

Ensemble Chimes Bankruptcy: Lessons Learned

Best practice recommendations to mitigate risk while continuing to derive the value
from vendor management systems

Mark B. Roberts, CEO, NACCB
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Over the last number of years, vendor management systems (VMS) have continued to gain momentum as a tool for companies wanting to more effectively manage their contingent workforce. Recognized for effectively capturing key metrics and streamlining processes, many clients have heartily embraced the VMS solution.

However, on January 7, 2008, the VMS landscape changed forever. Ensemble Chimes Global (Chimes), one of the leading VMS providers, filed for bankruptcy and effectively ceased operations. The shut-down caused significant disruption to companies that worked with Chimes. In the wake of the bankruptcy, stakeholders are posing the following questions: (1) "What can we do to reduce the risk of a similar collapse happening again?" and (2) "If another VMS provider should become financially distressed or insolvent, what can we do to minimize the fallout?" With these questions in mind, the National Association of Computer Consultant Businesses (NACCB) embarked on an effort to identify "best practice" recommendations for companies who have implemented (or are considering) a VMS solution.

The Aftermath

In the aftermath of the Chimes bankruptcy, NACCB, which represents almost 400 IT services companies in the U.S., received reports from many member companies on the ramifications of the collapse. The effects were far-reaching. While the particulars of every client's situation were somewhat different, common challenges emerged. Clients who had implemented the Chimes VMS solution were simultaneously dealing with a host of issues:

- 1) **The Immediate Need for New Processes:** With the abrupt cessation of Chimes' operations, clients needed to immediately implement new systems for processing requisitions, conducting interviews, hiring, on- and off-boarding and other functions that had previously been performed by Chimes. In many cases, clients had to resort to manual processing.
- 2) **Managing Consultant Relations:** The Chimes collapse sparked questions from IT consultants about their status and concerns about whether they would be paid.
- 3) **Contending with Legal Activities:** With no direct contractual relationship between clients and vendors, new contracts had to be drawn up in order to keep consultants working on critical projects. This issue was further complicated by bankruptcy provisions that had the potential to prevent the establishment of direct client-vendor relationships.

The Chimes collapse affected various stakeholders in different ways. The representative of one large financial services firm cited his great concern over losing consultants working on mission-critical projects. Vendors supplying consultants through Chimes faced considerable financial risk. Already facing uncertainty regarding payment of monies owed prior to the bankruptcy filing, owners and executives of vendor firms had to quickly decide whether to keep their consultants working at client sites without any assurance of payment for those services. According to the president of one mid-sized Minnesota IT Services company, "We took a considerable financial risk by keeping nearly all of our consultants on their assignments. During this time, we continued to pay all of our consultants even though there was a risk we would not be paid for their services." The Chimes collapse caused a number of

Preserving the Viability of Vendors

Karen Wilson is a principal with an NACCB member company and the co-founder of VMS Professionals, a national organization representing the professionals who are involved in the management of VMS at nearly 100 companies. VMS Professionals meets regularly to discuss experiences and best practices.

"What I heard from VMS Professionals' members is that typically their best suppliers are mid-sized firms. They are also the ones most likely to be hurt by the bankruptcy. Our members know the importance these firms play in their sourcing strategy and want to identify ways to protect everyone involved—internal customers, hiring managers and staffing providers," said Wilson.

consultants to even question their choice of profession. According to this same executive, "We had consultants questioning whether this is the lifestyle for them. They didn't realize that something they had no control over could have such a huge impact on their financial well-being. Consequently many of our consultants are now being much more cautious. They now realize the importance of 'knowing who they are doing business with both directly and indirectly.'"

VMS clients found themselves inventing processes they had long since left to Chimes to manage. In fact, one of the main reasons companies use a VMS is to jettison the processes associated with managing contingent labor forces that are resource intensive. However, without Chimes, companies had no processes in place to move forward with requisitions, hiring and the like. Many clients had to deploy substantial internal resources to quickly implement new manual systems to manage their vendors and contingent workforce.

