

OVERVIEW OF SERVICE LEVEL AGREEMENT

As part of your business you may agree to supply services to a customer. When you do this you need an agreement which sets out the level of service you will provide and this is called a service level agreement.

This guide provides you with an overview of what a service level agreement is and the issues you should consider when preparing and agreeing this type of agreement.

For further information please also see our [supply of services agreement guidance note](#) and [template agreement](#).

OVERVIEW OF SERVICE LEVEL AGREEMENTS



WHAT IS A SERVICE LEVEL AGREEMENT?

A Service Level Agreement (“**SLA**”) is an agreement that sets out the agreed level of service to be provided by a service provider to the customer. The SLA is usually part of a more detailed “supply of services” agreement and will be attached to the main supply of services agreement. Sometimes, however, the SLA exists as a separate standalone document which often does not incorporate key “boilerplate” provisions which should be included in any agreement.

As well as explaining the standard of service expected from the service provider, the SLA will often detail the financial consequences the service provider will suffer if they don’t meet the agreed service level.

Typically, the financial consequence of failure will be the payment of a service credit. This is a pre-determined amount that the customer may claim from the service provider (usually as a deduction from the next invoice or as a separate credit).



THE SERVICE LEVELS

The service levels that are incorporated into any agreement to supply services are bespoke to the particular service that is being provided. The acceptable level of service will be an integral part of the negotiation process and will allow the customer and service provider to reach an agreement of what standard will be satisfactory as well as the standard of service that will be unacceptable which, ultimately, affords compensation to the customer for the under-performance.

The SLA typically includes the following components:

1. The specification of services to be provided;
2. The service levels required for each service to be provided (for example, the standards of reliability, the response times and availability); and
3. The service credit regime relating to the relevant services. A service provider may not offer service credits as a matter of course but the customer should insist on this.

The number of service levels to be set in an agreement will be driven by the particular service being provided and the breadth of such services. It is important to note that service levels are not envisioned to be used to measure all aspects of every service to be provided under the supply of services agreement, but should

concentrate on the most imperative aspects of the services that are capable of being monitored and objectively measured. Additional tools can be used to capture the services that are not considered to be the most important, such as the use of key performance indicators which operate in the same way as service levels (i.e. they measure performance of a service), but are not connected to a service credit regime.



SETTING THE SERVICE LEVELS

When setting the service levels, the customer should bear in mind the following dos and don'ts:

DOS	DON'TS
<ul style="list-style-type: none"> Review the requirements for the services to be provided to identify the important parts of the services that need to be measured. 	<ul style="list-style-type: none"> Avoid having too many service levels – they can be administratively burdensome and progressively add less value the more they stray away from the important aspects in the provision of the services.
<ul style="list-style-type: none"> Determine the standard of the service that must be provided for the customer to receive satisfactory levels of service and value for money. 	<ul style="list-style-type: none"> Don't allow service credits to be the sole and exclusive remedy – if performance is extremely bad, the customer should retain the rights to sue in damages and terminate the contract.
<ul style="list-style-type: none"> Consider to what extent any variance from the required level of performance may be tolerable by way of exception rather than the norm. 	<ul style="list-style-type: none"> Avoid allowing service level re-assessment where possible as the service provider's bargaining position will have improved and its own performance may then affect the service levels being achieved.
<ul style="list-style-type: none"> Consider what level of performance should trigger: <ul style="list-style-type: none"> – service credits, the more severe the variance from the service level. the higher the service credit; – other remedies; such as a right to withhold payment or termination. 	<ul style="list-style-type: none"> Don't offer a bonus scheme (i.e. rewards for over performance) for the service provider unless: <ul style="list-style-type: none"> – there is consistent over performance; – there is a demonstrable benefit from such over performance; and – it is by way of offsetting the bonus against service credits otherwise accruing.
<ul style="list-style-type: none"> Scrutinise the service provider's pricing model to establish whether any risk premium has been added to the value of the service in return for its agreement to a service credit regime. 	<ul style="list-style-type: none"> Resist any premium added to the value of the service to reflect the service provider having to comply with set service levels.



WHO PREPARES THE SLA?

