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Negotiating Service Level Agreements (SLAs)

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Agenda

- Introduction to SLAs
- Frequently Addressed SLA Obligations
- Risk Allocation Issues
  - Limitations of Liability; Indemnity and Warranty Issues

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Introduction to Service Level Agreements

What is a Service Level Agreement (SLA)?

An SLA is a set of contractual agreements between a provider and a customer that specifies (often in measurable terms) the services that the provider will furnish to the customer.

SLAs are often an exhibit to a larger service or software license agreement rather than a stand alone agreement.

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Some Benefits of SLAs

- Sets expectations between provider and customer
  - An SLA may provide an objective basis for determining whether the service is deficient.
- May establish remedies for service failures such as procedures and service credits

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High Level Elements of An SLA

SLAs may have two different components:

- A Service Component – identifies the services that are going to be provided.
- A Management Component – identifies the process for managing the delivery of the services or for changing the services.

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Common SLA Service Components

- Identifies the services that are provided
- May clarify the services that are *not* provided
- Identifies assumptions underlying service availability
- Establishes service standards (e.g., the timeframes in which services will be provided)
- Defines the responsibilities of both parties

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Common SLA Management Components

- Establishes how service effectiveness will be tracked
- Identifies procedures for reporting service issues
- Identifies procedures for resolving service issues
- May identify procedures for revising services or service metrics

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Common Topics Addressed in SLAs

- Scope of Services
- Hours of support (basic vs. extended hours)
- Error reporting mechanisms
- Resolution efforts and time frames
  - Escalation
  - Metrics
- Credits
- Reporting and Management

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Frequently Addressed SLA and Maintenance and Support Obligations

Description of Services

- Common Rule of Thumb: A more detailed description of services is typically better than a description with less detail.
  - It reduces arguments about whether a failure has occurred.
- Description should be customized for the actual services being provided.

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Common Service Exclusions

- Physical installation or removal of software on Customer's equipment;
- Visits to Customer's site;
- Any electrical, mechanical or other work with hardware, accessories or other devices associated with Customer's use of the Service;
- Any work with any third party equipment, software or services;
- Any professional services associated with the Service, including, without limitation, any custom development, data modeling, training and knowledge transfer; or
- The set-up, configuration and use of the Service.

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Transition Obligations at Start-up

- For more complex arrangements, the SLA may contain an exhibit that details the obligations of the parties in connection with transitioning the customer from its existing service provider.

- Such arrangements need to address how the new provider will work with the existing provider.

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Service Metrics - 1

- How are service metrics defined?
  - Does entire service have to be unavailable or only particular portions?
- How are service metrics reported?
  - Does the customer need to have access to Provider tools to understand or obtain metrics?
  - Does the customer need to complain to get the credit?
- Is there a process for strengthening service metrics over time?
- Are service credits the sole and exclusive remedy arising from a performance breach?

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Service Metrics - 2

- Multiple service metrics can be measured, not just service uptime. For example:
  - time between reporting a problem and acknowledging the report (response time)
  - incidents resolved in time (resolution time)
  - data bandwidth and latency issues
  - timeliness of reports
  - reporting and meetings

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Example of “Uptime” Definition

- **“Uptime Percentage”** means the total number of minutes of Scheduled Available Time for a calendar month minus the number of minutes of Downtime suffered in such calendar month divided by the total number of minutes of Scheduled Available Time in such calendar month.
- **“Scheduled Available Time”** means [24 hours a day, 7 days a week].

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Example of “Downtime” Definition

- “**Downtime”** means any period, [greater than ten minutes], within the Scheduled Available Time during which the Customer in unable to access or use the Service because of an Error, excluding any such period that occurs during any Scheduled Downtime.
- “**Scheduled Downtime”** means: (i) ___ hours per [day][week][month] from _____ to _____ [Day/time zone]; and, (ii) the time period identified by Provider in which it intends to perform any planned upgrades and/or maintenance on the Service or related systems and any overrun beyond the planned completion time.
  - Is notice needed prior to scheduled downtime?

