



ARAG

Risk on the Rise:

*how legal liability may be jeopardizing
small businesses across Canada*

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Legal liability and legal risk exposure

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Why is it important to talk about legal risk?

As of December 2021, there are 4,090,716 small businesses operating in Canada. Small businesses are significant contributors to the Canadian economy and play a crucial role in driving economic growth in the country.

Owning a business can come with many perks. However, risk in business is inevitable, and that inherently includes legal risk. The looming threat of civil litigation can cause a considerable amount of distress to a business. The more contractors, customers, suppliers, employees, and even government regulatory agencies a business has to deal with, the more exposed it is to legal risk.

If we look at legal risk under our small business umbrella, that's 4,090,716 Canadian small businesses exposed to potential legal risks every single day.

Overview

In August of 2022, we asked a sample of nearly 1,000 small business owners across Canada if they had dealt with any type of legal dispute in the last three years. Our main objective was to understand the prevalence of legal issues within the Canadian small business landscape and gain insight into how these legal issues are managed.

7 out of 10 of the small business owners we surveyed said they had dealt with at least one legal issue in the last three years.

For context, we conducted similar research back in 2015. At the time, only 3 out of 10 had said they had dealt with legal disputes.

That is a staggering **230% increase** in legal disputes in only 7 years.





Is it Covid?

We know what you're thinking. Is it not normal for the number of legal disputes to rise? After all, we saw entire systems, industries and economies stagger overnight by a disastrous force that sent us all home, working off our dining tables for two whole years.

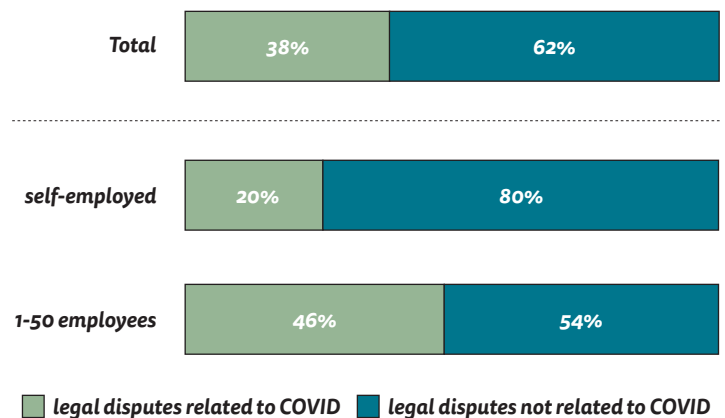
It's undoubtedly painful to reflect on the impact the pandemic had on the lives and livelihood of so many across the globe. Our restaurants, small businesses and retail stores alike shut their doors and had to adapt to a new reality and ways of living.

Provincial shutdowns, mass layoffs, broad economic uncertainty and financial hardship are only a few of the many factors that impacted their ability to operate and survive.

Isn't it normal to see an increase in the number of legal disputes over the last three years? That's a fair question to ask. Over the course of two years, we did see an unusual surge in the number of legal claims. We thought it was fair to assume that COVID played a major role, so when we surveyed small business owners across the country, we asked them if the legal disputes they faced were related to the COVID-19 pandemic. The results?

Only 38% of legal disputes faced by small business owners in the last three years were related to the pandemic.

Legal disputes related to the COVID-19 pandemic



We went in with the assumption that the crisis fundamentally raised the number of legal disputes to an all-time high. Turns out, the numbers weren't rising because legal risk is an inherent side effect of crisis.

The significant increase in legal disputes was only a reflection of a small business owner's everyday legal risk exposure, and as COVID-19 continues to make its wave, one thing has become very clear: legal issues are always present, with or without a crisis.

