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SZABO ASSOCIATES, INC. VOLUME 18, ISSUE 2, JUNE 30, 2003

Dear Friends:

The payment liability issue continues to be a hot topic with the media industry, and I was asked recently to give a talk on the subject at the NACM Credit Congress and the BCFM/BCCA conference. Many conversations with agency managers have yielded the indisputable fact that agencies will not budge on their sequential liability position, so it appears that media will have to grapple with the consequences for some time to come. This issue's feature article focuses on the problems of sequential liability for media outlets and offers suggestions to help avoid or mitigate those problems.

I will be speaking again on this issue as well as other media collection issues at the SEA 2003 Editorial Institute, August 25th and 26th, in Louisville, Kentucky. Our Calendar of Events also includes our annual Szabo Quality Awards Banquet, which will be held the last week of August.

Best wishes for a great summer,

Pete Szabo, President
Szabo Associates, Inc.

The Great Divide …
No End in Sight to Conflicting Liability Positions

The joint and several vs. sequential liability issue continues to plague media. Years of wrangling over the "rights" and "wrongs" of each position have left advertising agencies and media outlets in pretty much the same position that they were in more than a decade ago—on opposite sides of the "Great Divide." Seeking to minimize their respective levels of risk, agencies and media continue to lob their arguments over the chasm with no compromise position on the horizon.

No agreement exists between a media outlet and an agency if nothing is signed and the parties maintain conflicting liability positions. Lack of an oral or contractual agreement leaves the industry with no custom and practice regarding payment liability. Until the industry adopts one, the most media outlets can do to protect their interests is to be aware of the pitfalls inherent in the agencies' position and develop ways to avoid these pitfalls or reduce the risks that they impose.

Why Not Sequential?

Advertising agencies generally adopted sequential liability about a dozen years ago, when the AAAA endorsed the position and encouraged its membership to incorporate it into their terms and conditions. The clause reads as follows: "The Agency shall be solely liable for payment of all media invoices if the Agency has been paid for those invoices by the Advertiser. Prior to payment to the Agency, the Advertiser shall be solely liable." In other words, under sequential liability, the advertiser is the liable party until the advertiser pays the agency.

Most media outlets, on the other hand, have adopted the joint and several liability position. Influential trade organizations, such as the Magazine Publishers of America, the Broadcast Cable Credit Association, and the Broadcast Cable Financial Management Association, have also formally adopted it. Under joint and several liability, both the advertiser and the agency are liable for payment until the media outlet is paid.

At first blush, the sequential liability position seems reasonable. After all, why should an agency have to cough up money for something that benefits somebody else before the beneficiary gives it the money for the purchase? A deeper look, however, reveals several major problem areas that the sequential liability position poses for media.

1. The language of the sequential liability clause is vague and simplistic. The language of the clause fails to provide an adequate definition of liability in specific circumstances. The wording of the sequential liability clause provides only a simplistic, blanket approach to the agency's

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obligation to pay media: "When we get paid, we'll pay you." The implication is, "Regardless of the reason we have not been paid (or never will be paid) by the advertiser, we will not pay you until the advertiser pays us." If the sequential liability clause is taken literally (as it is meant to be taken), the legitimacy of the reason for nonpayment to the agency is irrelevant, and the agency is "off the hook."

Another situation that sequential liability fails to address is the practice of factoring receivables. An agency that factors receivables from an advertiser misleads a media outlet by placing the buy under sequential liability. Because the factorer has a blanket security interest in part or all of the receivables, the advertiser is bound to pay any unpaid billings directly to the factorer. This agreement invalidates the sequential liability clause, or the part of it that reads, "Prior to payment to the Agency, the Advertiser shall be solely liable." Factoring places a third-party obstacle in the way of media's ability to collect from the advertiser unless the media outlet has obtained a direct payment guarantee from the advertiser, a situation that could oblige the advertiser to pay twice.

Additionally, the clause also fails to address the circumstance of an agency disappearing, going bankrupt, or going out of business before it pays media. If the advertiser has not paid its media billings and its agency is no longer viable, the advertiser may pay the media outlet, the agency's estate, or perhaps no one unless sanctioned by a court of law.

2. Sequential liability fails to provide full disclosure between all parties. The major pitfalls of sequential liability exist because the advertiser and media do not engage each other in the media buying process. The media outlet and the advertiser are often largely in the dark about each other and about each other's agreements with the agency. Both the agency and the advertiser generally like it that way. Agencies do not want media to contact their customers, particularly about an unpaid bill. Advertisers feel that they fulfill their obligations through their contractual relationship with the agency. They are paying the agency to deal with media, and they do not want to be bothered by a continual flow into their offices of guarantees, credit applications, and other paperwork from media.