By virtue of the inherent connection between the customer's business demands and the necessity for the service to be carried out to a particular standard, the SLA should ideally be prepared by the customer (however, where services are "off the shelf" the service provider will usually have a set of standard service levels). In doing so, the customer should take the following into account:

- The particular services it wishes to be subjected to service levels. The customer needs to concentrate on the services and service levels which will have the most impact on its business. Therefore, the service levels should be set against those services that reflect the business needs in the majority of circumstances.
- Clearly defining the services and ensuring that those services that are to be subject to service levels are objectively measurable and achievable.
- Clearly setting the basis on which service levels are measured include express reference to the measurement period i.e. monthly, quarterly. Consider whether the period should be a rolling measurement period so that poor performance can be tracked.
- Whether breaches of the service levels or certain critical service levels should trigger a right to terminate.
- The minimum criteria necessary to verify that the required services have been achieved and completed to the acceptable service levels. Identify the spectrum of tolerability to the variance from the requisite standard.
- How the required service levels should alter over time and whether the levels should gradually increase in order to incentivise the service provider to improve the provision of the service.
- The impact of subsequent adjustment to any service levels. An example that is typically found within an IT SLA is provided to illustrate this point:
 - A service provided 24 hours a day, 7 days a week with a requirement for 99.99% availability over a 12 month period will allow for approximately 30 minutes of down time over the whole year.

- A service provided for 24 hours a day, 7 days a week with a requirement for 99.5% (a 0.49% reduction) availability over a 12 month period will allow for approximately 43 hours of down time over the whole year.

Therefore, a slight reduction of 0.49% has resulted in a significant difference as the service will then be unavailable for 43 hours over a period of 12 months as opposed to only half an hour unavailability over the same period. Thus, a customer should carefully scrutinise the implications of any adjustments made to the service levels throughout the duration of the supply of services.

- How the service levels and credit regimes would apply during a period of force majeure*. The customer needs to decide what circumstances (force majeure events) alleviate the service provider from being subject to the service levels and at what point (e.g. 4 weeks of inability to provide the services) should the inability to provide the services cause for termination of the agreement. The customer, however, may decide that it is down to the service provider to make its own arrangements to deal with force majeure (e.g. again using an IT SLA to illustrate, the service provider is expected to use separate sites and networks as backup sources in the event an interruption arises).

**Force majeure means a cause that impedes a party from fulfilling its obligations under an agreement which arises from an act or event beyond its control, such as acts of God, terrorism, riots, war, storms, fires, floods or any other natural disasters.*

- Any relevant industry standard service levels and their measurability.
- Whether the service provider is required to meet the service levels from day 1 or will there be a bedding in period during which the service provider will not face any consequences if it fails to achieve service levels.



THE SERVICE CREDIT REGIME

In the event that the service provider under-performs when providing the customer with its services, the customer's recourse for compensation would normally be whatever claim exists at law. However, bringing legal action every time the service provider under-performs would be impractical. Thus, providing a matrix that measures the service provider's performance against set standards and applies a credit where those standards are not attained will avoid contractual disputes and afford the customer an accessible remedy every time the service provider under-performs. This, as mentioned, is known as a service credit regime.

The key considerations when putting in place a service credit regime are as follows:

- Determination of the appropriate level of performance;
- Defining the point at which compensation becomes due;
- A scale which presents the increase of compensation as performance levels decrease or remain at a sub-standard level for a period of time;
- Defining a minimum standard of service acceptable to the customer to allow the customer to make additional legal claims without being limited to the service credit regime. This should apply in the situation where the level of performance drops to below what is deemed acceptable and becomes potentially threatening to the

customer's business (i.e. "critical service threshold") and thus, the customer has the ability to exercise other remedies (e.g. withholding payment and/or terminating the agreement and/or suing for damages (damages are losses that have been incurred as a result of the service level failure)).

- Identify a point at which, if the service provider continually under-performs, the amount of money increases that is deducted from the charges paid by the customer. This can be achieved, for example, by applying a number of points to each service failure and giving a monetary value to the points or, once a specific number of points have been reached, the customer is entitled to a percentage reduction to the charges. This is commonly known as a "ratchet".