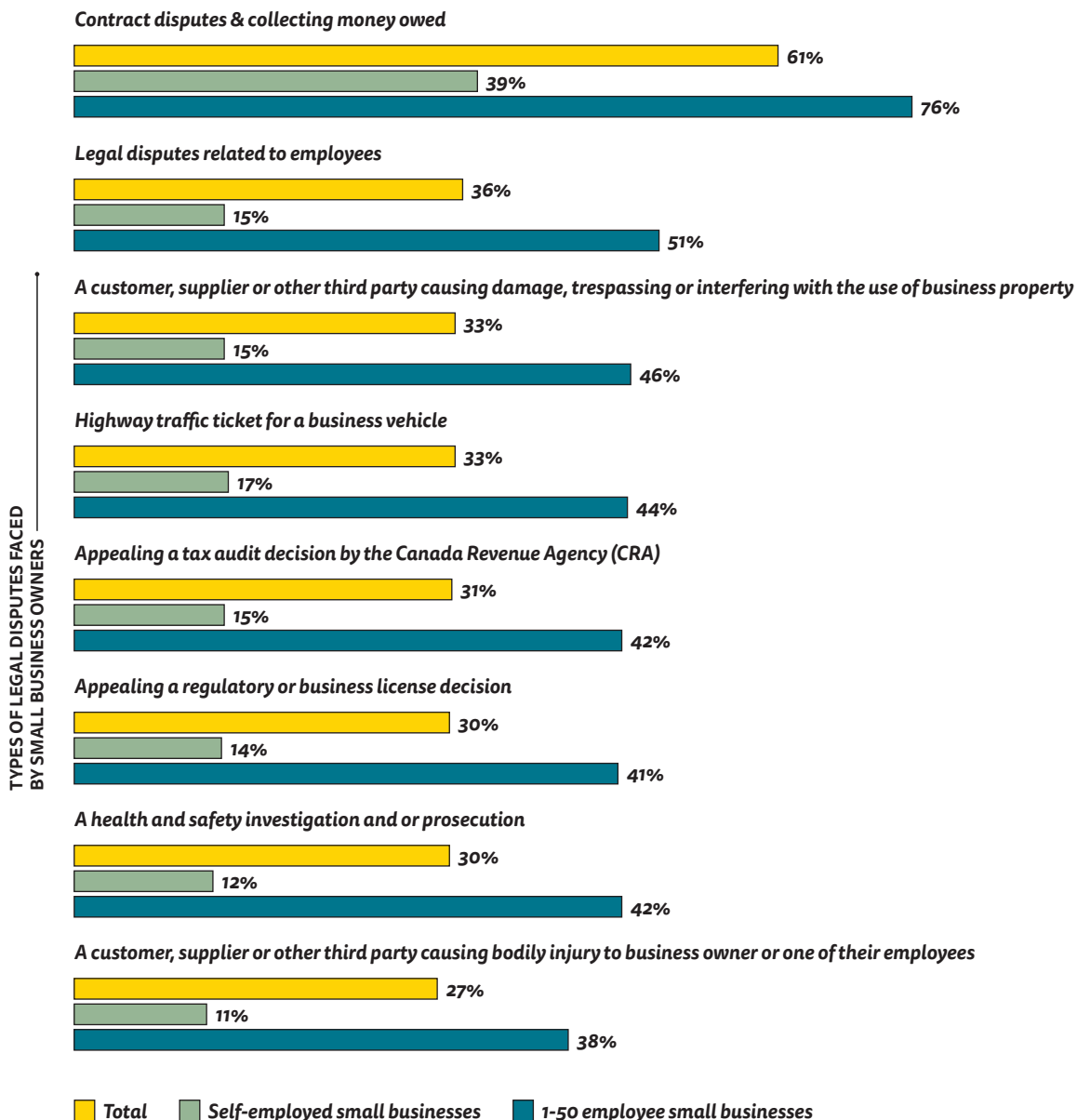
What kind of legal disputes do small business owners face?

From disputes with suppliers to customer complaints to audits by the Canada Revenue Agency (CRA), small business owners face a myriad of legal issues every single day.

