

Service Level Basics

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Service levels can play an important role in contracts for both suppliers and customers - if used properly. If used incorrectly, they are simply an administrative headache, or a way of removing the goodwill from a relationship in a rapid manner.

This article therefore looks at some of the key considerations in using service levels.

What is the purpose of a service level and what form does it take ?

The main purposes of a service level are usually to:

- A) Set a minimum level of service performance which is required by a customer

Having clarity of minimum levels of service can provide a customer with a degree of comfort, as well as provide a supplier with a realistic performance level which it needs to ensure that it achieves.

The form this takes, is entirely up to the parties, for example:

- In an e-commerce or hosted arrangement, a customer will want to ensure that the availability of the website is at a maximum level. The supplier may take the view that it would be commercially and practically unrealistic to guarantee full uptime, so instead the parties can agree a level of uptime which is acceptable, and express the service level as a percentage of availability over a period of time;

- With regard to support arrangements, the customer will want some clarity on when the supplier will respond and remedy any issues. The parties can therefore use response and remedy time service levels, which can be measured in minutes or hours for example, in respect of each incident;
- If a supplier is undertaking a form of back office processing for a customer, a customer may wish to apply an accuracy service level which specifies the minimum accuracy level in terms of a percentage or number of minor issues which are permissible, or which give rise to a certain type of remedy to the customer.

- B) Provide a means for liquidated damages

One of the concerns customers have, is that if there is a right for damages under a contract, it might simply be a theoretical right rather than a practical right. The reason for this, is that suing for damages means:

- There may be difficulty in assessing the quantum of damages which are likely to be recoverable, as this is something which is likely to be quite subjective, especially when one has to try to determine which damages are even recoverable in view of the limitations and exclusion clauses in the contract;
- That the relationship between the parties is going to clearly deteriorate if services are still being required to be performed by the supplier, whilst at

the same time the supplier is being distracted by a parallel court action;

- There will be a time lag between the loss actually being suffered, and the compensation being provided by the supplier, in view of the time associated with court proceedings, and any subsequent appeals process;
- Resources from both the customer and the supplier will have to be expended on the litigation, which takes the focus off the services, and risks further service deterioration.

Consequently, service levels coupled with a service credit regime can result in an effective method for incentivising a supplier to perform to a minimum level, with clear calculations for the amount of monetary compensation payable by a supplier if the service levels are not adhered to.

Which service levels to choose & how many ?

This is an area which requires a pragmatic approach.

A supplier should appreciate that there will be certain key areas in respect of which a customer is likely to require comfort, and the supplier should therefore entertain requests for a reasonable number of service levels.

A customer should take the view that although it could specify an infinite level of service levels, there are issues with such an approach:

- Having too many service levels will set off the relationship with the supplier on the wrong foot and simply antagonise them – this is certainly not conducive to a long term relationship;
- Specifying a service level requires the supplier to ‘buy into’ the fact that the service level is realistic. In an outsourcing relationship, a supplier may wish to compare the service levels looking to be imposed, against the current service levels being provided internally within

the customer’s business, to understand historic performance and whether the specific service levels being requested are a real requirement or a ‘wish list.’ The greater the number of service levels, the longer this aspect of the process is likely to take, and the longer the period before the outsourcing can be accomplished;

- There is no point having service levels unless they can be measured. If they are going to be measured, then they need to be reported. Having numerous service levels, means that there is likely to be voluminous service reporting. The consequences being: (1) it will take the supplier longer to undertake the measurement and reporting, and the cost of this will be factored upfront into the pricing; and (2) it will take the customer longer to digest the regular reports, and to understand what impact the various service levels are having at a practical level on the customer’s business.

So in producing service levels, the parties should adopt an approach whereby:

- A limited number of important service levels are made contractually binding. These should be ones which the customer needs to have comfort on;
- The service levels should be ones which can be measured in an objective manner;
- The service levels should be ones which can be independently verified by the customer. If the customer is relying purely upon the supplier to measure and report on service levels, with no ability for the customer to independently verify the service level performance, then the customer needs to recognise that it is putting all of its trust in the supplier’s hands, and it shouldn’t be surprised if the supplier is not therefore forthcoming in any service level breaches.

