collective wisdom®
SZABO ASSOCIATES, INC. VOLUME 21, ISSUE 4, DECEMBER 31, 2006

Dear Friends:

As we enter 2007, the "Great Divide"—the conflict between media and agencies over payment liability—continues to be a hot topic at media companies, industry conferences, and meetings between agency and media management. It is understandable that all parties would continue to make efforts to develop and enforce policies that best protect their interests. That said, Szabo Associates maintains that a "joint and several" payment liability position fairly and most effectively protects media in the event of non-payment. Our December feature explores this volatile issue in light of recent developments involving one of the world's largest media buying agencies.

On our Calendar of Events are the Comcast Spotlight Operations Conference in Muscle Shoals, Alabama, February 7-8; the Radio Advertising Bureau Annual Management Leadership Conference (RAB 2007) in Dallas, Texas, February 8-11; and the GAB Winter Institute (Georgia Association of Broadcasters) in Athens, Georgia, February 27-28.

All of us at Szabo wish you a very Happy New Year!

Best wishes,

Robin

C. Robin Szabo, President
Szabo Associates, Inc.

The Great Divide Widens …

OMD Strikes Blow to Media's Liability Position

Almost two decades ago, Szabo's *Collective Wisdom* began reporting on what we called the "Great Divide"—the conflict between media outlets and advertising agencies regarding liability for payment. Since that time, the issue has continued to plague media, with no real progress toward narrowing the chasm. At best, media and agencies have agreed to disagree, choosing to ignore or rewrite each other's liability disclaimers and hoping they can avoid facing off in court. At worst, we have seen the divide grow even deeper and wider, as agencies seek to further protect their interests in the event that their clients' troubles become their own.

As media and agencies have continued their stand-off over joint and several vs. sequential liability positions, Omnicom's OMD unit, the third largest media buyer in the world, recently delivered yet another blow to media, saddling the industry with new concerns. In a mid-summer move that dropped the jaws of media credit managers around the country, OMD changed the liability language on some of its insertion orders, one version of which stated: *"Agency is acting as an agent on behalf of its advertiser client, a disclosed principal, either named on this form or otherwise identified to Media Company. Agency will only be liable for the cost of the advertising purchased and other obligations to Media Company to the extent Agency has been paid by the advertiser for any such amount payable to the Media Company. For amounts not paid to Agency, Media Company will look solely to advertiser for payment. In the event Agency returns to the advertiser any such amount paid Agency by the advertiser, then Media Company will similarly repay such amount to Agency and look solely to advertiser for payment. Any terms in your invoices, documents or rate cards to the contrary are of no force or effect. Any modifications to this form made by Media Company are of no force or effect."*

The first three sentences of OMD's disclaimer are not surprising or new. The first discloses that the agency's client, the advertiser, is the principal who is to be held liable for payment. A basic principle of common law is that an entity—in this case, the advertiser—can be represented by an agent in its dealings with the public, and barring other considerations, the agent can bind the entity by its dealings just as the entity can bind itself. The second and third sentences state OMD's sequential liability position, whereby agencies are liable for payment to media only <u>if</u> they are paid and <u>to the extent</u> they are paid by the advertiser.

About 15 years ago, the American Association of Advertising Agencies (AAAA) issued a statement on the issue, defining sequential liability and encouraging its members to adopt the position. What shocked and dismayed media credit managers this go-around was the additional language that seemingly empowered

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OMD to demand, under certain circumstances, that media pay back to the agency what the agency—after having received payment from the advertiser—had already paid media. The concerns for media lay not only in the additional exposure that this language imposed on media properties but also in the possibility that it could set a precedent for further modifications to agencies' liability positions down the road.

Although OMD did not publicly disclose the reason for its change in language, the media buying giant has indicated that its intention was to protect itself in the event that an advertiser client files for bankruptcy, the advertiser's payment to the agency is deemed to be a preferential transfer, and a subsequent demand is made for OMD to pay back the alleged transfer. The company released the following statement regarding the new disclaimer: "From time to time, OMD USA works to clarify and improve the standard language included in its trade agreements on behalf of all clients. We are in the process now of doing just that with regards to a technical issue involving bankruptcies and preferential treatment. This issue is extremely rare and insignificant given the high credit quality and reputation of OMD USA's client base."

The motives and timing of OMD's move, however, left media sales and credit departments scratching their heads and industry groups and its proponents hustling to respond. In an August 22nd memo to its members, the Broadcast Financial Management Association and its subsidiary, the Broadcast Cable Credit Association, urged media companies to protect their interests by adopting a position of joint and several liability and by seeking legal counsel to best determine their companies' response to the new language. "Accepting orders which contain this language is a business decision based upon the individual company's parameters for acceptable risk," the organization stated in the memo. "If you encounter this language, we encourage you to discuss its potential impact with your legal counsel."