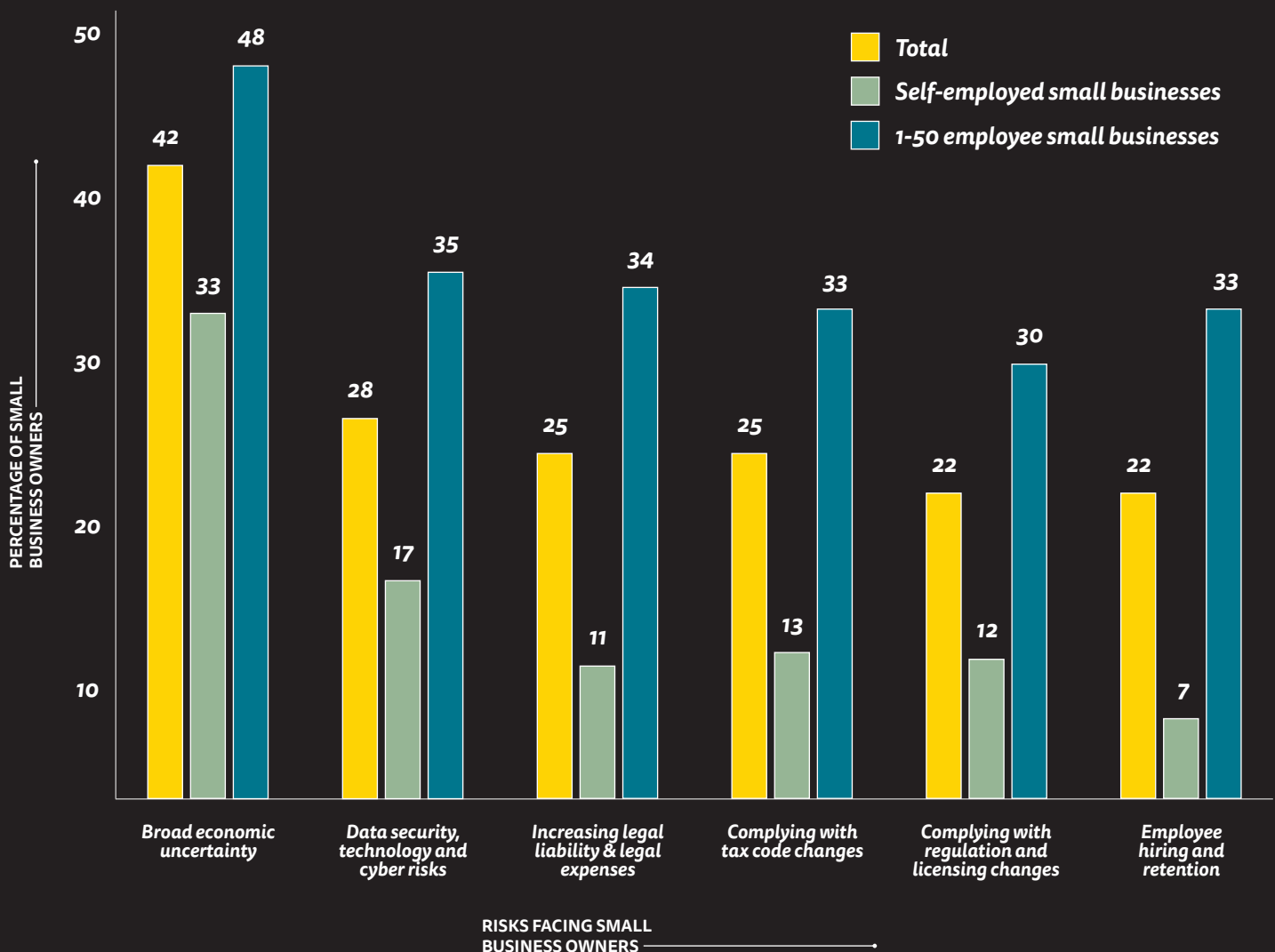
Our recent study revealed that half of the self-employed small business owners we surveyed dealt with legal disputes, and 83% of the small businesses with 1 to 50 employees dealt with them.

The types of legal issues encountered are similar, the most common one being **contract-related disputes**. This includes contracts with customers, suppliers, contractors and also disputes related to collecting money owed.

In the case of small businesses with employees, employment disputes were also quite common, followed closely by highway traffic tickets for business vehicles, property damage and/or trespass, and tax issues.



Increasing legal liability and legal costs rank 3rd in the top of mind risks that small business owners worry about.