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Exemplary Definitions of “Error”

- More Provider Friendly: “**Error(s)**” means the material failure of the Service to conform to the material specifications.
- More Customer Friendly: “**Error(s)**” means any event occurring within or caused by a component of the Service that causes or is likely to cause a disruption to the Service or any part of the Customer’s operations (including services provided to Customers).

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Common Error Exclusions

- Unauthorized modification of the Service
- Third party hardware or software issues
- Improper operation by customer
- Services, circumstances or events beyond the reasonable control of the Service Provider
- Any issue if a customer has outstanding past due amounts

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Common Software Upgrade Issues

- With respect to software, consider whether the customer is required to upgrade software to current version (or a recent version) to get support.
  - Customers may ask that versions will continue to be supported for a certain period of time following release.

- If the Provider needs to deliver a new major version that contains new functionality to fix an error, does the customer need to pay for the new version?

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What is the process for reporting and fixing errors?

- How is a problem reported?
  - E-mail? Website? Telephone call?
  - Time limitation on reporting the issue or requesting credits?
- What information is submitted?
  - Description of incident?
  - Requested severity level?
- What is the process for determining that a problem has been fixed?
  - When the customer or provider says it is fixed?
- When does the clock start and stop?

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Sample Error Severity Categorizations for Services

- **Priority 1** (Urgent) - Used to describe an Error in which the Service is unavailable.
- **Priority 2** (High) - Used to describe Errors that have a significant impact on the ability to use the Service but does not impair mission-critical business functions.
- **Priority 3** (Normal) - Used to describe Errors with the performance of the Service that are restricted to a single user or do not significantly impact the ability to use the Service.
- **Priority 4** (Low) - Used to describe future feature requests.

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Common Customer Obligations when an Error has Occurred

- Validate and attempt to recreate the issue.
- Report the problem.
- Provide additional analysis and reasonably cooperate with provider to resolve the issue.

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Resolution Times -1

Priority Level	Target resolution Time
Level 1 – Major	Within 48 hrs of acknowledgement
Level 2 – Significant	Within 5 Business Days of acknowledgement
Level 3 – Restricted	Within 20 Business Days of acknowledgement
Level 4 – No Impact	Will be determined by action plan

Consider whether the resolution times are aspirational goals or firm contractual commitments.

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Sample Credit Calculations - 1

Uptime Credit Mechanism (Availability Example)

Availability Percentage (during a Contracted Month)	Compensation (% of monthly subscription fee* for contracted month that is the subject of a claim)
98.0% - 99.2%	5%
97%-97.999%	7.50%
96%-96.999%	10.00%
95%-95.999%	12.50%
94%-94.999%	15.00%
93%-93.999%	17.50%
Less than 93%	20%

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Sample Support Scorecard

Priority 1 (High)	
Targeted Initial Response Time	within one (1) hour of the receipt of an Incident Report
Targeted Repair period	[X] hours from the time of Acknowledgment.

- Note use of the word “Targeted”
- Issue: Does a workaround constitute a valid repair?

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Sample Credit Calculations - 2

Mechanism Involving Multiple Factors

Number of Key Performance Metrics (KPIs) breached in applicable reporting period	Service Credit percentage of the monthly Support Service Fee
Breach of one (1) KPI	4 %
Breach of two (2) KPI	8 %
Breach of three (3) KPI	16 %
Breach of four (4) KPI	32 %
Breach of five (5) KPI	64 %

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Common Customer Requirements that Must be Fulfilled to Obtain a Credit

- Report the problem in a timely manner.
- Cooperate with provider in resolving the issue.
- Request a credit in a timely manner.

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Management Escalation Procedures

- What events trigger an escalation process?
  - Late response?
  - Disagreement about severity level?
- What is the timing of the escalation process?
- Who is involved in the escalation process?

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Reporting Procedures

- What reports does the provider supply?
  - Usage Statistics?
  - Errors?
  - Downtime?
  - Resolution?
  - Root Cause Analysis?

- When are the reports supplied??

