collective szabo wisdom®

SZABO ASSOCIATES, INC. VOLUME 28, ISSUE 4, DECEMBER 31, 2013

Dear Friends:

What should media do if an advertising agency with which they do business files for bankruptcy? What contractual obligations must media honor? How can they increase the chances of getting paid for pre-petition invoices? Many media properties are pondering these questions since the untimely closure of KSL Media, a large independent media agency, three months ago. In this issue's feature article, we discuss ways to reduce your exposure to risk and to increase your chances of recovery when such an event occurs.

Our winter calendar includes the Media Financial Management (MFM) 2014 CFO Summit on February 20-21 in Ft. Lauderdale, Florida.

All of us at Szabo Associates hope that the coming year will be one of prosperity and joy for all of you.

Best wishes,

Robin

Robin Szabo, President
Szabo Associates, Inc.

Get Paid When the Unexpected Happens!

KSL Media, a 32-year-old independent media agency, filed for bankruptcy in September. It was the first agency of considerable size (135 employees in three major cities) to do so in years. According to a declaration filed with the court by its controller, KSL intends to wind down its operation. The company's unsecured creditors' claims are estimated to total $95 million. Among KSL's 20 largest creditors are ESPN, with a claim close to $4.2 million; FX, with a claim of $1.8 million; and Comedy Central, with a claim of $1.2 million. The filing states that the company has assets between $10 million and $50 million, with liabilities in excess of $50 million.

What happens to media companies when the unexpected demise of an agency leaves them with a substantial amount of money still owed? Can they seek remedy from the advertisers, the defunct agency's clients? What should media companies do about ads that have not yet run but were ordered prior to the filing of the petition? Are media required to honor long-term contracts for the purchase of time or space to comply with the Bankruptcy Code's requirements regarding executory contracts?

The demise of KSL Media should serve as a cautionary tale to media. The agency had taken some hits this year, most notably the loss of its $130 million Bacardi account. The departure of its CEO followed, but there were no indications of the shop's impending closure. Then came the filed declaration with the court charging that a departed KSL controller had embezzled money from the company, leading to millions in damages and losses. "Stuff happens" is the sanitized message here, and media must always be prepared to avoid being downwind when the stuff hits the fan.

Being prepared should always begin with the inclusion of a strong liability clause in all media contracts, agreements, and correspondence. Additionally, media must understand the relationships between the parties involved in the buy, the methods by which agencies are paid by their clients, and the options allowed and available under the law to collect money owed if bankruptcy occurs.

Establish a liability position "with teeth."

We have always promoted the joint and several liability position, which holds all parties responsible for payment until the bill is paid, as the preferred position for media. While there are thousands of agencies that do accept media providers' terms and conditions, including the joint and several liability position, many do not. Members of the American Association of Advertising Agencies (4A's) generally have adopted the sequential liability position, in which the agency is responsible for payment only if and when it is paid by the advertiser.

The Media Financial Management Association (MFM) has offered a compromise solution that toughens the sequential liability position to better protect media from nonpayment. The clause, which is part of its new Electronic

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Media Credit Application (EMCAPP®), states that the advertiser is liable for payment until the funds have been transferred to the agency or media provider. If the advertiser has not paid the agency, and the agency then files for bankruptcy, this liability position could allow the media provider to pursue the advertiser directly for payment.

A joint and several position will still offer the best protection for media, from a liability perspective, if the agency goes bankrupt. Even if the advertiser has paid the agency, you may still be able to collect your money from the advertiser because it has benefitted from your service. In either case—joint and several or sequential with teeth—the risk of agency bankruptcy is one good reason among many to make sure that the advertiser is aware of, and has accepted, your position when the buy takes place.

Understand the relationships.
Confusion often still exists about the relationship between the agency and advertiser, and particularly, the role each plays in the media buying process. In fact, advertisers themselves are not always fully informed about the liability positions of media and of their own agencies. For example, some media properties bill the advertiser, without its knowledge, "in care of" the agency, if the agency refuses to assume liability for the buy. With no firm liability position, however, "in care of" billing will not establish advertiser responsibility for payment.