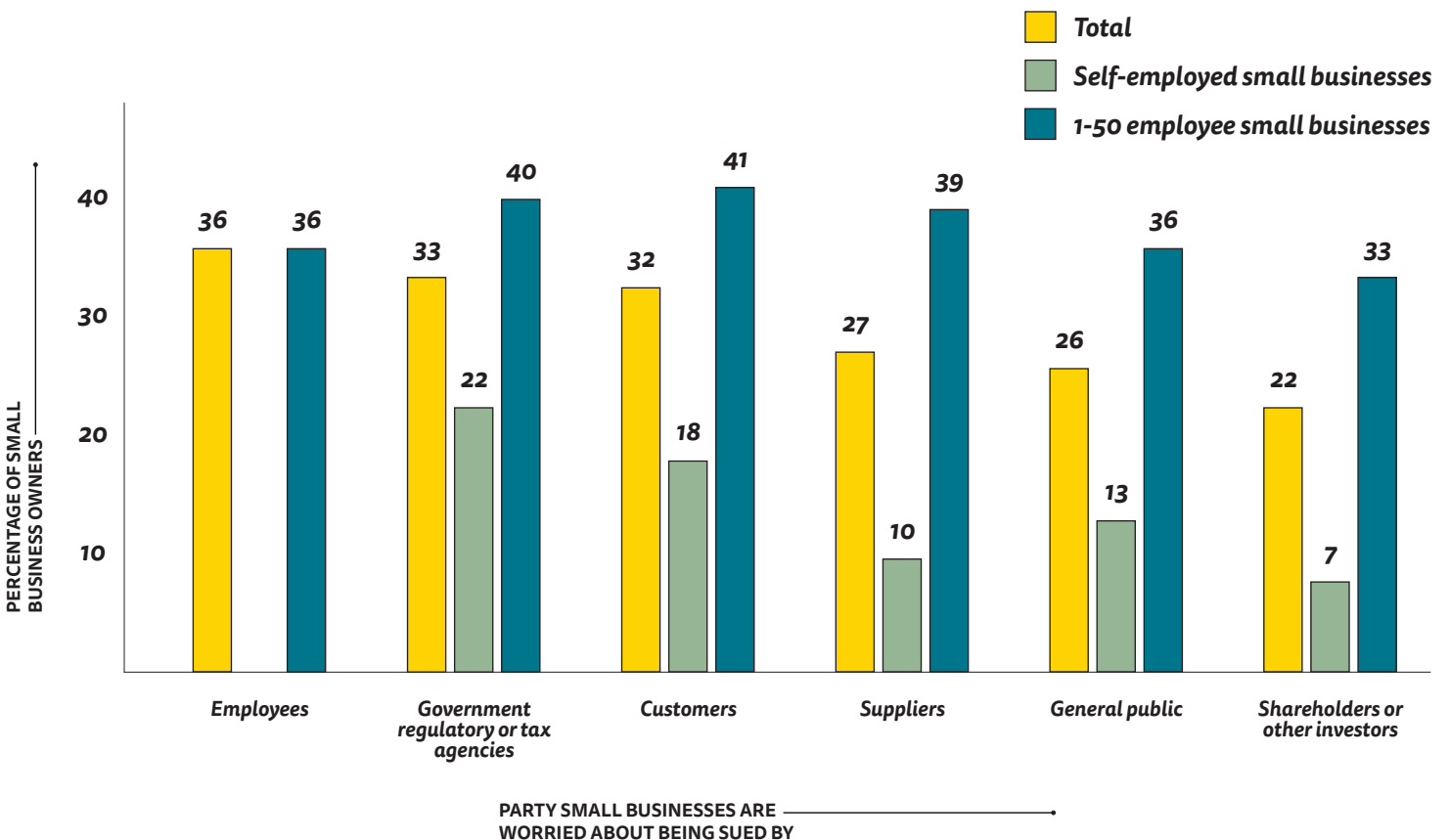


While broad economic uncertainty continues to be a leading concern for small businesses across the country, small business owners' perception of legal risk has changed. Falling closely behind data security, technology and cyber risks, increasing legal liability and legal costs now rank #3 in the top of mind risks that Canadian small business owners worry about.



What's keeping small business owners up at night?

The chaotic nature of risk and the inherent worry that follows it keeps a small business owner busy thinking – and overthinking – about various things. Our study showed that 49% of small business owners in Canada have some level of worry about being sued for an alleged wrongdoing. Most notably, small businesses are worried about being sued by:



Running a small business is a permanent juggling act.

There's no business without legal risk, and talking about it is as important as ever. Previously, legal liability was studied in hindsight, but with clearer vision and analysis, we can safely say it no longer occupies a back seat in planning business objectives.

It's important to talk about legal risk not only because of its obvious prevalence within the Canadian small business landscape, but also because the financial, mental and time impacts it has on these small businesses are alarmingly significant.

Let's talk impact.

In 2015, we looked at legal risk exposure and the types of legal disputes that Canadian small business owners faced. This time, we wanted our study to focus primarily on the impacts a legal dispute can have on a small business owner. We split impact into three main categories: **financial**, **mental**, and **time**.

The way we see it, there are two ways to deal with a legal dispute: *choose to deal with it yourself - or - hire a lawyer to deal with it on your behalf*. Whichever path one decides to take, there are a handful of consequences and impacts that follow.

Money

According to Canadian Lawyer Mag, the average cost of hiring an experienced lawyer in Canada is \$448¹, and a simple civil action lasting longer than 7 days can cost up to \$92,118². This excludes adverse costs and disbursements that the business owner may be required to pay in addition to the standard legal fees.

Additionally, business owners face day-to-day operational legal bills to simply call a lawyer to ask legal questions, discuss scenarios and receive legal assistance. It's no surprise, then, that:

53% of the small business owners we surveyed said that the legal dispute(s) they faced had a large or moderate financial impact on their businesses.

The majority of these small business owners said that they paid anywhere between \$1,000 and \$10,000 in lawyer's fees and other legal expenditures over the course of three years. That's a lot of money that a small business owner can otherwise invest into the growth and wellbeing of their company.

This is one of the many reasons why small businesses often choose not to pursue and defend their legal rights, as accessing the justice system in our country can be incredibly costly.

Our study also showed that a lot of self-employed small businesses prefer to try and solve legal issues themselves. It's true that the financial burden may not be as heavy when choosing to navigate the legal system without hiring a lawyer, but other impacts increase, causing considerable distress to a small business.

¹ Data from Canadian Lawyer Mag 2016 Legal Fees Survey

² Data from Canadian Lawyer Mag 2021 Legal Fees Survey





Time

70% of the small business owners we surveyed said that they spent a lot of time dealing with these legal disputes.