In addition to putting short-term process fixes in place, clients in many cases wanted to formalize the legal relationship with vendors. Absent a contract, clients could not be assured of keeping their consultant resources and vendors could not be assured of being paid. Before the bankruptcy filing, clients had a contractual relationship with Chimes, and Chimes had contractual relationships with each of the vendors. In most cases, no contractual relationship existed between clients and the vendors. With Chimes in Chapter 7, the legal rights and obligations of both clients and vendors were thrown into doubt. First, while in bankruptcy, the parties to the contracts could not force Chimes to continue performing its obligations under the contracts pending the decision to assume, reject or assign the contracts. Second, absent permission of the Bankruptcy Court, clients and vendors were not automatically free to contract directly with one another. Clients could have been forced to work with new vendors and consultants. Had the Bankruptcy Trustee elected to press the matter, the court could have barred clients and their vendors from working together potentially causing cataclysmic disruption to projects.

The potential financial impact on the vendor community is considerable. A survey of the approximately 400 NACCB member companies showed that 20 percent were directly impacted by the Chimes bankruptcy. Of those firms impacted, almost half estimated their outstanding account receivables with Chimes to be over \$100,000 with many of the potential losses significantly higher (in some cases exceeding \$1 million). While it appears some of these receivables will ultimately be paid, the potential losses remain significant, hitting some firms particularly hard.

The Bankruptcy Process

Almost immediately after the bankruptcy filing and cessation of Chimes' operations, clients and their staffing providers looked to directly contract with one another. While a common sense approach from a business continuity standpoint, both clients and vendors had to contend with potentially significant legal obstacles, in particular, the U.S. Bankruptcy Code.

"The Bankruptcy Code dictates how the contracts of a debtor party (i.e. Chimes) will be handled," said Mark Bloom, a nationally prominent bankruptcy attorney with the law firm of Greenberg Traurig, LLP. While the Bankruptcy Trustee (the individual appointed by the court who is charged with marshalling the assets of the debtor for the benefit of creditors) in this case quickly relented (with court approval), allowing clients to contract directly with the existing staffing vendors, in many cases it goes very differently. "The Bankruptcy Trustee can take up to 60 days in a Chapter 7 case and several years in a Chapter 11 case to accept, reject or assign a contract. Without agreement of the Trustee or special permission of the court, parties may remain bound to their contracts with a VMS in bankruptcy even though the VMS has ceased performing its obligations," added Bloom.

The ramifications of this bankruptcy principle can be devastating to both clients and vendors. While there is usually a strong desire to maintain the status quo and avoid disruption of ongoing projects, the ability to do so may be shrouded in uncertainty for an extended period of time and ultimately may not be possible at all. With a VMS in bankruptcy (particularly if it has ceased operations), clients may be inclined to quickly enter into direct relationships with vendors to keep current consultants working. However, absent court permission (which may or may not be granted), all parties do so at their own peril. Any work done without relief from the court could be deemed a breach of the VMS' contracts with both clients and staffing vendors and potentially a violation of Bankruptcy Code and the court's Automatic Stay (the equivalent of a court injunction). In practical terms, vendors may not be able to keep their consultants in place as they bear the risk they may not be paid for these ongoing efforts (which would be on top of any unpaid amounts incurred prior to the bankruptcy filing).

Beyond the initial uncertainty surrounding the options available to clients and vendors, the typical structure of the contractual arrangements between client and the VMS, and the VMS and the vendors significantly increase the likelihood of massive disruption of projects in the event of a bankruptcy. The Bankruptcy Code may actually provide an incentive for the Bankruptcy Trustee to seek to prohibit clients from retaining their existing vendors and consultants and impose a substitute workforce. Here is why.