A common myth about advertising agencies is that they have a fiduciary responsibility to pay media providers if they are paid by the advertiser. An agency is not a fiduciary, which by legal definition is "one often in a position of authority who obligates himself or herself to act on behalf of another and assumes a duty to act in good faith and with care, candor, and loyalty in fulfilling the obligation." In other words, the advertiser generally does not entrust funds to the agency to pay media on its behalf. Agencies treat media money from the advertiser as "general" commingled funds, not as segregated funds held in trust for the media provider. Agencies can do whatever they want with the funds they receive from advertisers. They also can pledge as collateral any accounts receivable that are due them from advertisers.

Another myth that needs to be dispelled is that advertising agencies are "agents for a disclosed principal." Advertisers generally prefer to remain detached from the media buying process to avoid being considered a "principal" and, therefore, possibly being held liable for the actions of the agency acting as the agent on the principal's behalf.

The 4A's recommends that its member agencies include in their client agreements a clause that, for media and production purchases, the agency is functioning as an agent for a disclosed principal. The purpose of the clause is to define the agency's role and reduce the agency's exposure to risk in the event of an advertiser's default. By law, a person or entity acting as an agent for a disclosed principal is not liable for the contract debt of the disclosed principal. This legal-sounding language notwithstanding, simply stating that you are an agent does not make you one. Without proper documented authority, an agency cannot bind its client, the advertiser, to any agreement.

Agency of Record (AOR) documents can effectively address the confusion about the roles the agency and advertiser play in the media buying process and further protect media in the event of an agency bankruptcy. The document, which you can develop in-house, states the authorities that have been granted to the agency to act on behalf of the advertiser in purchasing space or time, including the agency's authority to contract in the advertiser's name and to bind the advertiser to the agreement's terms and conditions. The document should also include a statement that, if the advertiser entrusts the agency with money to pay the media provider, the advertiser will remain liable if the agency fails to pay. In order to be enforceable, the AOR document must be signed by someone authorized to do so on behalf of the advertiser.

Media can further lower their risks by engaging the advertiser as a participating player in the media buying process. Advertisers that are true players are more likely to "police" their agencies to make sure the media portion is paid on a timely basis.

Understand the payment methods.
Media can increase their chances of timely payment by understanding how and when advertisers pay their agencies. The standard 15% agency commission, received when the agency makes a media purchase, was once the predominant method of agency compensation. About 20 years ago, a shift began to a fee-based model, calculated on hourly rates, project fees, or monthly retainers, alone or in combination. According to a 2010 survey of major marketers by the Association of National Advertisers, about three-quarters of agency compensation agreements were fee-based. Additionally, about 70% of large advertisers employed performance incentives, usually based on agency performance reviews and sales goals.

Most agencies do not provide advertisers with detailed billing. Since the only reference may be a particular campaign and month, media may find it difficult to look at an agency-to-advertiser invoice and determine which portion is theirs among numerous unnamed media providers. Such general billing also makes it difficult to determine the amount that the advertiser paid the agency for a specific buy, or to try to collect from the advertiser if the agency goes bankrupt. Here again, establishing a relationship in which the advertiser is a participant in the buying process can help offset this problem. Advertisers also stand to potentially benefit from this involvement, which reduces the likelihood that media will pursue them for payment if they have honored the agreement and the agency fails to pay media.

There have been numerous

accounts in the press bemoaning the trend that advertisers are demanding longer-term payment schedules from their agencies. While some high-profile marketers such as Procter & Gamble, Johnson & Johnson, and Anheuser-Busch In-Bev pay vendors 75 days out or longer, the practice of stretching payment terms is not widespread. A recent survey by the 4A's concluded that most clients are still paying their bills within 30 days, with relative consistency across service activities and media channels. The report also indicated that agencies pre-bill some clients to offset the negative impact of slower payments.

Thirty-day payment terms are reasonable and should be enforced! Agencies should have received their payment from advertisers in time to meet media's payment terms. Additionally, agencies with fee-based agreements are paid their fees on a monthly basis, regardless of the volume of buying that takes place. If an agency is delinquent, chances are that bureaucracy and back office inefficiencies are to blame. Proactive efforts can break this pattern of behavior! (For specific tactics that really work, see *Collective Wisdom,* March 2013.)

Know your options.
So the worst has happened: The agency has filed for bankruptcy. Additionally, the agency ordered ads pre-petition that have not yet run post-petition. What to do?