When a small business owner is handling legal issues without the help of a lawyer, they have to spend a lot of time looking for credible resources, trying to understand the complex nuances of the law and what their legal rights and obligations are given a certain situation.

When handling legal issues with the help of a lawyer, although some of that burden is taken off the small business owner's shoulder, they still need to dedicate time to finding a qualified lawyer, negotiating the best possible rate, and also be very involved in the process every step of the way.

Compared to the financial impacts of a legal dispute, there was an increase in the number of self-employed small businesses who said they spent a lot of time dealing with legal disputes. This reinforces yet again why small business owners often choose not to defend their legal rights, as access to justice is often so complex that they see little to no value in pursuing it.

Stress

The greatest, however, is the mental impact that legal disputes have on small business owners, as:

73% said that they experienced a lot of or a moderate amount of mental stress on a personal level when dealing with these legal disputes.

Small business owners, when handling a legal issue without the help of a lawyer, are once again stuck looking for credible resources and trying to navigate the legal system on their own. This can cause a significant amount of stress, and often leave small business owners feeling helpless and unable to defend their legal rights.

When handling legal issues with the help of a lawyer, although some of that burden is taken off the small business owner's shoulder, the mental stress of having to find a lawyer, negotiate the best possible rate, and also be very involved in the process every step of the way can have a negative toll on them. Not to mention the financial burden which would inevitably cause mental stress.

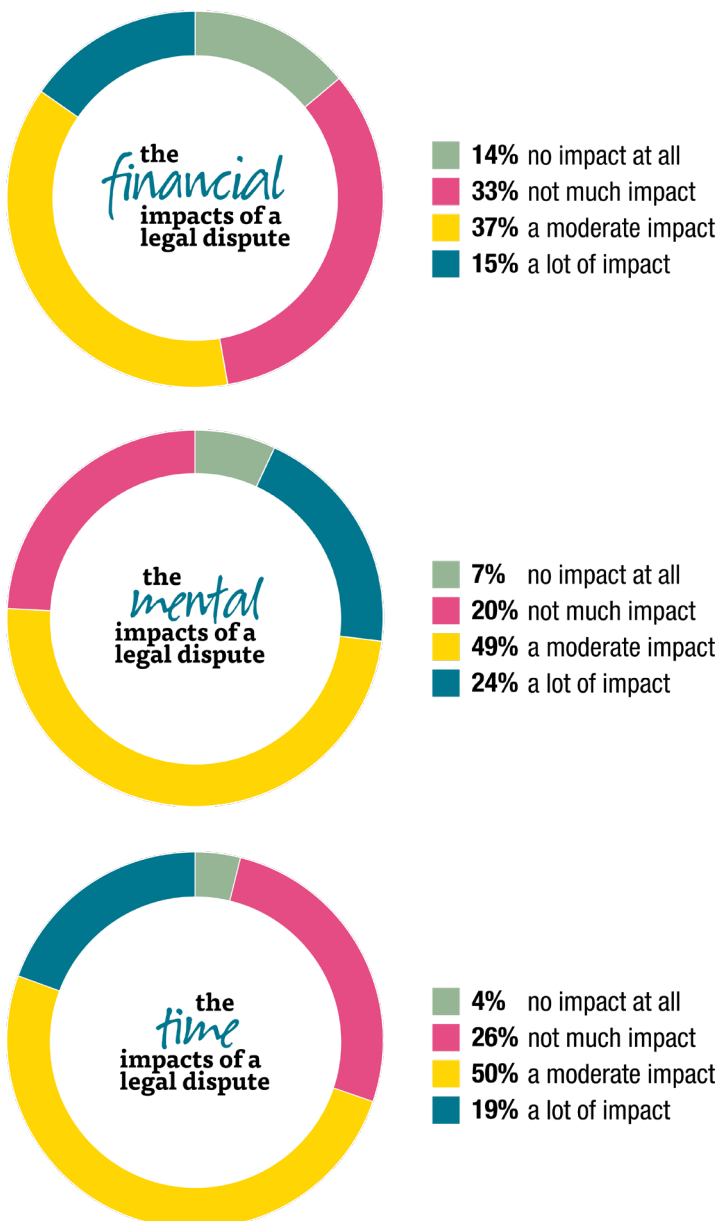
Other impacts

In addition to the financial and mental impacts, our study found that legal disputes could have great implications on the reputation and productivity of a small business, as well as its ability to grow and expand.

Reputation

A small business's reputation is as important as its mission. Once compromised, it can leave a long term negative effect on a business, and impact its ability to grow. The majority of small businesses don't have the kind of budget they can allocate to PR agencies to help them in times of reputational crisis.