In order to assume a contract, the debtor must generally "cure" all monetary defaults (i.e., pay) owed to the non-debtor party. From the perspective of the Bankruptcy Trustee seeking to maximize assets and minimize liabilities, the services contracts with clients are largely beneficial (because they provide for cash inflows), while contracts with staffing vendors are largely a detriment (because they provide for cash outflows).

Therefore, the Bankruptcy Trustee, on behalf of the VMS in bankruptcy, may seek to assume the services contracts with clients without having to pay any "cure" costs (because there are rarely any monetary defaults by the VMS under those contracts). Under the contract with staffing vendors, the VMS may be liable for outstanding invoices and other amounts, which would need to be cured for the subcontract to be assumed.

Since the payment of cure amounts will only be required under the VMS' contract with the staffing vendor, the Bankruptcy Trustee may have an incentive to assume the services contracts with the client but reject the sub-contract with the vendor. This may result in the Bankruptcy Trustee entering into a new contract with a new staffing vendor in order to avoid the necessity of having to cure amounts owed to the former staffing vendor. In turn, a new staffing vendor will likely place new consultants with clients—replacing the existing workforce.

Best Practices

Across the industry there have been numerous discussions in articles, blogs, webcasts and meetings on Chimes, the VMS model and ways to reduce the risk to clients, vendors and consultants. With an opportunity to reflect

The Counter-Intuitiveness of the Bankruptcy Process

Some of the rules applicable in bankruptcy surprise those unfamiliar with the process:

- Even though the debtor is temporarily relieved of its contractual obligations, both clients and vendors often remain bound.
- You may not be able to work or contract directly with the vendors and consultants currently supporting you.
- You may not be able to work with an alternative VMS provider of your choosing.
- Your rights and obligations under your VMS contract may be unclear for an extended period of time.
- The monies you have paid to a VMS for staffing services may never reach the vendor who actually performed the services.

on the lessons learned from the bankruptcy, NACCB has collected the recommendations from a variety of sources including owners and executives of its member companies as well as its outside legal counsel, Greenberg Traurig, LLP. NACCB best practices recommendations fall into two broad categories: contractual protections and business continuity planning.

For clients who work with a VMS or are considering working with a VMS in the future, what can be done to mitigate the risk of disruption and financial loss? There are a number of proactive measures clients can implement before a problem arises.

Contractual Protections

The contracts between the client and the VMS, and the VMS and the vendor can be drafted in a manner that significantly reduces the risk of disruption and financial loss.

Minimizing the Likelihood of Operational Disruption

- **Multi-party Contract.** One option is to enter into a single multi-party contract between the client, the VMS and the vendor. By including all parties in a single contract, the trustee in a future bankruptcy would not readily be able to selectively assume the client contract and reject the vendor contract.
- **Integrated Contracts.** If the multi-party contract approach is not operationally feasible, the client/VMS contract and VMS/vendor contract can be integrated. To be integrated, the contracts must cover the same subject matter. There must also be an expressed intent for the two contracts to be “integrated” or treated as one. Like the multi-party contract approach, integrated contracts would also prevent a trustee from selectively assuming only the beneficial part of the arrangement.
- **Cross-Default Clauses.** If there are separate contracts between the client and the VMS and the VMS and the vendors, a client should ensure that a breach of the VMS/vendor contract (i.e. for non-payment) would be deemed a breach of the client/VMS contract. With such a clause, the Bankruptcy Trustee will likely be unable to assume the client contract without also paying the amounts outstanding under the VMS/vendor contract, helping to ensure that the trustee assumes both contracts together and the client continues to have access to the same workforce going forward.
- **Avoiding “Exclusivity” Language in the Client/VMS Contract.** While often well-intentioned, language which establishes the client/VMS relationship as exclusive in managing the contingent workforce can be very problematic in the event of a VMS insolvency. While the Bankruptcy Trustee in the Chimes case never pressed the issue and allowed clients to contract with vendors directly as well as enter into

A Dual Perspective: Staffing Company & VMS Provider

One large IT Services company experienced the Chimes collapse from two vantage points. As both a staffing vendor and a VMS provider, the company had to deal with the fallout in both its business lines.