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Service/Software - Evolution

What is the process for changing the platform, operating system or application?

- Can the customer refuse or delay a change? (unlikely for services)
- How much notification needs to be given for service changes?
  - Different notice periods for routine vs. emergency changes?
- Will a test environment be provided prior to implementing a service change?
- How does pricing work?
- Are the number of service changes in a given time (e.g., 6 month period) limited?

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Operations Meetings

- How often are the parties obligated to have operational meetings?
- Are the meetings in-person or telephone?
- Who needs to attend the meetings?
- Are official minutes kept?
- Dispute resolution procedures?

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Service Suspension

Contract may allow the provider to suspend services.

From a contract perspective, the customer should make sure that such right may only be exercised in well-defined situations, preferably with advanced notice.

- Provider will try to reserve the right to immediately suspend in egregious situations.

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Underlying Hosted Service/Co-Location Issues -1

Can the provider use an underlying hosted service or co-location center and still comply with its customer's SLA obligations?

- Consider:
  - Response times
  - Reporting obligations
  - Subcontracting and assignment provisions

Does the provider have sufficient recourse against the data Center?

- Will the provider pay the customer more credits than it will receive? (not an atypical situation)

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Underlying Hosted Service/Co-Location Issues -2

Does the service provider:

- have a business continuity plan?
- provide redundant operations from different sites?
- routinely test its back-up capability?
- routinely attempt to restore data?

It is important to consider the impact of bankruptcy on the ability to access data and the ownership of back-up media.

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Escrow Issues -1

- U.S. Bankruptcy Law 365(n) provides protection to licensees.
  - If licensor goes bankrupt, licensee can continue using rights.
- Many foreign bankruptcy laws do not provide similar protection.
- Escrow Issue: U.S. Bankruptcy Law likely prohibits exercise of springing license grant.

Therefore a “present license” is needed to use escrow materials.

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Escrow Issues -2

- Some types of contracts may be appropriate for escrow (typically software rather than cloud).
  - Software escrows may have little value in many cloud service arrangements because the customer may not have the equipment/data center infrastructure to actually utilize the escrow.
  - Service Escrows: Situation may be different if service is an “app” running on a commercial third party platform.
- Data Escrows - Data stored with a third party that can be accessed separately by customer.
- Terms (e.g., release conditions, scope of use, etc.) can be negotiated - See next slide

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Escrow Issues -3

- Who pays the costs and is it worth it?
- What is escrowed? Improvements? Verification?
- What are the release conditions?
- What is the timing and release process?

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Sample Customer Favorable Escrow Release Conditions

- Provider stops providing maintenance or support for the Software.
- Provider materially breaches this Agreement.
- Provider becomes subject to bankruptcy proceeding or insolvency or enters into any arrangement with its creditors.
- Provider is subject to a change of control.
- Provider permanently ceases operation of its business.
- Others? Fails to add competitive functionality?

Provider will want attempt to limit these release conditions.

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Sample Cloud Services Escrow Provision -1

Provider will at Customer's request: (a) cooperate with Customer to appoint an escrow agent designated by Customer to hold a copy of all of the source code for the software used to provide the Services ("**Source Code**") along with all annotated source code listings, flow charts, decision tables, schematics, drawings, specifications, documentation, design details and other related documents reasonably necessary to understand the design, structure and implementation of the Source Code and to maintain, support and build the object code of the software used to provide the Services such that a third party programmer reasonably skilled in the languages used in such materials could maintain and support such software without further assistance or reference to other materials, and all maintenance releases or updates thereto (collectively, "**Escrow Materials**"); and, (b) within thirty (30) days following such request, execute a source code escrow agreement with such escrow agent in a form mutually approved by the parties ("**Escrow Agreement**") that releases the Escrow Materials upon a Release Condition.

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Sample Cloud Services Escrow Provision -1

Within five (5) days following the execution of the Escrow Agreement, Provider will deliver the Escrow Materials to such escrow agent.