Media outlets are not privy to the arrangements between the agency and the advertiser with respect to schedule authorization, payment, and discrepancy notification. They are also "out of the loop" when it comes to changes and cancellations initiated by the advertiser, unless or until they are notified by the agency.

Media outlets are also not privy to understandings that may have been exchanged between the agency and the advertiser. Perhaps the agency guaranteed the advertiser certain ratings with the buy or implied that a certain result would be achieved. The agreement between the agency and media would not, of course, have any such conditions attached.

When buying services are involved in the buy, the water gets even muddier. Did the agency or the advertiser contract with the buying service? Did the buying service in turn contract with another buying service for part or all of the buy? Just how many entities are involved in the sequential liability chain?

At the same time, advertisers are usually unaware of which media outlets were bought, the specifics of the schedule, and each media outlet's terms and conditions, which include its payment liability position.

3. The sequential liability position leaves media outlets with little recourse in the event of nonpayment. What happens if the agency fails to properly execute its side of the agreement with the advertiser, and the advertiser then legitimately refuses to pay the agency? How can media expect to get paid by an advertiser that did not receive the expected benefit from the advertising and whose agreement is solely with the agency? Or, if the advertiser says it paid the agency, and the agency says it has not been paid, how can media know what the facts of the matter are? Unless someone is willing to produce cancelled checks or open their books and records, the media outlet may not be able to establish the facts without suing both the agency and the advertiser and going through the discovery process.

Additionally, while the agency may hold fast to its sequential liability position and the media outlet may hold fast to its joint and several position, the advertiser holds fast to <u>no</u> position, since its dealings are with the agency only. The advertiser may not even be aware that it is liable for payment to media until it pays the agency. The agency, unless it truly an authorized agent of the advertiser, cannot bind the advertiser.

What to Do.

As serious as the pitfalls of the sequential liability position are, there are practical steps you, as a credit manager, can take in dealing with them, all of which revolve around credit policy as defined and executed by your company.

1. Define your credit policy. Managers (general, operations, and sales) should all be involved in clearly defining the policy and determining the degree to which its terms and conditions will be enforced.

There are four basic approaches to credit policy, defined by a company's level of emphasis on analysis and collections. There are, of course, an infinite number of gradations along the analysis and collections scale, but your policy will fall largely within one of these general approaches.

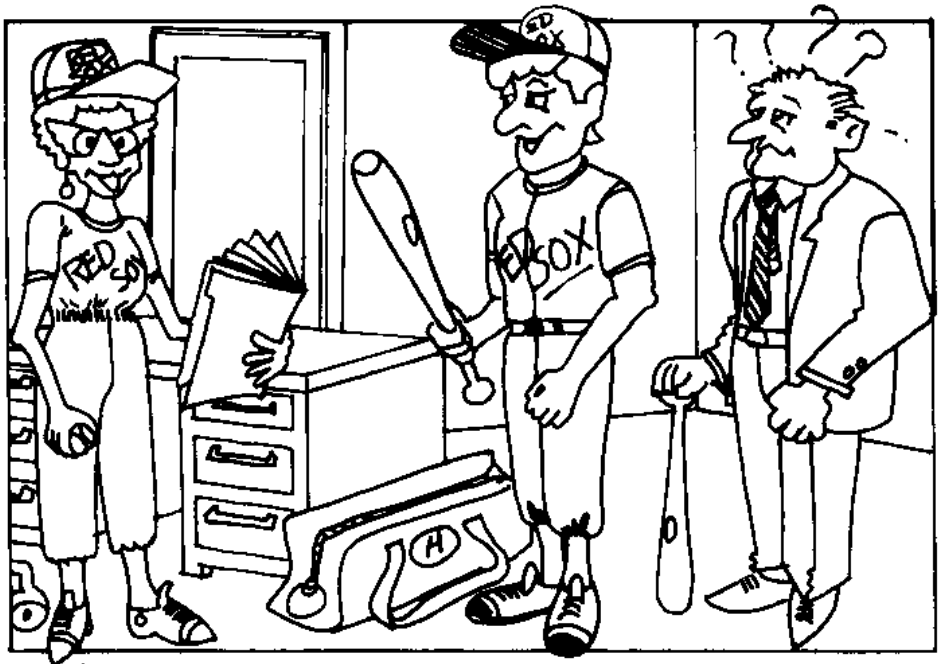
A strict analysis/liberal collections policy places emphasis on up-front due diligence. A liberal analysis/liberal collections policy emphasizes increasing the company's market share. A strict analysis/strict collections policy may work best for companies that produce a product or service that is essential and that have little competition. A liberal analysis/strict collections policy provides customers with easily available credit, but the collection process begins as soon as the account is past due.

