

# NEWSLETTER

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## LETTER FROM ERIC...

Summer is winding down and I hope that all of you are weathering the ups and downs of the recently uncertain economic times. If you have read a few of my past newsletters, you know that I often focus on prevention. In the current issue, I talk primarily about proactive planning, both general business planning and some specific suggestions to avoid problems with internet advertising and employee theft or embezzlement.

Many of my clients have balked at suggestions like those you will read about here. Eventually, I realized that clients did not take action because there was no immediate benefit for the bottom line.

Because I am a small business owner myself, I certainly understand the reluctance to invest time where you see no immediate return. Most of my suggestions will not increase your sales this month or solve your cash flow issues. To implement the suggestions takes time and effort which could be spent on increasing sales, customer relations, or improved marketing. I'm often in the position of the doctor advising his patient to eat better and exercise. It's good advice but it's not going to help me today.

However, I can say, like the doctor, that you will not only avoid costly litigation (the legal equivalent of the heart attack), but you will feel better. If you construct a workable business plan and hold regular meetings of partners or directors, if you put into place solid financial con-

trols, then your business will benefit and be more profitable (as well as avoiding that legal heart attack). Business advisors and coaches will agree.

Please give me a call or send an email and let me know how you are doing.

Sincerely,

*Eric D. Morton*

## P.S. Updates on my website

My website at [www.ericmortonlaw.com](http://www.ericmortonlaw.com) is undergoing changes from time to time as I try to make it more useful to current and prospective clients. Your comments and suggestions are always welcome.

If you are familiar with my newsletters from the past, you will notice that the format has changed somewhat, to reflect the new look on my business cards and website. If you received a copy of this newsletter by mail, you also received one of my new cards.

## THE IMPORTANCE OF BUSINESS PLANNING

When I organize and dissolve business entities for my clients, I urge them to take the needed legal steps to properly protect their businesses and their investments of time and money. But legal protection is simply not enough. A solid business plan is equally important.

Business owners often consult me when their businesses are failing or they are breaking up with their partners. I can almost always trace the problems to a lack of planning: failure to work with an attorney to form the organization and failure to develop a business plan. The owners did not think through some fundamental questions such as the division of responsibilities and decision-making or whether to reinvest profits or take dividends. This lack of direction results in a lack of focus and conflict between the owners and, ultimately, failure.

A business plan should determine how the company will be controlled, how it will market its good and services, the business milestones, and plans to attract investors. A good plan is a tool to address the financial issues such as cash flow, product development, the roles of the key managers and owners, and the larger goals of the company.

I encourage owners to create a business plan for even the smallest of businesses to formalize the specifics of what they are doing and where they are going. I frequently stress the importance of having partners to fully state their expectations from the beginning of a business venture. The most frequent source of

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conflicts and misunderstanding by new business owners is the question of who contributes what in exchange for stock in the corporation. A business plan can be scaled to serve the company; it need not be complicated or long to be effective.

The business plan is a concrete model, a blueprint for the owners to follow and a tool to communicate with accountants, attorneys, financial planners and other business advisors. For example, the business plan itself often determines the type of entity best suited for the business (partnership, corporation, limited liability company) and the owners know who will fill which roles in the company. As a result, the formation documents and contracts such as buy/sell agreements are easier to draft. This saves owners time, money, and frustration. After formation, the plan gives directors or managers a reference to discuss and make decisions. Eventually, a business plan can be shown to investors, as it provides the basis of private placement memorandums and other investment documents.

If you are not familiar with business plans, be sure to seek help. Many organizations give advice, often for free, to small business owners. SCORE – the Society of Retired Executives – gives free counseling to business owners. Chambers of Commerce often have clinics, seminars, or other resources to help entrepreneurs create business plans. Local community colleges may offer courses or counseling to small business owners, while local business development centers often have formats and guidebooks for writing business and marketing plans.

When you draft a business plan, don't overlook the input of a good accountant who can address contributions to the business, tax issues, and cash flow. This can be critical, particularly because cash flow and taxes are two of the major culprits that strangle new businesses. Bankers, attorneys – of different types – and financial planners can all contribute to the plan and the formation of the business. This process encourages

feedback and input. From my experience, the more input the better.