Provider hereby grants to Customer a non-exclusive, non-transferable, non-assignable license to use and copy for internal business purposes, distribute to agents or contractors providing services to Customer or its Affiliates, and modify any Escrow Materials released to Customer to continue to use and maintain the software used to provide the Services in the manner provided by Provider to Customer and/or its Affiliates under the Agreement.

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Disaster Recovery - 1

Typical customer questions about the service provider

Does the provider:

- have a business continuity plan?
- provide redundant operations from different sites?
- routinely test its back-up capability?
- routinely attempt to restore data?
- What events cause the service provider to engage in data recovery operations?

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Disaster Recovery - 2

- What events cause the Provider to engage in data recovery operations?
- Does the contract contain data recovery goals?
- What are the consequences if the data is not recovered within the specified time frames?
- Who takes priority if multiple customers of the service provider are affected?
- How will a force majeure event impact contractual obligations? (see slides below)

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Customer Favorable Obligations concerning Disaster Recovery Plans

Vendor will maintain during the Term, a Business Continuity Management Program that includes all aspects of Business Continuity Planning and Disaster Recovery Planning. The Business Continuity Management Program and the resulting Business Continuity Plan will cover all the Services to be performed under this Agreement. Vendor will provide Customer with the opportunity to review and evaluate the Business Continuity Management Program, including the Business Continuity Plan and will remediate any findings. Such review and evaluation may include participation in Customer's; (a) vendor testing and assessment process including the completion of online and/or on-site assessment(s), as appropriate; and (b) recovery testing of a mutually agreed upon scope and frequency. Vendor will conduct at least annual internal information security audits of its Business Continuity Plan and certify the results of each such audit to Customer within ten (10) days of completing each such audit.

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Disaster Response

In the event of a disaster or any other disruption event that prevents or impairs Vendor from performing the Services, Vendor will notify Customer and immediately implement its Business Continuity Plan to restore and continue providing the Services to meet the Recovery Objectives. Upon cessation of the disaster or disruption event, Vendor will as soon as reasonably practicable, provide Customer with an incident report detailing the reason for the disaster or disruption and all actions taken by Vendor to resolve the disaster or disruption.

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“Force Majeure” Events

- Parties can bargain for effects of “FME.”
- Consider scope and wording (what is/is not considered FME).
- What form of relief is granted (excused from performance, suspension of performance, termination, etc.)?
- What are the disaster recovery obligations during an FME?
- Are some customers contractually prioritized?

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Sample Force Majeure Clause

Except as expressly set forth in Section [X], neither Party will be liable for, or be considered to be in breach of or default under this Agreement on account of, any delay or failure to perform as required by this Agreement as a result of any cause or condition beyond such party's reasonable control, provided that the Party affected by such delay is using reasonable commercial efforts to mitigate or eliminate the cause of such delay or its effects and, if events in the nature of the force majeure event were foreseeable, used commercially reasonable efforts prior to its occurrence to anticipate and avoid its occurrence or effect. In the event of any such occurrence, the affected Party will promptly notify the other in writing.

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Security Obligations

Are security obligations contained in an SLA?

Are physical and logical security procedures required?

How is security verified?

- Note that a customer audit may not be permitted under law or under other provider contracts.

Is a separate Data Protection Agreement needed?

- Often used when handling EU data.

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Termination Right for failing to meet SLA

- What severity levels count towards termination? (Severity 1, Severity 2?)
- How many issues need to occur in what period of time?
  - 2 in 6 months, 12 months?
- Is there a right to terminate if issue lasts beyond a certain amount of time?
  - Severity 1 isn't resolved within 24 hours?
  - Severity 2 isn't resolved in 48 hours?

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Termination and Transition - 1

- Every contract will end at some time.
  - It is important to plan for termination issues prior to contract execution.
- Customer will want the agreement to address:
  - Transition assistance
    - Data migration
      - Format of data?
      - It may not be easy to copy or download the data.
  - Continued provision of services until transition completed.
- Provider will want payment for early termination and for any post-termination services.

