

Service Level Agreements

By Kurt E. Anderson, Esq.

Purpose

With the purchase of almost any service, the buyer is frequently concerned about ensuring the quality of the service. Service Level Agreements (SLAs) are used by buyers to ensure that they receive the quality service the buyer expects (or at least to ensure that the buyer pays less for poorer quality service). Similarly, SLAs are used by sellers to set their customer's expectations with respect to the quality of service as well as to limit the seller's exposure if the seller is unable to provide the highest quality of service.

Types of Things Covered

SLAs can be applied to many different aspects of service. To say that SLAs provide "quality" assurance, is a slight misnomer. In reality, SLAs are used to set service expectations based on "quantitative" measures. For computer/software technology services, the types of items covered by a SLA frequently include the following:

Response Time: The period of time between the reporting of a problem and the service providers first response to its customers.

Resolution Time: The period of time elapsed until a problem is fixed.

Availability/Up-Time: The period of time a service (or software) is up and running. This frequently is measured as a percentage of promised hours of availability.

Response and resolution times are almost universally varied based on the severity of the problem. Severity is typically defined by reference to gradient of severity "levels" where level 1 is the most severe problem. The number of different levels and the definition of the severity at each level vary greatly.

Service providers that do this well, have processes in place to measure statistics about the actual response/resolution times and up times they actually regularly provide to their customers. They then use these statistics to set their SLAs. By keeping such data, service providers can have much greater confidence in their ability to meet their SLA commitments. They also know the limits of their performance ability and, thus, what they can and cannot offer in terms of SLA metrics.

Credit vs. No Credit

SLAs can be established with or without providing financial penalties or credits to the customer if the service provider's performance falls short of expectations. Without penalties or credits, the SLA is nothing more than another contractual promise. If breached, the customer's remedy would be determined by the terms of the contract of which the SLA is typically a part. Such contracts frequently provide for notice and cure period (e.g., 30 days) for breaches of the agreement. Thus, without penalties or credits, if a service provider breaches a SLA to provide a four (4) hour response time, for example, the customer's only recourse may be to provide notice and a cure period measured by days, weeks or months (not hours). This would clearly be an unsatisfactory result for the customer.

In response, service providers can provide financial penalties or credits if the SLA metrics are not met. While penalties can be provided for, they are frequently not used. Generally, most lawyers do not favor penalties since contractual penalty provisions may be legally unenforceable. Credits toward future service are much more common. In these cases, if a SLA metric is not met, then the service provider gives the customer a predefined credit toward future service. On the other hand, if the SLA is exceeded, then the service provider may seek higher service fees. This creates a dynamic whereby the service provider has an economic incentive to provide better service and the customer is assured that it will not have to pay the same amount for poorer performance.

Liquidated Damages

If credits are provided, then it is generally both parties' expectation that the credit will serve as the sole compensation to the customer for the service provider's failure to meet a particular SLA. Otherwise, the customer could receive the credit and also seek damages for breach of contract as well. Such a circumstance could result in a windfall to the customer. Thus, it is important that the SLA expressly provide that such credits are intended as liquidated damages and the customer's sole and exclusive remedy. If this is done, it is equally important for the customer to ensure that each SLA metric has a floor below which failure to perform constitutes a breach. Consider the following example:

Response Time	Incentive to Service Provider	Credit to Customer
0 – 2 hours	10%	N/A
2 – 4 hours	5%	N/A
4 – 6 hours	-0-	-0-
6 – 10 hours	N/A	5%
10 hrs [or more]	N/A	10%

SLA metrics defined in this manner have no “floor”. If the service providers response time is ten (10) days, it faces the same 10% credit it would have to give if its response time were ten (10) hours. From a customers standpoint, this is frequently unacceptable. One way to address this is to expressly provide for a floor below which the service providers failure to perform constitutes a breach. This could allow the service provider to limit its liability for failures to conform to the SLA metric, which are tantamount to failure to perform altogether. In these situations, it is also important to consider including shortened notice and cure period for breach. The failure to respond in twelve (12) hours in the foregoing example, may warrant a twenty-four (24) or forty-eight (48) hour notice and breach cure period in a contract where other breaches allow for a thirty (30) day cure period.

Summary

When structured well, SLAs with service credits can provide a win-win relationship for both the service provider and the customer. The customer gets: 1) the comfort of knowing that the service provider has an economic incentive to perform better; 2) assurance that it will pay less for poorer performance; and 3) the remedy of breach of contract if performance falls below a specific floor. Conversely, the service provider may be provided with the opportunity to earn greater fees for better performance and also provide itself with a cap on its potential liability if it is unable to provide the level of service it originally contemplated.