Entrepreneurs are creative people. They have great ideas for products and services but they don't always think through where they are going and what they are doing from a business perspective. A business plan brings entrepreneurs into the process of how they will operate, capitalize, market and, eventually, where they will go with their new business. It can streamline the formation process, prevent failure, and ultimately provide the foundation for a successful company.

## THE REALITIES OF INTERNET ADVERTISING

Despite its generally poor reputation among the public, email advertising is here to stay and it remains a powerful tool. When this tool took off a few years ago, consumers became increasingly annoyed by inappropriate emails and the large number of them. The word "spam" came into common use to describe unwanted emails. Abusive email advertising, including obscene emails, fraudulent emails and inundations of email ads brought on legislation and reforms with the Internet advertising industry.

Business of all types use email advertising to inform customers of new products and sales, to distribute newsletters, and advertise calendars of events. Many businesses rely almost exclusively on emails for advertising in conjunction with their websites. The purpose of this article is to familiarize the reader with some aspects of internet advertising and its regulation

In 2003, Congress enacted the Controlling the Assault of Non-Solicited Pornography and Marketing Act of 2003 ("CAN-SPAM"). CAN-SPAM regulates commercial email, including how they can be sent and what they must contain. Put simply, this law means that email advertisements must not use deceptive or misleading sender information, the

subject line must not be fraudulent, and the messages must have an opt out mechanism the recipient can use to stop further commercial emails from the sender. The email itself must also clearly identify the content as an advertisement, identify the sender, and give a valid postal address for the sender.

Congress enacted CAN-SPAM, among other reasons, to provide a consistent standard for email advertisers. Many states had enacted anti-spam statutes before CAN-SPAM and these state laws created conflicting standards that are incompatible with the interstate nature of the internet. Congress also specifically preempted all state laws except those statutes that ban fraud.

In California, the legislature enacted a series of statutes under the heading of Restrictions on Unsolicited Commercial Email Advertisers ("UCE") which is found in Business and Professions Code (section 17529.1, et seq.). This law prohibits the use of a third party's IP address without permission, false header information, and false subject lines. The law also provides for penalties of as much as \$1,000.00 per email violating those prohibitions.

The California UCE law has been abused by a few individuals in California. These individuals sue companies that provide commercial email advertising services and, sometimes, the advertisers themselves. There might have been some legitimate lawsuits a few years ago but recently these lawsuits have become largely frivolous. Most of the companies sued by these individuals are compliant with CAN-SPAM and the frivolous lawsuits target individuals who are employees or otherwise affiliated with the advertisers in an attempt to extort money from the defendants.

The California UCE law has been abused by a few litigious individuals in California. It typically occurs when one of these litigious persons targets several websites and gives out an email address for various offers on those websites. Addresses at these sites are then sold to companies that compile lists of such addresses.

These lists are sold to Internet marketing companies (known as publishers). Publishers use these lists for email advertising campaigns. A publisher will conduct an email campaign on behalf of a business client (an advertiser). The litigious individual receives an advertising email from this campaign and sues the advertiser in small claims court under the California UCE law.

There might have been some legitimate lawsuits under this law a few years ago but recently these lawsuits have been almost entirely frivolous. Most of the companies sued by these individuals are compliant with CAN-SPAM. These frivolous lawsuits sometimes target individuals who are employees or otherwise affiliated with the advertisers. Most of the time, these suits are simply an attempt to extort money from the defendants. Often, the companies that are sued will pay a few thousand dollars to get rid of the case which is what the litigious individual expects. These kinds of cases are on the decline in California since the courts have begun to rule against the litigious individuals and publishers are more compliant with the law.

Since email advertising is such a powerful and cost-effective tool, how should a business go about doing so without having trouble with the laws regulating commercial emails? The safest approach is to use a reputable commercial email service provider. These companies have strict policies and procedures so that they will not run afoul of CAN-SPAM. Insist on a guarantee in your contract that the company is CAN-SPAM compliant. Check the company on the Spamhaus ([www.spamhaus.org](http://www.spamhaus.org)) website to ensure that it is not listed as a spammer. Ensure that the emails sent are accurate in every way. Do not give inaccurate information to be inserted in email advertisements. This is not the place to stretch the truth about a product or service. Insist that the subject lines of all emails match the contents of the emails.