34% of the small businesses we surveyed indicated that legal disputes would have a negative impact on their business's reputation.



Productivity

Legal issues can take a small business owners away from doing what they love. When they're spending their time dealing with lawsuits, that's time away from things they could otherwise do to improve and work on their businesses. 40% of the small business owners we surveyed indicated that legal disputes can have a negative impact on their business's productivity.

Future plans for growth and/or expansion

39% of small business owners stated that legal disputes can have a great impact on their business's ability to grow and/or expand. Allocating time, budget and effort that could otherwise be used to grow and expand a business can negatively impact its future.



Perhaps our most alarming find, however, was that...

3 out of 10 of the small business owners we surveyed personally knew another business owner who was significantly impacted by or lost their business following a legal dispute

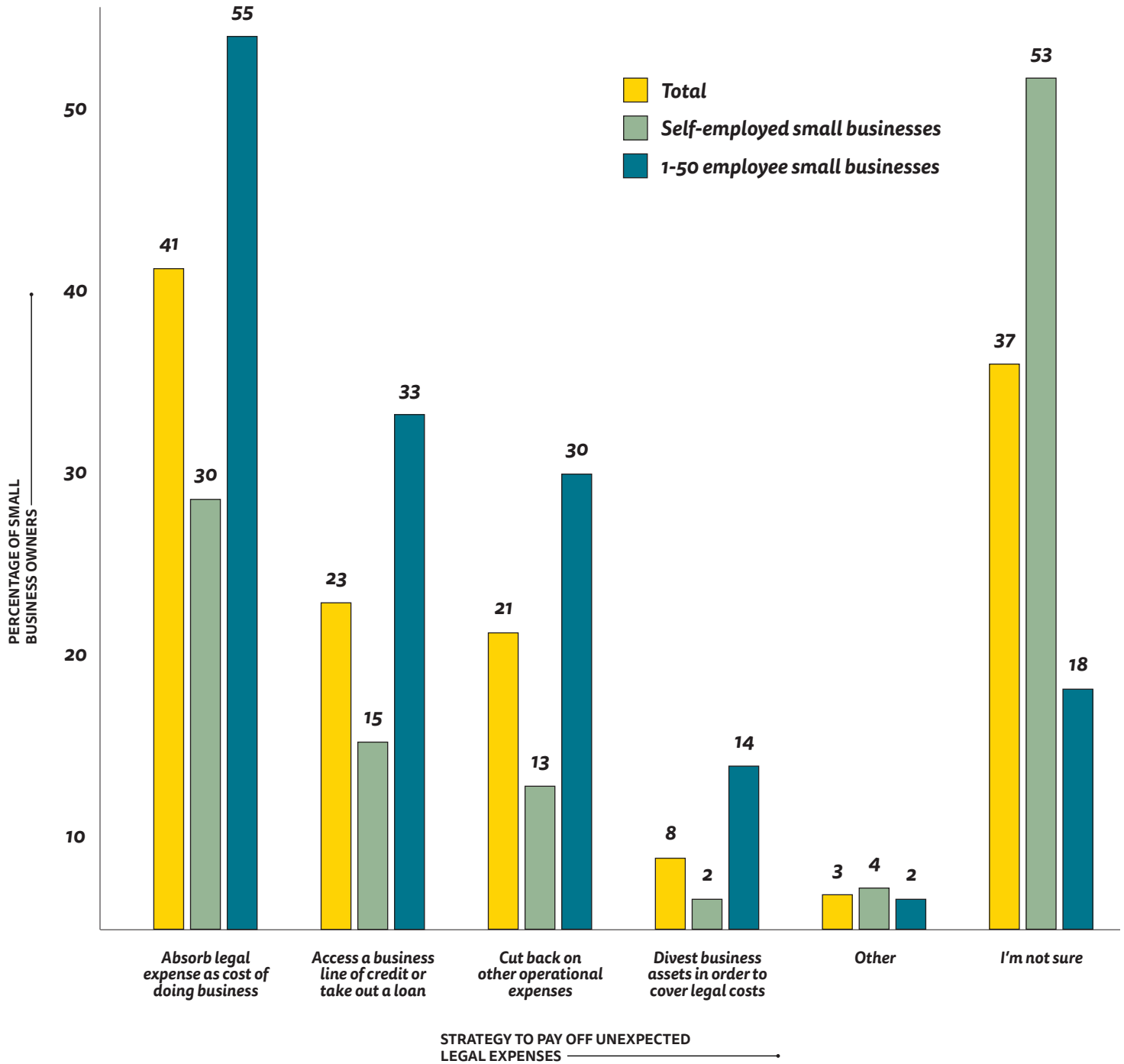
This number has more than tripled since our first study back in 2015, when only 1 out of 10 had said they knew an impacted business owner.