“Obviously we were concerned about the impact it was going to have on our own staffing business. We had performed services, but weren’t sure if we were going to be paid for them,” said a senior executive of the company. “On the other hand, as a VMS vendor, we were disappointed by the negative light the bankruptcy was casting on the VMS sector,” he added.

Through discussions with others in the industry, a number of recommendations were developed. One of the key recommendations that quickly surfaced was the implementation of multi-party contracts. “We tell clients it’s a good way to protect themselves and their vendors,” added the executive.

As clients and prospective clients of VMS providers look for ways to safeguard themselves, it appears well-structured contracts are leading the list of recommendations.

agreements with other providers, a future Bankruptcy Trustee may not be so inclined. He or she may assert that the right to “exclusivity” in the client contract is a valuable right owned by the bankruptcy estate. To preserve the value of that right, the Bankruptcy Trustee may argue that any direct contractual relationship with a vendor or entering into a new contract with another VMS provider constitutes a breach of contract and a violation of bankruptcy law. To reduce the risk such an argument will prevail, the client/VMS contract should avoid language suggesting the relationship is “exclusive.”

- **Shortening the Time the Trustee has to Make a Decision.** Under the Bankruptcy Code, the Bankruptcy Trustee has 60 days in a Chapter 7 and potentially several years in a Chapter 11 case to decide whether to assume, reject or assign the debtor’s contracts. Delays of this magnitude can be extraordinarily disruptive to client projects. While not always enforceable, client contracts should contain a provision to shorten the time the trustee has to make his or her decision.

Increasing the Likelihood Your Vendors will be Paid

- **Separate the Payment Mechanism.** In either a single multi-party contract or two separate contracts, clients can provide that the vendor and VMS are paid separately for their respective services. By eliminating the VMS’ role as the conduit for vendor fees, the risk of financial loss to vendors (threatening their viability) would be significantly reduced.
- **Require the VMS Provider to Hold Vendor Fees in an Escrow Account.** As an alternative to paying vendors directly, clients can insist their VMS provider hold the vendor’s portion of the service fees in a segregated escrow account. To implement this recommendation, the client/VMS contract and the VMS/vendor contracts would need to provide for the establishment of an escrow account stipulating that the funds in the account are solely for payment of vendors, that the funds are held in trust for the benefit of the vendors and that it prohibits the commingling of vendor funds with other monies.
- **Ongoing Financial Due Diligence.** While clients typically conduct some form of financial due diligence on a prospective VMS provider, the evaluation of the financial condition of the provider should be ongoing. Clients and vendors should ensure they are contractually entitled to ready access of the VMS provider’s financial information throughout the term of the agreement. By regularly monitoring the

A Chimes Client Perspective

A large, global financial services firm used Chimes to manage its contingent workforce which averaged 650 IT and administrative personnel. The firm had no contractual relationship with any of the 40-50 agencies it was using on a regular basis to manage its workforce needs. The company had also been using Chimes as a conduit for paying its staffing providers and for time collection and validation. “When Chimes went away, we were left with a heavy administrative burden,” commented a representative from the company.

What lessons can you learn from this firm’s experience? Here are a few lessons its management shared:

- Using the VMS as a payment conduit? Put the money into an escrow account that protects it from liquidation.
- Does the VMS service multiple business units within your organization? Build a governance structure into your business continuity plan. Identify the primary decision-maker on contingent workforce issues within those units.
- Are you leaving too much in your VMS provider’s hands? Allowing your VMS provider to manage the vendors on a day-to-day basis makes sense, but you should keep one hand in the mix. It is important to maintain a current list of the subcontractors (staffing providers) including contact information for a manager who can assist you in an emergency.

financial viability of their VMS providers, clients and vendors can greatly increase the likelihood they will be able to detect and address problems before they lead to a significant operational disruption.