Two days later, on August 24th, OMD advised BCFM/BCCA that it had reverted to using its older (pre-July) liability disclaimer. The disclaimer assumes a sequential liability position but does not include the "payback" language. On September 26th, BCFM/BCCA president and CEO Mary Collins and board member Linda Feldmann, an attorney with Leventhal Senter and Lerman PLLC, spoke with OMD USA's CFO Barbara Burger, Omnicom Media Group's Corporate Counsel Craig Gangi, and Tom Finneran of the Management Services Group of AAAA. In a follow-up Advisory Alert to its members, BCFM/BCCA stated, "They [OMD] understand our concern about the original language and are working with us to narrow the scope … BCFM and BCCA continue to suggest checking all insertion orders to confirm that they conform with your corporate liability policy."

Although OMD has, for now, retracted its "payback" language, media should not minimize or forget the concerns that the incident has raised. The company has indicated that it intends to continue considering modifications that will further protect its interests. Additionally, acceptance by media of these modifications could encourage similar moves by other agencies to review and modify their own liability positions.

The potential risk that such language poses for media is considerable. Even if confined to the bankruptcy environment in which an agency seeks to recover from media what it has been required to pay back as an alleged preferential transfer, the concept is fraught with pitfalls for media. Media companies could be required to make such a repayment without having been party to the discussions regarding repayment. Additionally, a media company could be faced with a demand for repayment several years after the buy took place. If these scenarios are not nightmarish enough, we can consider one outside the bankruptcy/preferential transfer situation, in which a dishonorable agency simply decides to refund money to an advertiser and then claims that media must pay it back.

So, in view of the consequences that such modifications can hold for media, what should media do to protect its interests regarding payment liability?

Adopt a "joint and several" liability position. The joint and several position— whereby both the advertiser and agency are liable for payment until the media outlet is paid—still provides the best protection to media if either the agency or advertiser fails to pay. (See the sidebar in this issue for Szabo's recommended wording for your liability clause.)

Most likely, the agencies with which you do business hold a sequential liability position. Although AAAA agencies are free to adopt any liability position they prefer, the organization strongly endorses and encourages adoption of sequential liability, which clearly best protects agencies' interests.

In a perfect world, in which you expect payment from the person or company with whom you are dealing, the sequential liability position makes sense. In the real world of media, however, it fails to allow media fair recourse in the event of non-payment. The vague wording of the clause provides a blanket approach to the agency's obligation to pay media, regardless of circumstances surrounding the advertiser's failure to pay. The clause fails to address the practice of factoring receivables, which places a third-party obstacle in the path of media's ability to collect from the advertiser. Additionally, what happens if an agency disappears or files for bankruptcy before it has paid media? In the case of agency bankruptcy, what if the advertiser has not yet paid its media billings to the agency? Whom will the advertiser pay—the media outlet, the agency's estate, or no one?

Put "teeth" into your position. Agencies will not abandon their own sequential liability position because media insist on joint and several. At the same time, media and agencies need each other and are unlikely to turn their backs on doing business because they disagree on the payment liability issue.

Knowing those realities, it is inadequate to simply establish a joint and several liability position as part of your credit policy and fail to give it "teeth." Think in terms of, "What will best protect my company's interests if we ultimately end up in court?"

Proper and ample documentation is, by far, your best weapon if a dispute arises. While signed contracts that include a joint and several liability clause are your best defense, the absence of signed contracts is another reality of the media world. Even so, many opportunities exist to put your joint and several liability position in writing.

Short of a contract, the most effective document is your credit application, which should include a clear and apparent statement of your liability position. If feasible, the application should be completed and signed by both the advertiser and the agency. Make sure the persons who sign have the authority to bind their companies. If it is not practical or advisable to have the advertiser complete and sign a credit application, get written confirmation from the advertiser that the agency is authorized to negotiate and enter into a binding contract on the advertiser's behalf.

State your liability position, in writing, to all parties involved in the transaction. Make sure the parties receive this notification before you run the advertising! Failure to do so could imply to a judge that you accepted the other party's position. Subsequently, use every opportunity to include your liability clause on relevant correspondence. Restating your position on invoices will help supersede the common agency practice of including its sequential liability position on insertion orders. Attach a letter stating your liability position to all

