

# AAAA Bulletin

AMERICAN ASSOCIATION  
of ADVERTISING AGENCIES

*To main contacts, CEOs, presidents, Board of Directors, relevant committees, and SFNAs.*

**Date:** May 12, 2000

## AAAA LAUNCHES NEW SERIES OF POSITION PAPERS ADDRESSING KEY INDUSTRY ISSUES

### *Update on Sequential Liability First on List*

The AAAA is launching a new series of official Position Papers designed to provide members with guidelines and solutions to management-related issues and problems.

The AAAA Management Division is developing the Position Papers in response to member requests that the association adopt a more proactive stance on current issues and bring them to the attention of members and the industry at large.

Enclosed is the series' first installment, in which the AAAA updates and re-emphasizes its 1991 position on the controversial issue of sequential liability. The document also outlines media trade associations' contrary positions and offers recommendations on how AAAA members and their clients can best address this issue.

Member agencies are urged to share this and future documents with clients as appropriate in order to provide advertisers with the agency industry's official position on the topics covered in the series.

The update and the re-emphasis of the AAAA point of view is particularly relevant at this time in light of the proliferation of clients such as dot-coms and other thinly capitalized companies.

Future AAAA Position Papers will be Board endorsed and will cover such subjects as what should be included in overhead, the importance of written agency-client agreements, standard termination terms, and guidelines for determining client conflict, among others.

The AAAA would appreciate your feedback on this project. If you agree or disagree with a particular position, or if you have ideas for future topics that you feel should be addressed, please contact me (212-850-0760 or [bill@aaaa.org](mailto:bill@aaaa.org)).

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## A Position Paper from the American Association of Advertising Agencies

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# SEQUENTIAL LIABILITY

### **I. AAAA Re-Emphasizes Its Position on Sequential Liability for Media Payments**

Since 1991, the American Association of Advertising Agencies has maintained that advertisers and their agencies are "sequentially liable" for media payments.

Under "sequential liability," a medium could look to the agency for payment if the agency had been paid by the advertiser, but would be limited to seeking payment directly from the advertiser if the agency had not yet been paid.

The specific wording adopted by the AAAA Board of Directors and reflected in AAAA standard media contract forms is:

*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.*

### **II. Media Trade Association Leaders Disagree with the AAAA Position**

Media trade associations resist the concept of sequential liability, preferring "dual liability" (otherwise known as "joint and several liability"). This would mean that both the client and agency continue to remain liable for payments to the media, if the client had already paid the agency, or if the agency had not yet been paid for purchased media services.

Although beneficial to media, this position is in one sense illogical; you cannot hold everyone simultaneously liable for payment. Sequential liability is fair to the agency (i.e., it is liable to the media only if it has been paid) and fairer to the client (i.e., the client is no longer liable once it has paid).

### **III. Re-Emphasizing the AAAA Position on Sequential Liability is Particularly Relevant Today**

Increasingly, the growth in marketing and advertising spending is from thinly capitalized companies, including dot-coms and other start-ups, many of which have limited probability of long-term, stand-alone success. Questionable viability and/or under-capitalization increases the need to focus on risk and provides media companies, agencies and others with an incentive to mitigate or eliminate their credit exposure.

Any liability theory other than sequential liability benefits the media and works against agencies' interests when future payments may not be assured. When the media rejects sequential liability, you should consider requiring payment from the client in advance and in full before commitments become non-cancelable. As an alternative, you might consider requiring the advertiser to be the contracting party, with the agency performing its services as media consultants.

## **IV. Recommendations to AAAA Members**

### *Media Contracts:*

All AAAA media contract forms include a sequential liability statement. This statement indicates that unless otherwise set forth in writing by the agency, the agency will be solely liable for payment to the medium to the extent proceeds have cleared from the advertiser to the agency for advertising run in accordance with the contract. For sums owing but not cleared to the agency, the advertiser named on the contract will be solely liable.

These forms carry only AAAA approval and are not endorsed by any media organization. (Available forms can be obtained from the AAAA Media Services Division.) Use of these forms by AAAA agencies is entirely voluntary.

### *Credit Applications:*

Media credit applications usually provide for dual liability and terminology establishing liability is often included within a range of unrelated provisions and printed on the reverse side of the application. Subject to the advice you receive from your agency's attorney, the AAAA recommendation is to amend these forms by striking the dual liability phrase and incorporating the sequential liability language which is previously detailed in this paper. You should initial any changes that you make.

### *Client Agreements:*

To properly define the agency's role, and to reduce its exposure in event of a default, it is important to include within the client agreement a clause stating that, for media and production purchases, the Agency is functioning as an agent for a disclosed principal.

## **V. Rejection of an Order**

A medium may reject an agency's insertion order or contract (or its own credit application, if it has been amended by the agency) because it contains a "sequential liability" provision. If this occurs, there are usually three options available to the agency and advertiser:

1. The advertiser can refuse to place the order under any terms other than sequential liability.
2. The agency can continue to submit an insertion order or contract containing sequential liability language, but the advertiser should be made aware that the medium's use of different liability language could, under the worst circumstances, mean that the advertiser could be liable to pay twice.
3. The agency and the advertiser can accept the medium's proposed liability terms. If this alternative is chosen, your client should be aware of his potential "double exposure" if dual liability is imposed.

## **VI. The Order is Accepted and the Insertion Order/Contract is Returned, Annotated with a Different Liability Clause**

In this instance there are typically three available courses of action:

1. The advertiser may elect to cancel the order.
2. The agency can send the medium a written statement that it rejects any liability language different from its proposed language.
3. Advertiser and agency may choose to ignore the medium's endorsement or annotation changing the agency's initial verbiage, and let some future court decide which liability clause is enforceable, if the need arises.

## **VII. The Parties**

Liability involves three parties: the advertiser, the medium, and the agency. All should discuss these liability issues with their attorneys in order to understand them.

Writings on this issue have too often only focused on the agencies and the media, while the clients' stake is tremendous. Sequential liability is in the clients' and agencies' best interests and both should leverage their interests by making their preferences known to the media.

Sequential liability offers an added level of financial comfort to advertisers. The credit record of AAAA members is exemplary and we believe that AAAA members offer, in most cases, an extra level of financial stability to their clients. But many advertisers may use a variety of firms to service their particular advertising and promotion needs. If any of these firms are thinly capitalized or in questionable financial condition, the advertiser could face the risk of dual payment if that firm suffers financial reversals and a dual liability contract is in place.

## **VIII. A Closing Recommendation to AAAA Members**

The economy is in a robust growth cycle, and as is often stated, this growth is largely from companies with great ideas and technology, but which are either thinly capitalized or financed by venture capital, which can be withdrawn.

Suppliers and partners to these companies are aware that there is potential credit exposure, and are likely to attempt to minimize their individual risk. One way that media and production companies, and other third-party suppliers, may attempt to mitigate their loss exposure is to adhere to joint liability provisions or to look to agencies as guarantors of payment.

We recommend that you discuss risk with your attorneys and your clients and that you have this discussion on an up-front basis, before making any substantial third-party commitments. When appropriate, you should consider requiring payment before media closing or cancellation dates. This is becoming more widespread in doing business with dot.coms and, depending on your particular circumstance, may be a prudent path to follow.

*Adopted by AAAA Board of Directors, February 1991 • Revised April 2000*