Business Continuity Planning

It's safe to say that the Chimes bankruptcy was a surprise to most of Chimes' clients. When the announcement was made, many companies weren't quite sure what to do next. The Chimes VMS managed all of the processes that made a company's contingent recruitment strategy tick. With limited resources and little "what if" planning, operations were being significantly disrupted. While it's imperative to take care of the legal aspects of the VMS relationship, it is just as important to have processes in place to maintain business continuity in the event your VMS temporarily or permanently ceases operations. Here are some recommendations based on "lessons learned" during the Chimes bankruptcy.

- While not likely a topic your current or prospective VMS provider would like to discuss, you should ask if they have put any contingency plans in place for the benefit of their clients in the "unlikely" event they should cease operations. At a minimum, you should understand their operation: where the funds are kept, where your data is housed, along with other important operational details.
- What is your company's contingency plan in the event of a VMS shutdown? While the Chimes collapse was not a natural disaster, the methodology for developing a contingency plan would not be very different from other types of disaster planning. At its most basic, what are the processes and who are the people you will need to get up and running quickly? How do you reach them? Clients of Chimes likely have the outline of a contingency plan based on the actions they took in the aftermath of the collapse. You should refine and document your processes into a disaster recovery plan for future use. For those that were fortunate to have avoided Chimes and the resulting disruption, now is the time to develop a contingency plan should your current or future VMS provider encounter a problem.
- Are you setup to work with your staffing suppliers directly if your VMS provider were to cease operations? While it is critical to address the legal issues surrounding a direct client/vendor relationship as discussed above, you also need to be prepared operationally. Could you quickly contact your vendors if your VMS were not available? Could you manage your vendors and their consultants (at least temporarily) to minimize disruption? You may wish to develop this capability as part of your overall contingency planning.
- Does your company's situation warrant a backup VMS? Would the sudden unavailability of your VMS potentially cause such significant disruption to your operations so as to warrant some form of redundancy? While an expensive option, a backup VMS solution may be appropriate for some clients.

Where to Go From Here

Since the initial bankruptcy filing by Chimes in early January, there have been a number of developments. Some monies owed to vendors have been paid, while other receivables remain unpaid. The Bankruptcy Trustee sold the company's assets to Beeline, the VMS business unit of MPS Group, Inc. While a number of issues remain outstanding, the Chimes bankruptcy has clearly highlighted the often overlooked risks inherent with a VMS arrangement.

We hope this white paper has offered some useful “best practice” recommendations on how to reduce the risks associated with working through a VMS. We recognize that this white paper does not so much represent the final word on these issues as it does the beginning of a constructive dialogue between all stakeholders in the VMS model.

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About the Author

Mark B. Roberts

CEO, NACCB & NACCB Services, Inc.

Mark Roberts currently serves as the CEO of the National Association of Computer Consultant Businesses (NACCB), a national trade association of almost 400 IT Services companies. He also serves as CEO of NACCB Services, Inc., NACCB’s wholly-owned subsidiary that operates TechServe. Prior to being named CEO by the NACCB Board of Directors in February 2003, Mark served as COO & General Counsel of the association. He writes and speaks frequently on both business and legal issues affecting the IT Services industry. He also serves on the Labor Relations Committee of the U.S. Chamber of Commerce. Before joining NACCB, Mark was a partner in the Labor and Employment Group of Steel Hector & Davis LLP, one of Florida’s oldest and most prestigious law firms. Mark’s practice consisted of counseling national, international and local companies, including staffing firms, on a wide range of issues arising out of all aspects of the employment relationship. He also served for four years in the Washington, D.C. office of Congressman Benjamin A. Gilman of New York.

1420 King Street, Suite 610

Alexandria, VA 22314

Phone: (703) 838-2050 Fax: (703) 838-3610

www.naccb.org

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