A critical part of defining your policy is assessing the practicality of asserting your legal rights in the marketplace. Such factors as the economy, the local market, and your company's ranking in the marketplace will affect the level of risk you are willing to take and therefore the level to which you are willing to enforce joint and several liability. For example, if your policy is strict analysis/strict collection, your inventory is low, and your position in the marketplace is high, then it may be practical to insist that all parties sign off on your terms and conditions. On the other hand, if your policy is liberal analysis/liberal collections because you are fighting tooth and nail to increase your market share, then you may have to accommodate other terms. When market conditions change, your credit policy should also change to reflect your new circumstances.

2. Assess your portfolio. In general, about 80 percent of media business come from 20 percent of your customers, which means 80 percent of your company's financial risk involve 20 percent of your customers. Analyze this 20 percent—both agencies and advertisers—for creditworthiness. Most large advertisers are publicly traded, and financial data is easy to obtain. By using the Internet to research public companies, you can unearth a great amount of information with minimal effort. If the company is private, find out how they are paying your competitors through credit groups or through media trade organizations such as the BCCA, MCA, and AMCEA. If an agency or advertiser is a division of a larger parent company, do not assume that the parent will "rescue its child" if it defaults on its obligations. Analyze each entity on its own merits. If they are local companies, visit them, and stay attuned to general business conditions in your community.

The less creditworthy the company is, the more likely it might be to conform to your terms and conditions. Carefully review all documentation on agencies or advertisers that you deem to be high risk. Do not assume that because your terms are printed on the reverse side of your confirmation contract, they are either agreed upon or enforceable in a court of law. You must have a signed agreement for your joint and several clause to be readily enforced. Additionally, credit applications are often returned, signed, with part or all of the joint and several liability clause crossed out. If you are unable to get a high-risk agency to agree in writing to your joint and several clause, obtain a written signed guarantee from all parties or consider cash in advance.

Make sure that the party liable for payment, the party to whom you are extending credit, is aware of its liability. Make sure that the advertiser understands and agrees that it is liable to you until it pays the agency. Even if the agency implies that it is an authorized agent, get written signed confirmation directly from the advertiser.



"WE HAVE HERE AN ADVERTISER, ITS AD AGENCY, THE AGENCY'S BUYING SERVICE, AND THE BUYING SERVICE'S BUYING SERVICE. AND I THOUGHT WE HAD TROUBLE FIGURING OUT 'WHO'S ON FIRST'!"

3. Set standards for new customers. Your credit policy, defined and agreed upon by your management, provides the framework for evaluating prospective customers and negotiating the agreement. You and your management should have a clear

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understanding about what constitutes adherence to the policy and where some flexibility may be justified and advisable. Make sure new customers know what your expectations are regarding adherence to your terms and conditions, and follow through with diligence and consistency.

Because payment to you depends on payment by both the advertiser and the agency, you have inherent rights to ask questions of both to determine your level of risk. *Make sure that the agency and the advertiser confirm their answers in writing!*

Here are some questions you could consider asking the agency:

1. What is the payment arrangement you have with the advertiser?
2. Is it in writing?
3. What are the terms? How do I know if my terms with you are realistic without my knowing what your terms are with your client?
4. When do you start collection efforts?
5. Who does the collections?
6. What kind of training do they have?
7. When will you notify us if you have not been paid?
8. When do you want me to contact the advertiser directly?
9. How do I know the buy is authorized?
10. How do I know that the advertiser is not disputing your invoice?
11. Have you received any up-front money?
12. Which markets or media are you paying first?
13. May I have a copy of your contract with the advertiser?

Here are questions you could consider asking the advertiser:

1. Have you authorized the agency to place buys on our facility?
2. Will you confirm that you are liable to us, up to the time you pay your agency, for all buys that have been placed and run as ordered on our facility, regardless of any dispute that may take place between you and the agency?
3. If the agency goes bankrupt, will you immediately pay us directly for unpaid billing rendered or to be rendered by the agency?
4. Will you pay us directly if and when I request that you do so?
5. Will you complete and sign a credit application?
6. Will you notify us if the agency factors their receivables from you?

On the issue of payment liability, agencies and media outlets will regard each other across the "Great Divide" for a long time to come. There seems to be no comprehensive solution that addresses all the problems inherent in agencies' insistence on the sequential liability position. Additionally, as we have indicated, it is not always practical to doggedly pursue every party in every case for signed documentation of payment responsibility. The more you know about the pitfalls of sequential liability, however, the more you can do to smooth the way for agreements that parties on both side of "the divide" will find acceptable. ♦

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