It is this type of approach which is likely to provide the parties with clarity and comfort, as opposed to one which takes a naïve view that more is better – in fact, service levels are a

perfect case for the expression ‘Quality rather than Quantity.’

Service Credits

It is the service credits which give the service levels their ‘teeth.’ The service credit regime will specify what the consequence is if service levels are not complied with, whether it results in a set payment or discount of charges, or whether it triggers a termination right.

Again, care needs to be taken when devising a service credit regime. Formulating an overly complex regime will make the scheme difficult to administer. A simple approach, which is clearly understandable is the key – yet it is surprising how many lawyers and consultants deal with this through pages of text, overly complex definitions and cross-references to various difference schedules and parts of the agreement. The better approach, is to use formulae and algebra to specify the service credit regime in a precise and concise manner.

There are those lawyers who may feel exposed through their lack of mathematical knowledge to devise such formulae, but this should not be an excuse to avoid such an approach. The service levels themselves are going to be devised with input from the client’s commercial or technical team, and this is something that they can help with formulating as well.

The other issue to be aware of, is that the service credit amounts can not be truly penal in nature, as after all true penalties are void if they are not a genuine pre-assessment of the associated losses. Furthermore, adopting a Draconian approach with regard to the service credits, is again one which will not foster goodwill between a customer and a supplier, with the inevitable consequence of delaying the completion of the contractual negotiations between the parties.

‘Get Out of Jail Free Card’

A customer negotiating service levels and credits with a supplier, should be aware of the various ‘tricks of the trade’ which it should avoid where possible, as these can remove the very protection the customer is looking to put in place.

Some common examples are:

- Having a service level of 97% may seem to be quite a high standard, however, if it relates to a service which is supposed to be available on a 24/7 basis, and the service level is measured on a monthly basis, then that means an outage of 21.6 hours would still result in the 97% service level being achieved – this would mean that 3 outages per month, lasting for 7 hours a day from 9am on 3 weekdays, would not breach the service level – it would be doubtful whether this level of service would be acceptable to any business !

Best practice: Have higher service levels, and have them measured on a daily or weekly basis. Increasing the service level and decreasing the period over which it is measured, will increase the comfort for a customer.

- Having service levels and credits in a Schedule, but then having something which is contradictory in the front end of the agreement, with an express precedence clause which stipulates that the front end prevails, will negate the protection in the service level and credit regime.

Best practice: Ensure that focus is provided on the front end of the agreement and not just the schedules.

- Suppliers sometimes make reference to certain events being excluded from the service level calculations, such as planned outages or emergency maintenance outages. However, such exclusions can be drafted in a way which results in the service credits rarely being triggered, if ever !

Best practice: Check the interaction between the express exclusions and the service level regime, to verify that the exclusions are commercially and practically acceptable, and not just a mechanism to create a nonsense of the service level and credit regime. If certain

incidents, such as planned outages, are to be excluded from the calculations, ensure that there are appropriate parameters included around such outages, eg requiring the planned outages to be outside normal peak/working hours; having a reasonable notice period in advance in respect of planned outages; having a limit on the number of planned outages per month; having a limit on the duration of a planned outage; making it quite clear for what purpose a planned outage is permitted; etc.

Conclusion

Service levels and service credit regimes are a vital part of certain types of service contracts, and if properly used, they can be a welcomed addition – providing clarity of consequences for both the customer and the supplier.

The key though, is to focus on those service levels which need to be contractual, and express them together with the associated service credit regime, in a manner which makes sense, and can be administered by the commercial parties themselves, and not require lawyers to be drawn in post contract signature to describe how they work. Formulae, conciseness and worked examples, can work wonders with regard to this.

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