



KEYNOTES

# Service Level Agreements

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## What is a Service Level Agreement?

A Service Level Agreement (or SLA) is the part of a contract which defines exactly what services a service provider will provide and the required level or standard for those services. The SLA is generally part of an outsourcing or managed services agreement, or can be used in facilities management agreements and other agreements for the provision of services. This article is primarily aimed at customers and provides some simple tips for drafting effective SLAs.

## What should be included in an SLA?

A properly drafted and well thought out SLA should have the following elements:

- It will state the business objectives to be achieved in the provision of the services.
- It will describe in detail the service deliverables.
- It will define the performance standards the customer expects in the provision of the services by the service provider.
- It will provide an ongoing reporting mechanism for measuring the expected performance standards.
- It will provide a remedial mechanism and compensation regime where performance standards are not achieved, whilst incentivising the service provider to maintain a high level of performance.
- It will provide a mechanism for review and change to the service levels over the course of the contract.
- Ultimately it will give the customer the right to terminate the contract where performance standards fall consistently below an acceptable level.

## The main elements of a good SLA

### 1. Overall objectives

The SLA should set out the overall objectives for the services to be provided. For example, if the purpose of having an external provider is to improve performance, save costs or provide access to skills and/or technologies which cannot be provided internally, then the SLA should say so. This will help the customer craft the service levels in order to meet these objectives and should leave the service provider in no doubt as to what is required and why.

### 2. *Description of the Services*

The SLA should include a detailed description of the services. Each individual service should be defined i.e. there should be a description of what the service is, where it is to be provided, to whom it is to be provided and when it is required. For example, if one of the services is the delivery of a specific report, the relevant provision of the SLA should describe the report, state what it should include, state its format (perhaps referring to a specific template), how it is to be delivered (e.g. by email), to whom, when and at what frequency (e.g. to the finance team daily by 10 am each weekday morning).

### 3. Performance Standards

Then, taking each individual service in turn, the customer should state the expected standards of performance. This will vary depending on the service. Using the “reporting” example referred to above, a possible service level could be 99.5%. However this has to be considered carefully. Often a customer will want performance standards at the highest level. Whilst understandable, in practice this might prove to be impossible, unnecessary or very expensive to achieve. On the other hand, the service provider may well argue that service levels should be set deliberately low in order to guarantee that the service can be provided at a competitive price. It is all a matter of judgement and the customer will need to consider each service level carefully – it is often the case that individual services will be weighted differently depending on their business importance. Performance standards for availability of an on-line service are generally high as it is vital for the customer to ensure constant availability of the service. Other individual services may be less important and the service levels for these can be set at a lower level.

The service provider and the customer will also need to set these performance standards in the context of anticipated workloads and the service levels may need to vary in the light of any changes to these workloads during the course of the contract. All this can be built into the SLA so that the cost implications of a change in workload can be factored in.

### 4. Compensation/Service Credits

In order for the SLA to have any “bite”, failure to achieve the service levels needs to have a financial consequence for the service provider. This is most often achieved through the inclusion of a service credit regime. In essence, where the service provider fails to achieve the agreed performance standards, the service provider will pay or credit the customer an agreed amount which should act as an incentive for improved performance. These service credits can be measured in a number of ways. For example, if the 99.5% level for reporting is not achieved, the SLA could include a service credit that a specified reduction in price is given for each 0.5% shortfall in performance in each week. Alternatively, service credits can be given where there are, say, three or more failures to meet a service level in any specified period. Again, each service level needs to be looked at individually and a sensible level of credit agreed between the service provider and the customer for failure to achieve the agreed level over a specified period of time. The important thing is to ensure that the service credits are reasonable and incentivise the service provider to do better, and that they kick in early enough to make a difference.