As of December 2021, the Canadian economy totalled over 4 million small businesses. If 3 out of 10 small business owners said they personally knew another business owner impacted by legal disputes:

Would it then be safe to assume that legal risk exposures may be jeopardizing a significant number of small businesses in Canada?



How ready can you really be?



In today's tumultuous climate, we at least have the advantage of foresight. In all of its disruption, the COVID-19 pandemic taught us that anything can change at any given moment, and we have to be ready. Because the state of our economy and the future of our markets are so uncertain, we're able to observe the trajectory of emerging risk and can plan for issues before they arise.

We asked small business owners what they would do in the event of an unexpected legal dispute. Most of them said they would absorb it as a cost of doing business and take a profit hit. Others said they

would set aside a budget, access loans or business lines of credit, and even cut down on expenses to accommodate the legal dispute. These are all solutions that to some degree get the job done. But why should a small business owner lose thousands of hard-earned dollars or get into even more debt¹ to pay for an unexpected legal issue? All for an uncertain outcome that can take them away from doing what they love.

37% of these small businesses even said that they're not really sure what they would do in the event of an unexpected legal dispute.

LEI and the bigger legal risk mitigation picture

7 out of 10 small business owners dealt with a legal dispute in the last three years.

This number shows that there's high frequency and high need for a solution that protects the Canadian small business owner from the costs of litigation.

Yes, commercial policies do provide some legal coverage, but there are gaps in a typical commercial portfolio. Most of the time, these policies don't cover contract disputes, which, as we saw earlier, happens to be the #1 legal issue that small business owners deal with. Most of the time, these policies don't cover a business license suspension, nor do they cover tax audits, or even highway traffic tickets. There's so much a typical commercial portfolio doesn't cover, and this is where LEI comes in to fill the gaps.

LEI mitigates the risk.

There are ways to deal with unexpected legal disputes. When we asked small business owners how they would prepare for one, they gave us many options. But when options like taking out bank loans and setting aside budgets are presented, why isn't LEI?

Access to justice need not be so complicated and complex. Small business owners should not have to take profit hits or cut down expenses in order to defend their legal rights.

The average cost of a commercial LEI policy in Canada is \$275 per year¹. **The majority of small business owners are spending, on average, anywhere between \$1,000 to \$10,000 on lawyer's fees and other legal expenditures.** Compare this to a \$275 annual LEI policy that provides coverage for various types of legal disputes, all of which have proven to be disputes that Canadian small business owners experience. **The cost of a legal expense insurance policy is very little in comparison to the costs of retaining legal counsel, when faced with a legal dispute.**

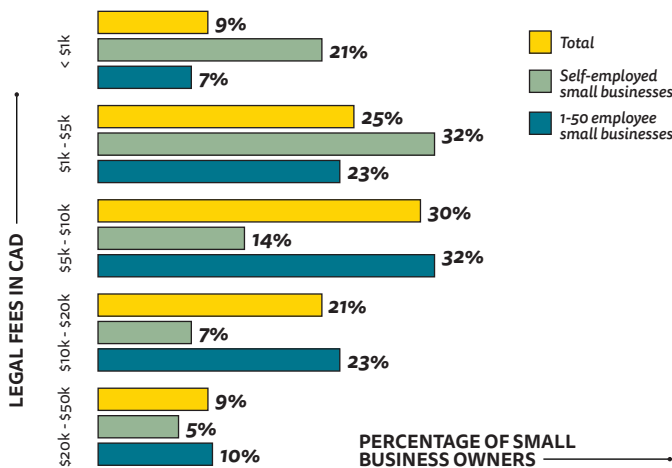
LEI also mitigates a lot of risks that are top of mind worries for small business owners. Tax audits, licensing issues, and even hiring and retention are all in some ways covered under a commercial LEI policy.

Most importantly, LEI gives small business owners access to legal services that can assist them in their journey when faced with a legal dispute. A small business owner can have an unlimited 24/7 access to a legal helpline and speak to lawyers who can answer any legal question they may have, even if it's not covered by their policy. They can have access to customizable legal documents, and even get lawyers to review and draft legal documents on their behalf².

With a commercial LEI policy, small business owners don't need to spend time, money and effort looking for resources or for ways to understand their legal rights and obligations. They don't need to find lawyers, negotiate rates, or worry about legal fees.

LEI lessens the impact, and it does so by supporting a small business owner in their legal journey from start to finish.

Business Expenditure Towards Lawyer's Fees and Legal Expenses



¹ Our study showed that the revenue bands of 75% of the small businesses we surveyed, both self-employed and those who have between 1 to 50 employees was anywhere up to \$2,000,000. The average mandatory rating (including contract disputes and debt recovery) for revenue bands up to \$2,000,000 is \$275.

