Service Level Agreements – are they worth it?

Key Points

SLAs are a frequent feature of supply contracts such as outsourcing, ICT, etc. They are often closely negotiated. Yet, while many customers see them as a valuable commitment to have, they usually end up being a great way for suppliers to **limit** rather than **expand** responsibility and liability. All that effort by customers to get an SLA, only to be worse off? The flip side is that suppliers can be better off.

Plus SLA regimes can have some nifty get-out-of-jail-frees for suppliers, as our Stuart van Rij outlined in his CIO article, *Service-level blunders*.[1]

SLAs do have an important function in helping control one of the major problems with ICT contracts: scope creep and uncertainty around the extent and nature of obligations. Well drafted, they can more clearly define scope and what it is that the supplier must do, and that it is not required to do (unless otherwise agreed by way of change control, etc).

About the only usable thing most SLAs do for customers – before looking at the bigger picture as we note below - is to establish benchmarks which the supplier must be seen to meet (and if they don't, there's some formal recognition of this). Maybe, for example, the service delivery manager looks bad to his or her seniors in management reports, confirming SLA breaches.

One client has made the point that, given this, one of the most important things in a contract is the ability to escalate to the supplier's senior management if there's a problem: that is more powerful than thin SLA payments or rebates.

Of course, if they choose to, and have the bargaining position, there is much that customers can do to better their SLA rights.

But the bigger picture is important: if the liability and SLA do not carefully control scope and liability, the supplier may have to bullet-proof the service, thereby adding cost. Many customers would take the risk in exchange for lower prices.

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We wrote comprehensively about this issue in 2004, and little has changed since then: what we said then still applies today. See *Service level agreements: Are they worth the paper they are written on?*[2] In hundreds of SLAs we've reviewed, we've never seen one that provides for a payment or a rebate that is beyond the largely irrelevant, well short of real losses incurred by a customer due to the breach. And, when we act for customers on disputes, the SLA is almost always irrelevant to recovery of losses. For suppliers they can help provide protection from claims in two ways in particular:

- Keeping the dollar exposure down;
- Reducing scope creep and additional and inappropriate obligations (and uncertainties) as to what the supplier must provide.

Many SLAs state that the rebate or payment is the sole remedy for breach of the service level. But, even if they don't, a well-drafted limitation of liability eliminates or substantially reduces relevant claims for losses.

Such limitations are not necessarily bad things: for example, if a supplier had extensive potential liability, it may be forced to gold-plate its service to reduce risk. Likewise if there is uncertainty on the scope and responsibilities upon the supplier. That pushes up the price. Given the choice, many customers would pay less and take more risk. Some of that risk can be insured.

In theory that makes sense, including from an economics perspective, although the thinking gets a little wobbly when a supplier (such as a monopoly) has the ability to force terms on customers.

Even if the metric triggering breach is favourable to the customer, the payment is usually low, as noted above. But suppliers' SLAs can be crafted in such a way that they rarely kick in, are difficult to prove, etc. We've seen many of these even in SLAs said to be carefully negotiated by the customer: The pitfalls for customers (or winning positions for suppliers) are overviewed in Stuart's article noted above.

For this sort of reason, where a multinational wouldn't budge on its commitments, one of our publically listed clients in a large supply contract emphasised that they wanted a clear escalation path written into the agreement, so that the customer could quickly get the ear of the supplier's senior management. That would lead to strong outcomes in the real world.

And that highlights that the best path to getting great outcomes is not always the path down the middle. This client had another great insight. Ensuring that the supplier had an outstanding project director (matched by an outstanding person on the customer side) was the most important thing. That turned out to be right. And that brought 50 pages of contract down to 12 on a $15M deal critical to the customer.

They focussed on the right thing in the circumstances. That's what matters.

1. http://www.wigleylaw.com/assets/pdfs/2007-(2)/service-level-blunders.pdf

2. http://www.wigleylaw.com/assets/pdfs/2004/ServiceLevelAgreements.pdf

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