### 5. Critical Failure

Service credits are useful in getting the service provider to improve its performance, but what happens when service performance falls well below the expected level? If the SLA only included a service credit regime then, unless the service provided was so bad as to constitute a material breach of the contract as a whole, the customer could find itself in the position of having to pay (albeit at a reduced rate) for an unsatisfactory overall performance. The solution is to include a right for the customer to terminate the agreement if service delivery becomes unacceptably bad. So the SLA should include a level of critical service level failure, below which the service provider has this termination right (and the right to sue for damages). For example, if service credits kick in if a service level failure has occurred twice in a particular period, the SLA could state that the customer has the right to terminate the agreement for material breach if the service level has not been achieved, say, eight times in the same period. Again, as with service credits, each service level has to be looked at individually and weighted according to business importance. With an on-line service, availability of that service is crucial so you might expect the right to terminate to arise earlier than for a failure to

provide routine reports on time. In addition, the SLA could group certain service levels together for the purpose of calculating service credits and the right to terminate for critical failure; SLAs sometimes include aggregate point scoring systems for these purposes.

### Other SLA provisions

Whilst service levels, service credits and the right to terminate are the main provisions in a Service Level Agreement, depending on the structure of the entire agreement, an SLA can include other matters, such as the following:

#### 1. Changes to pricing

Pricing may need to vary depending on a number of factors and the SLA may therefore include a pricing review mechanism or provisions dealing with the sharing of cost savings.

#### 2. Contract Management

In longer term contracts, the parties will need to keep performance of the services under review. Provisions dealing with reporting, meetings, information provision and escalation procedures for disputes are sometimes included in the SLA rather than in the main body of the agreement. Unfortunately these types of provisions are often overlooked, but for a contract for services to be successful, it is vital that contract management procedures are agreed and are actually followed.

#### 3. Change Control

Often the SLA will include a change control procedure, which sets out a mechanism for agreeing and recording changes to the agreement or to the services to be provided. In an agreement of any length or complexity, it is inevitable that changes will be made to the services (which will have a knock on effect on the service levels) and an agreed and properly implemented change control procedure is vital.

### Common mistakes

Unfortunately many Service Level Agreements leave a lot to be desired and do not actually provide the protection the customer requires. Here are some of the more common mistakes:

- Don't let the service provider draft the service level agreement. It is vital for customers to go through the process of deciding what services need to be provided, how they are to be provided, when, where and to whom.
- Do not allow the service level agreement to become a marketing document. This can happen when the service provider prepares the SLA. In such a situation the first draft SLA contains large chunks of material taken from marketing documents which do little more than provide a high level overview of the services without any detail. These statements are often not measurable and therefore difficult to enforce. Subjectivity should be kept to a minimum.
- Do not leave preparation of the Service Level Agreement until the last minute. The SLA should take priority and should be worked up at the start of the process. A last minute introduction of a strict SLA might lead your service provider to revise their pricing upwards.

- Do not aim for absolute perfection. Instead, prioritise which service levels are most important. When drafting, do not expect an unrealistically high level of service performance as this may (a) not be necessary and (b) lead to an increase in the price. There must be enough in the contract for the service provider otherwise the relationship will not work from the outset. Remember that the best outcome is a long lasting and mutually beneficial relationship with the service provider.
- Don't overdo it! Remember that someone from the customer side needs to monitor service levels and compliance by the service provider. If you include too many detailed service levels which you cannot effectively monitor (due to a lack of people/expertise etc.) then the efficacy of the SLA is reduced.
- Don't have service levels without a compensation regime of some sort. Include service credits: there must be an incentive for the service provider to do better.
- Don't have overly long service level measurement periods. Contracts where performance is measured over a number of months before any right to service credits arises, may lead to the customer having to put up with sub-standard performance for a long period of time without any right to a remedy under the agreement.
- Take care if you want to base service levels with an external service provider on non-binding internal service levels. Sometimes organisations have their own internal service levels which are not legally enforceable but are used as a guideline for the expected level of service to be provided by one part of an organisation to another (e.g. the IT or HR function). Don't be tempted just to apply these to an external service provider without consideration, particularly, of the business objectives for the services.
- Don't lose sight of your objectives. Ensure the service levels reflect the overall objectives for the contract. If the overwhelming business objective is to save money, ensure that the service levels are focussed on achieving this.
- Always include a right to terminate for critical failure and define carefully what "critical failure" actually means. You might not want to use this right, but if service performance is poor, you will be glad that you have it in the contract.

## Conclusion

Putting together an SLA can be a difficult process – as it often involves documenting processes which have previously arisen organically within an organisation. But if you keep your business objectives in mind and follow the tips in this article, any SLA you do produce should enhance the business relationship with your service provider and help you receive the service you expect.



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