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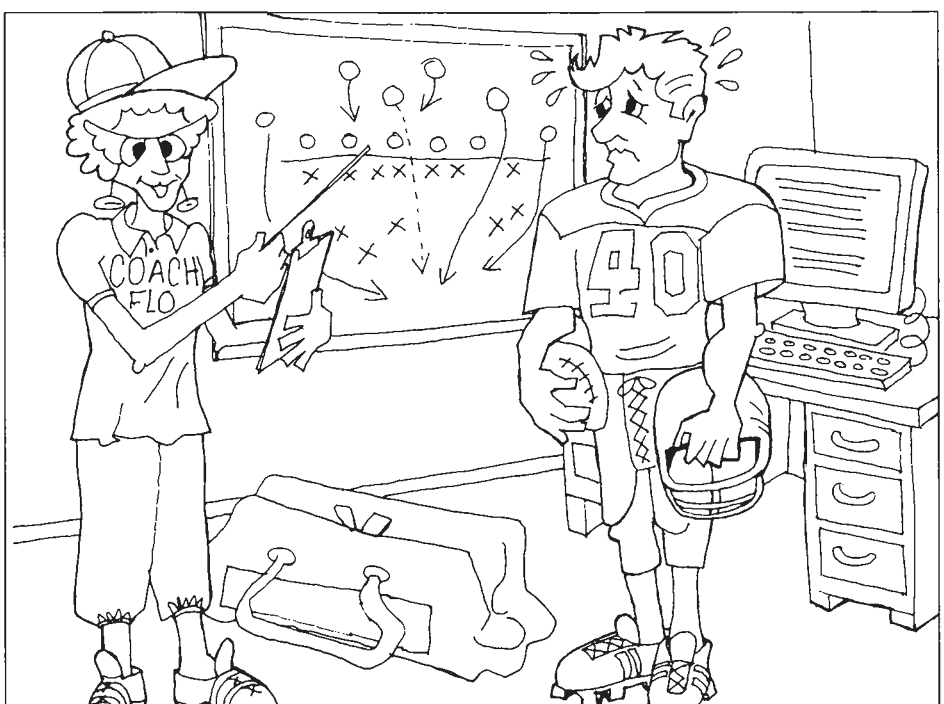
The Joint and Several Liability Clause . . .
Clear and Complete

Szabo recommends the following wording for your joint and several liability clause:

"Notwithstanding to whom bills are rendered Applicant and Third Parties shall remain jointly and severally obligated to pay to Media Provider the amount of any bills rendered by Media Provider within the time specified and until payment in full is received by Media Provider. Payment by Applicant to Third Parties or by Third Parties to Applicant shall not constitute payment to Media Provider.

Applicant understands that should Applicant place advertising through an advertising agency (or other Third Parties) that Applicant will continue to be responsible to Media Provider for payment of such advertising. In the event Applicant is an agency requesting advertising on behalf of a client, Applicant acknowledges its joint and several liability for the payment of such advertising under the terms set forth herein above.

If Applicant is an advertiser, all agencies which place advertising buy orders with Media Provider shall be conclusively deemed to be authorized agents for Applicant."



"HEY, IF YOU THINK THIS IS COMPLICATED, JUST WAIT 'TIL MONDAY'S SEMINAR ON MEDIA PAYMENT LIABILITY ISSUES!"

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contracts, and instruct rep firms to include your joint and several liability clause on national sales contracts that are sent to agencies and buying services. Publish your liability clause on your rate card.

Agencies often will amend media credit applications and other documents by striking your liability clause, substituting their sequential liability clause, and initialing the revised wording. With your legal counsel, develop a procedure for dealing with this contingency. Will you reject the order altogether or reject the amendment, annotate the document with your liability clause, and return it to the agency? If you choose to do the latter, accompany the document with a letter explaining your action, and copy all parties involved in the transaction. Also develop a plan with your attorney to deal with subsequent responses by both the advertiser and agency.

Develop a clear policy for resolution of disputes. Know ahead of time what you will do and when you will do it if either the agency or advertiser fails to pay. If the agency refuses to pay, will you inform it that you intend to notify the advertiser of the non-payment? If the agency claims it has not been paid by the advertiser, will you contact the advertiser? If so, when?

Involve sales personnel. Enlist the sales representative's participation in procuring a completed credit application, resolving disputes, and assisting in the initial collection process should a delinquency occur.

Stay vigilant. Carefully review insertion orders for any changes in language. Notify your legal counsel of any alterations in an agency's liability position, and enlist its help in evaluating options and developing procedures. Become an active participant in industry associations. Association conferences and publications can help you stay apprised of developments and trends regarding the liability issue.

The nature of the media industry and the absence of custom and practice regarding payment liability leave media with no recourse but to do all they can to reduce risks inherent in agencies' liability positions. Media and agencies have regarded each other across the "Great Divide" for so long that it is conceivable that a degree of resignation or even complacency may have settled upon some in the media industry. If so, the recent move by OMD should wake up media to a new reality about the payment liability issue ... that continuing efforts by agencies to further protect their interests could become a growing obstacle to EDI transactions between agencies and media providers in the future. ♦

For additional "Collective Wisdom" articles on payment liability, visit the Szabo website at szabo.com. Relevant issues include March 1989, June 1989, March 1991 (Forecast), June 1991 (sidebar), September 1991, September 1992, September 1993, December 1993, September 2000, June 2001, and June 2003.

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