If your company is sued in a suit claiming violation of the California UCE statute, contact an attorney. Even if your company has been sued in small claims, you

should seek the advice of counsel. Most judges are not familiar with the statutes that govern commercial emails and this is particularly true in small claims courts where the judges are often temporary judges.

Do not shy away from using commercial email advertising. It is a very cost-effective way of staying in touch with customers and advertising goods and services. The fact that a few individuals have pursued frivolous suits should not deter businesses from email advertising. Simply use a reputable email service provider and ensure that any emails sent in your company name are truthful and comply with the law.

### EMBEZZLEMENT: IT CAN HAPPEN TO YOU

Believe it or not, embezzlement is a common problem. Embezzlement and other types of employee theft may not get a lot of publicity but I have seen number of cases of in recent years. One local banker I know reports that business owners frequently come into his branch with problems of employee theft but because employers are embarrassed or because of the overhead to pursue prosecution by the District Attorney's office.

Usually, embezzlement occurs when a trusted employee begins to siphon money to personal use through unverified expenses, credit card abuse, bogus payments to relatives, or checks and cash withdrawals. Invariably, the employee is in charge of the bookkeeping of the company in addition to having the power to write checks. The trusted employee has typically been with the company a long time and the owners have given more and more latitude over time with less supervision. The employee realizes over the years that he or she can take money and one day is tempted to do so, perhaps to cover some personal financial setbacks.

Even the theft of equipment, supplies, or time can be very expensive. One client

put a manager in charge of his business for almost a year, with little to no supervision. The employee stole thousands of dollars in equipment and supplies. In one sense, the company provides the opportunity for the theft when oversight is lacking.

Unfortunately, employers have few remedies in cases of employee embezzlement. Companies are embarrassed. Police are usually reluctant to pursue these cases unless the amounts stolen are large. The employee is usually broke (which is often the motive for the theft) and the employer has little motive to pursue a lawsuit.

Sadly, the embezzler is often a partner or co-owner of the business who has significant access to the company's financial resources. The company books disappear, the company purchases equipment and cars for no business purpose, or relatives receive gratuitous salaries and commissions. When I litigated a lawsuit concerning what was then a well known southern California retail company, one of the two partners, with the help of the company's CFO, siphoned a considerable amount of money. The company never performed an independent review of the company's financial statements or an audit of the financial records.

The key to minimize your exposure to embezzlement is prevention.

1. Accept that it can happen to you. The problem in every case is that employers and partners do not think that it can happen to them. Recognize that humans are human. Money changes people, complete trust can give rise to temptation. People and their children get sick and make people insecure. Trust is a great thing but you cannot predict the future or read minds. Do not place too much trust and unsupervised authority in any employee or partner.

2. Audit, supervise and review. Employers should regularly audit accounts, review general ledgers, dig into the purpose of expenses. Audit the use of supplies, credit cards, and equipment. Make

sure that employees know that this is and will be done. Supervise managers. Owners should check on the money, accounts, equipment use and supplies that are entrusted to their managers. Make these practices part of the business model for your company, not as a punitive measure but simply as a part of the company culture.

Owners should hold regular meetings of partners or the board of directors. Partners must actively probe questionable expenditures. Contracts, hiring, expense payments, equipment purchases, and other capital outlays should be brought to all the partners (directors) approved by them – and not done unilaterally by one owner. If all owners actively monitor and understand the company's financials, including the balance sheet, the profit and loss statement, and the cash flow, the opportunities for internal theft will be minimized.

3. Hire—and supervise—an independent bookkeeper. The person keeping track of the company's finances should

be independent and disinterested. Resist the temptation to do it yourself or have a partner or spouse perform this important role. The extra expense is well worth it. Partners have equal access to the records and no one is tempted to indulge in creative accounting. If the company has an in-house bookkeeper or CFO, those persons should also be independent, not the friends or relatives of the owners.

The good thing about all of these preventive measures is that they are very good business practices and will help the company with its taxes, protect its corporate identity, monitor its cash flow and keep the relationships of the partners healthy, too.



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#### ABOUT THE NEWSLETTER...

The *NEWSLETTER* is published in Carlsbad, California. We welcome your comments. If you would like to be removed from or added to our mailing list, please let us know.

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