Long-term contracts for the purchase of media contracts constitute executory contracts under the Bankruptcy Code (see *Collective Wisdom,* March 2005). The law permits only the debtor in bankruptcy to decide what it wants to do with these contracts—to "reject," to "assume," or to "assume and assign" the contract. The choice is subject to court approval. In a Chapter 7 (liquidation) bankruptcy, the debtor or trustee must assume the executory contract within 60 days of filing. If the contract is not assumed within this time frame, rejection is automatic. In a Chapter 11 (reorganization) bankruptcy, there is no specified time limit for either assumption or rejection. Absent a court order, the debtor is not required to make the decision until the plan of reorganization is confirmed.

If the debtor chooses to reject the contract, the rejection constitutes a breach of contract, which would then allow you to file a pre-petition claim for damages. Of course, pre-petition unsecured claims usually garner small recompense. On the other hand, by assuming the contract, the debtor must "cure all default," including pre-petition invoices, and provide adequate assurance of future performance.

If the debtor chooses to "assume and assign" your contract, you will then be required to continue doing business with another party. The good news here is that you would enjoy the same benefits that you would receive had the debtor simply assumed the contract, including preferred status over most other creditors.

Why would a debtor not quickly reject an unprofitable contract rather than continue to accrue debt before ultimately rejecting it? By dragging out the rejection process to the bitter end, the debtor may avoid having to "cure" the pre-petition debt, required for continuation of the contract, while benefitting from your post-petition services. An agency may insist on a continuation of advertising to prevent advertisers from filing a claim against it. Advertisers might file claims not only for money already paid to the agency but also for damages caused by the failure of the ads to run. In any case, if the debtor fails to pay for your post-petition services, you are within your legal right to consider the debtor in breach of the contract and refuse to perform.

A thornier problem occurs when the debtor is current on post-petition invoices, yet you feel uneasy about continuing the relationship because of its uncertain future. If the debtor rebuffs your request for cash in advance, you might quickly file a motion with the bankruptcy court to compel the debtor to either assume or reject the contract within a specified number of days. It costs money to file such a motion in court; however, you should receive a quick response. If the contract is rejected, you are off the hook. If assumed, you will be entitled to adequate assurance of future performance (i.e., the debtor must demonstrate to the court's satisfaction that it has the ability to pay for post-petition services).

"You haven't paid the invoice because of a 'back-office' problem? I've been to your office, and the front office is 20 feet from the back office. How about I stay on the line while you walk back there and straighten out the problem?"

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Another possible solution might be to contact every advertiser on your contract, verify its wish to continue advertising, and receive, in writing, its commitment to pay for the ads. While this will certainly be an arduous task, it may ultimately be more rewarding than dealing with the bankruptcy court.

What if you are owed considerable money in pre-petition claims? Is there a way for you to separate yourself from the unfortunate pack of unsecured creditors that stand to receive only a small percentage of their claims? One way that you may be able to move closer to the front of the unsecured creditor queue and improve your chances of getting paid in full is to be deemed a "critical vendor." Critical vendors are identified by the debtor as essential to its continued existence. The debtor usually urges the bankruptcy judge to approve payment of these vendors' pre-petition claims. If you are able to attain this status, you will be expected, in return, to continue to sell services to the debtor under the same or better terms as before. Critical vendor status raises otherwise low-priority pre-petition unsecured claims to higher priority administrative claims; however, standards for approval are high and a higher court can revoke the status. Additionally, gaining critical vendor status will not ensure that the bankrupt debtor will be able to pay for your continued services.

Prepare for the worst.
You know the old saying, "Hope for the best, prepare for the worst." While dealing with customer bankruptcy is an inevitable part of the media industry, proper preparation can go far to lessen the pain. Good policy and procedures—including a strong payment liability position and timely, consistent collection efforts—can sub-stantially reduce your losses while alerting you to possible red flags. Understanding the relationship and agreements between advertisers and the agencies with which you do business can help you reduce DSO and address disputes and discrepancies more efficiently. And finally, should the worst occur, staying abreast of the bankruptcy proceedings, exploring options that best serve your chances of recovery, and taking timely action with the advice of your legal counsel can help keep any losses to an absolute minimum. ♦