overly expansive litigation should also request limits to the interrogatories, document requests, and requests for admission, as well as the number of depositions a party can take. Finally, litigation costs are sometimes driven up by failure to plan

and execute. The lawyer who waits until the last minute to do anything will invariably find that some documents were not produced or that an extension to the discovery period is required. Often, this raises costs and other burdens. Serving early discovery and taking certain depositions early might be more efficient and might also lead to a better-litigated case.

Second, the court sometimes causes litigation to be more costly than anticipated. Some costs are unavoidable. For example, a court making a difficult decision might get it wrong and the party will have to pay to appeal to correct it. Most courts also work hard to make the process more efficient. The federal court magistrate judges often offer early settlement conferences (for free) if the parties desire. Many judges in both court systems allow for discovery disputes to be resolved informally by letter brief and telephone.

However, courts may not realize the costs borne by parties who rely on certain expectations about the court system that do not pan out. For example, what if a motion takes several months to resolve? In that case, the parties may not even be involved in discovery and other activity, yet they have the litigation weighing on them while they are waiting for resolution. What if a party tries to enforce a deadline, but the judge is lenient and allows a late pleading? In that case, the innocent party might pay twice—once to oppose the tardy occurrence, only to lose, and a second time to evaluate materials it previously did not believe should be part of the case. Even where a party has failed to produce discoverable information, the prevailing party in a motion to compel will not necessarily recover its fees under Federal Rules of Civil Procedure 37 or 45. The result is another loss by winning: the party will get the documents but pay more than a reasonable amount to get them. Such occurrences will contribute to the small business client's sticker shock and will involve a layer of frustration that the money appears to be going "for nothing" and that the process is unfair to them, whether it is or not.

For the lawyer, managing costs may also mean picking one's poison. Filing multiple motions to compel, opposing motions to compel, moving to strike a tardy expert, for example, need to be weighed against the costs. Some motions might not be worth it, and some positions might not be worth taking.

V. RECOMMENDATIONS FOR COURTS AND POLICYMAKERS

Federal Rule of Civil Procedure 1 states that the federal rules “should be construed and administered to secure the just, speedy, and inexpensive determination of every action and proceeding.” This suggests there is no question that courts are aware that litigation time and costs are significant concerns to litigants. And, courts have taken numerous steps that can lead to more efficient dispute resolution. For example, the federal district court of Minnesota has published model protective orders for a variety of cases. The models will be largely suitable for most disputes and they will be familiar to the courts and other litigants in the event a dispute arises. But the courts can do more, or do better.

The Rocket Docket. In state court, parties can designate a matter with respect to its complexity. Less complicated cases are assigned a tighter schedule. Several years ago, the federal courts adopted a “rocket docket” option under which parties could opt to litigate their disputes under a compressed schedule.⁵ The option is still available, but it is not mentioned in any of the magistrate judges’ orders setting pretrial scheduling conferences. At a minimum, rather than requiring mutual agreement, why not let one party opt for a shorter schedule? Under such an option, rather than wait for a Rule 16 conference or submission of an Informational Statement to see if parties agree, any party wanting an expedited calendar could force a slightly shorter discovery schedule (or a “trial certain” date within a year) by serving discovery simultaneous to or at any time prior to a certain point—such as the date of the Rule 16 conference in federal court or the Informational Statement deadline in state court.

Frontloading discovery obligations. As discussed above, the prepared lawyer will address electronically stored information and other discovery matters at the earliest stages. Courts and the rules have built in some procedures for dealing with such matters, but the rules are due for an update as lawyers and the vendors who handle the discovery are getting better equipped and more familiar with the process. By clarifying the expectations and the timing—including matters as specific as which servers, computers, employees, or back-up tapes will be preserved and searched—at the earliest stages, the parties will be better able to strategize their

5. See, e.g., U.S. DIST. CT. D. MINN. R. P. EXPEDITED TRIALS 1–12, available at <http://www.mnd.uscourts.gov/expedited-trial-rules.pdf>.

approaches and evaluate and address costs at the front end.

Frontloading settlement discussions a better way. It is not clear how often an early settlement conference works in resolving disputes. However, the typical order in Minnesota federal courts for a settlement conference requires a submission from the parties that addresses only (1) the merits, and (2) the parties' settlement discussions. Usually, there is no requirement that the parties submit to the court a budget or range of costs for the litigation going forward, though magistrates and mediators often raise that topic during the conference. For example, at an early settlement conference, the parties could be ordered to budget how much it will cost to (1) conduct written discovery, (2) take depositions, (3) make non-dispositive motions, (4) hire or rebut an expert, (5) make or respond to dispositive motions, (6) make pretrial submissions, (7) conduct trial, and (8) appeal or respond to an appeal. While a lawyer should disclose these categories to his small business client anyway, and judges likely don't need the information for their own purposes, making the disclosure in this context formalizes the process at exactly the time both sides will have the opportunity to avoid the costs.

Obviously, these procedures would not provide a silver bullet, but in some cases they could help lead to an earlier or more cost-effective resolution.

VI. CONCLUSION

The most important question to a small business litigating in Minnesota might not be the merits but the cost. The hard costs, not to mention the distraction and delay, are likely to be among the business's largest liabilities and could threaten its existence. The costs will often come at the worst time and in the worst form, particularly if they come while the small business is experiencing other growing pains or if they involve a larger competitor or a payer on which the business is dependent.

The lawyer's ability to prevent costs and fees that arise as a natural consequence of litigation is limited. However, through wise implementation of a fee agreement, proper management of the case at the earliest stages, and efficient decision-making throughout, the small business can minimize the discomfort. Because such steps are not always enough, Minnesota courts should continue to promote cost-saving options and creative approaches to ensure the just, speedy, and inexpensive resolution of litigation.