Historically, service credits should be a genuine pre-estimate of any loss suffered by the customer in receiving an diminished level of service, not a penalty to the service provider for providing the unacceptable service. However, recent case law has indicated that the focus when considering the validity of a service credit regime will be whether the service credits are "penal" rather than whether they represent a genuine pre-estimate of loss (*Cavendish Square Holding BV v. Talal El Makdessi; ParkingEye Limited v. Beavis* [2015] EWSC 67).



CAN THE SERVICE CREDITS BE CAPPED?

One of the major issues a service credit regime presents is that a service provider may only be willing to agree to a service credit regime on the proviso that the credit is capped at a fixed "at-risk" amount. This highlights the importance for the customer to ensure that the service credit regime is not stated to be its sole and exclusive remedy (making other remedies such as termination also available).

The considerations that should be taken into account when negotiating the presence of a service credit cap are as follows:

- The scope of services subjected to the service levels.
- Whether the service credit cap should be applicable on an annual, quarterly or monthly basis. The customer should bear in mind that an annual cap

could potentially result in a lower overall cap as the pro-rata monthly amount could work out less than any cap set on a monthly basis. However, alternatively, an annual cap effectively allows for the accrual of any pro-rata amount allocated to a particular month, but not claimed.

- If the service credit regime is the customer's sole and exclusive remedy (which, as mentioned, is not advisable) then the customer should seek a high cap.
- The customer needs to ensure that the cap is sufficient enough to ensure that the service credit regime still motivates the service provider to achieve the service levels and recompense the customer for the diminished level of service.



WEIGHTING

A service credit regime may contain a weighting mechanism to apportion a larger credit to the failure of the service provider to achieve service levels for certain key services. Where the customer's business

prerogatives are subject to change, it should ensure that there is a provision in the SLA permitting the customer to reallocate the weightings between the service levels.



WHO DETERMINES THE SEVERITY OF THE SERVICE LEVEL FAILURE?

As the customer is the party at a disadvantage when the service provider has failed to achieve the requisite service levels, it should be the customer who determines the initial degree of severity. To provide comfort to the service provider that the customer does not exaggerate, contractual measures can be put in place to protect its position.

For example, if the impact of the failure subsequently is objectively determined to be lower than the customer initially predicted, the service provider may be able to recover a portion of the service credits paid.



CAN THE SERVICE PROVIDER EARN BACK SERVICE CREDITS GIVEN?

In certain circumstances (e.g. where the service provider insists on being able to remedy the service level failure within a short period after the failure) the SLA may provide that where the service provider remedies any service level failure and the failure does not reoccur within a given period of time, the service provider can "earn" back the service credit given.

If this regime is utilised it is advisable to set up an escrow account for which any service credits given to the customer are paid into and subsequently released to the customer if the failure re-occurs and any service credits earned back by the service provider are given back to it.



WHAT HAPPENS WHERE THE UNDER-PERFORMANCE AFFECTS MORE THAN ONE SERVICE LEVEL?

The service provider will want to ensure that the customer is prohibited from claiming twice where the same root cause affects more than one of the service levels (e.g. where availability and reliability service levels are not achieved because the service provider does not adhere to its 99.9% availability target and as a result,

the reliability of the service provider decreases). In this situation, the service provider may require that the customer chooses the service level failure that gives the greater service credit, and the failure to perform the other service to the adequate standard is effectively ignored.



BONUS PAYMENTS FOR AN IMPROVED SERVICE

The customer should be extremely cautious if it is considering bonus payments which offer the service provider an incentive for performance in excess of the service levels. This is because, the customer's business may not need excess performance in certain areas and thus, the customer is not gaining any benefit, but is effectively paying extra for a service that is not necessary.

Nevertheless, to omit any incentive for the service provider to perform in excess of the service levels could be discouraging and so a happy medium between having to give service credits for under-performance and receiving a service bonus for over-performance could be appropriate. If a customer is able to clearly identify

aspects of the service that it would benefit from receiving an over-performance the customer may wish to utilise bonus payments to incentivise the service provider.

Alternatively, a mechanism by which the service provider can set off any over-performance by any under-performance could be considered. However, the customer should again bear in mind that the under-performing may cause a bigger inconvenience and loss than receiving any service in excess than what is required. This type mechanism might also encourage the service provider to focus on the "achievable" service levels to the detriment of the other service levels.

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