Service Level Agreements:

Are they worth the paper they are written on?

Michael Wigley

SLAs are often part of commercial agreements with telecommunication providers. Customers frequently see these as useful additions to a provider's commitments. They are also used of course for computer services such as support and outsourcing. But many that we see are badly drafted. They don't meet the needs of the provider, the customer, or both. SLAs are hard to write well yet they can provide good commercial outcomes. There are ways to better achieve desired results.

Limiting Liability: an important background to SLAs

Telco vendors can't promise 100% performance. And they must limit their liability. Even the most robust telecommunications service is not 100%. No customer would want to pay the big cost of taking a service that is at or very near 100% availability. So there has to be some risk for the customer (although with mission critical services this of course is reduced using redundant circuits and so on).

A typical example of how a telco frames its responsibility is in the leading New Zealand legal case on telecommunication SLAs (*Pronet v. Clear*). Clear contracted that it would *"… use all reasonable efforts to provide a high quality reliable service to the Customer…. but does not guarantee that … Services will be continuous or fault free."*

A prudent vendor will also limit its liability (for example, by excluding claims such as for lost profit and by capping its liability at a specified figure).

Is it right that providers should be able to heavily limit their liability?

Yes, and I suggest it is ultimately in the interests of both the supplier and purchaser to do so. However, that's not to say that it is always fairly implemented. There can be an imbalance. A limitation of liability clause is a way of allocating risk. Without it, a supplier may have to goldplate its service to avoid exposure to risk. So the cost of the service is likely to go up. Many customers, when faced with the choice, would prefer instead to take on additional $ risk in the event of a breach, and reduce the service purchase price.

Our courts accept that limitation of liability clauses aren't necessarily one-sided and inherently bad. They can reflect the allocation of economic responsibility. And, after all, many of the telco's customers also limit liability with their own customers.

SLAs are a useful solution

Limitation of liability provisions typically lead to vendors having relatively low exposure in respect of their services. Customers however often want greater reassurance that robust services will be provided. They will want to focus on particular key metrics such as the percentage availability of the service, and so on. SLAs present a useful solution. They're often associated with a rebate, taken off the next invoice if a service level metric is not met.

Usually the monetary remedy is limited to less than the monthly charges paid to the vendor (and often much less). This remedy is almost always for much less than the customer's true loss. The key thing for the customer is that the vendor is making a commitment. It has some "skin in the game". The $ penalty might be relatively low but it's not a good look for vendors to miss service level metrics. Repeated failure might also lead to the right to terminate the agreement.

Ironically, carefully framed service levels with rebates are another way of restricting potential vendor liability yet providing some commitment to the customer. The vendor achieves an important outcome (reducing $ exposure), and the customer has a firm commitment from the vendor, based on metrics.

In our experience a common failure for vendors is to make at or close to 100% commitment on a particular service level. This can happen either in the agreement or, more likely, in the proposal or other marketing material leading up to the deal. This can lead to unexpected liability (and possibly completely unlimited liability under our Fair Trading Act). This is a real risk area for vendors, when their sales people are trying hard to push the quality and reliability of the service without thinking too much about the detail.

The careful approach is to recognise that the service will not always be perfect, customers know this, and so frame the service levels appropriately. There are a number of ways of doing this. Some of the longer SLAs go into a lot of technical and legal detail. We think this can often be done in simpler language.

Some things to consider:

* Choice of words is important. For example, in the *Clear v. Pronet* case, Clear made a commitment of 99.8% internet service *availability*. Clear argued that 99.8% *availability* was breached only when the service was unavailable outright. The judge quickly concluded that reduced performance was enough for there to be "unavailability" for this purpose. Packet loss, slow service and increased error rate meant the service was "unavailable" even though traffic could get through.
* Use mechanisms which allow for the times when the service level won't be met (eg "95% of helpdesk calls will be answered within 2 minutes").
* The vendor should have a high level of reassurance that the commitment it makes will be met. Our experience is that often the commitment is made without that level of assurance. An example from software support agreements illustrates the point. We commonly see agreements that promise that mission critical outages in the software will be fixed within say 4 hours. However, it's not possible to promise certainty in this area, as the software could take considerably longer to fix. It's prudent to soften this (yet still have a firm commitment) such as by using words like "target" or saying that the problem will be fixed in a specified percentage of cases within that time.
* Measurability of the metric is a problem, particularly for customers. While new technology increasingly allows monitoring, that is not always the case. There is not much point in having a metric if it can't be measured.
* Vendors should push for metrics based on functional deliverables (eg: the technology will do X).Customers will ideally want (but won't usually get) metrics revolving around business outcomes.
* There should be clarity about excluding – from any availability period – items such as planned outages and *force majeure* events.
* Consider carefully how the rebate links with the breach of the metric.
* One option is for an agreement that also allows for the opposite (eg: extra payment to the vendor where an SLA is exceeded).

Overall however, there's the practical reality. It's rare for rebates to actually be paid out for poor performance. Often the failures aren't being, or can't be, monitored. Often, the dollars involved mean it is not really worth pushing a rebate claim too hard.

This in practical terms means that SLAs are frequently more about moral and commercial pressure than anything else. If customers want to apply direct dollar pressure, they need to seek to increase the amounts of the rebates (or extra sums payable for breach). But that won't always be easy in negotiations. Often, focus is better placed elsewhere.

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