² Coverage may change depending on the policy.



There's interest, but is there awareness?

"If you could have an insurance policy that covers legal expenses related to settling employment or contract disputes, collecting debts owed to your business, appealing a business license decision, defending against a tax audit and offering general legal assistance on any legal matter as well as free legal document review, how likely would you be to purchase such a policy if it cost your business approx. \$2,000 per year?"

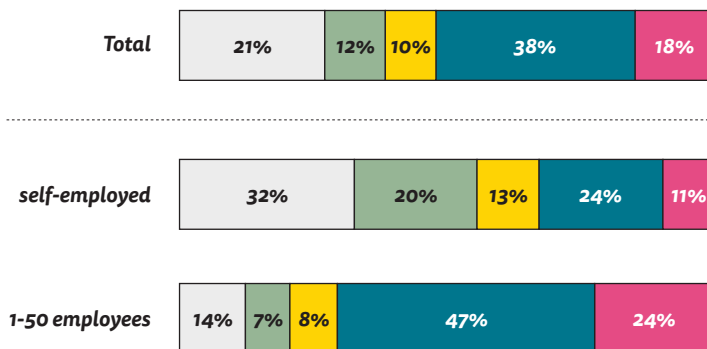
The above question alone saw:

56% of all business owners surveyed saying they would be very likely or somewhat likely to purchase a legal expense insurance policy.

Based on a short description where we overstated the cost of an LEI policy relative to the average premium of \$275, to see if there would be interest, more than half of the small business owners we surveyed showed interest and readiness to invest in LEI.

Is it safe to assume that a \$275 policy would then generate even higher interest? This assumption is based solely on the price being the deciding factor, without any additional insights given to small business owners that demonstrate the true value of LEI.

Purchase intention for an all-encompassing policy



■ very unlikely
 ■ somewhat unlikely
 ■ somewhat likely
 ■ very likely
 I do not have enough information to make a decision

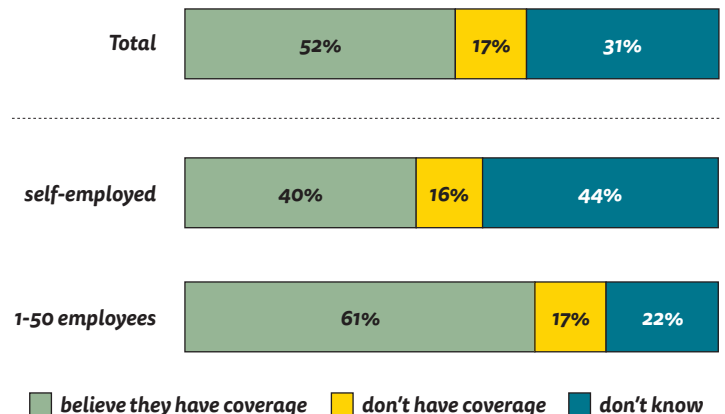
Additionally, **only half (52%) of the small business owners believe their current commercial policies provide adequate legal expense coverage.**

As mentioned before, many of the common legal issues that small business owners face are not typically covered by your traditional commercial policy.

31% said that they do not know if they even have coverage for legal expenses in their commercial portfolios.



Protection from majority of legal disputes





An even more surprising discovery is that...

6 out of 10 small business owners surveyed said that their broker or insurer has never spoken to them about the financial impacts of a legal dispute.

7 out of 10 small business owners surveyed said that their broker or insurer has never spoken to them about the mental impacts of a legal dispute.

Our research shows that it appears not all Canadian small business owners are aware that there are insurance options available to mitigate their legal costs.

As an industry, we could do better to ensure our small business clients are aware of these options and as prudent risk managers ensure this protection is included in their insurance portfolio.

The implications of our research for the Canadian P&C insurance community are raised here: [Legal Risks - Why Is the Canadian P&C Industry Not Talking About Them?](#) We highly encourage you to give it a read as it dives even deeper into lack of awareness and what we're missing as an industry.

We collectively owe it to business owners to discuss legal risks

Why is it important to talk about legal risk?

Is it because it's prevalent, more than ever, within the Canadian small business landscape? Is it because it's present, with or without a crisis? Is it because it impacts small business owners on a personal level - both financially and mentally? Or is it because there is a general lack of awareness, and it's needed now more than ever as businesses treat legal fees as a cost of doing business?

This report is not finished, far from it. As we continue to study, develop and understand how our industry is changing, we need to make sure we keep our small businesses in mind and at heart; to consistently present solutions that make it easier for them to navigate our complex justice system.

We have long maintained that LEI is a priority risk mitigation solution that every small business needs to have within its commercial insurance portfolio. We strongly believe in our mission to provide access to justice to every Canadian, and we stand by our efforts to ensure their legal risks are well managed.