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Termination and Transition - 2

- Beware of termination obligation that includes an agreement to agree.
- Example termination obligations:
  - Continue to provide services during the transition
  - Assist with transition
    - Deliver data
    - Delivery ancillary information
  - Securely destroy records

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Sample Customer Favorable Transition Services Obligation

If this Agreement expires or is terminated for any reason, then Customer may extend the Term of this Agreement for up to an additional twelve (12) months, at Customer's request and option, from the termination or expiration date ("**Transition Period**"). During any such Transition Period, Provider will: (a) continue to provide the applicable Services; (b) provide the additional transition services reasonably requested by Customer; (c) coordinate communications to provide for an orderly transition of the Services to Customer or another service provider designated by Customer; and, (d) work with Customer promptly and in good faith to provide for an optimal and orderly transfer or such Services, including, but not limited to assistance in transferring services, equipment, licenses, all record layouts, data, data definitions and file structures (with definitions), data files in a format reasonably requested by Customer, and any and all other information, resources and materials used to perform the Services to the extent necessary for a conversion from the Services to Customer or to any new service provider selected by Customer.

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Risk Allocation Issues

Risk Allocation

- Typically, the customer wants to impose a combination of the following obligations on the provider:
  - Operating procedures (cloud) / obligations
  - Warranties/Covenants
  - Indemnities
  - Audit
  - Insurance
- Typically, the provider wants to minimize obligations (especially any obligation that slows its ability to make changes or causes “out of process” deviations) and impose other limitations on its liability

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Operating Procedures

- Customer will want to try to memorialize diligence results (including vendor procedures)
- DPA obligations
- Back-up and recovery procedures
- Compliance procedures
- Audit procedures

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Warranties / Covenants

- If a Provider provides warranties, they are often “soft”:
  - Compare: “Provider will have a security policy” vs. “provider will have and comply with its security policy”
  - Compare: “Provider will prevent unauthorized access” vs. “ Provider has reasonable security measures in place that are designed to prevent unauthorized access”

Providers may push to provide a capped indemnity obligation rather than a warranty to avoid termination issues for breach

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Indemnification - 1

- Indemnities
  - Like warranties, providers typically provide very limited, if any, indemnification obligations.
  - Providers will vigorously push back on typical liability caps (damage cap and consequential damages cap).

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Indemnification - 2

- Traditional exemplary indemnity clause

Provider will indemnify, defend and hold Customer, its affiliates and their principals, agents and personnel harmless against all costs, fees, expenses, damages and liabilities (including attorneys' fees and other defense costs) suffered, incurred or awarded against Customer as a result of any third party claim, suit or dispute relating to or arising from:

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Indemnification - 3

- Defend and Pay Awarded Damages

Provider will defend Customer against any third party claim, action, proceeding or suit, and will pay for the resulting costs and damages finally awarded against Customer to such third party by a court of competent jurisdiction or agreed to in settlement by Vendor, arising from:

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Indemnification - 4

- IP Indemnity - Providers will typically:
  - Defend and pay finally awarded judgment
  - Want to exclude effects of combinations used by or activities of the customer
    - Observation: The customer creates a combination in most cloud arrangements
    - Potential compromise: Provider indemnifies for a combination, unless a reasonable non-infringing combination was available
  - Want to exclude certain customer data issues

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Limitation of Liability

Three Categories of Damages:

- Direct (basic measure of damages)
  - Difference between contract price and market price at time of breach
- Incidental damages
  - Costs directly associated with obtaining replacement goods (seller's breach) or selling goods (buyer's breach) may also be recovered
- Consequential damages
  - Usually lost profits / damage to reputation, etc.

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Damage exclusion clauses can backfire

Piper Jaffrey & Co. v. SunGard Systems International, Inc., No. 04-2922, 2007 U.S. Dist. LEXIS 11399 (D. Minn. Feb. 16, 2007).

- Consequential damage exclusion clause in software license limited the software owner's copyright infringement claims arising from the customer's unlicensed use of the software following termination of the license agreement.
- Court rejected the argument that the copyright infringement claim arose outside of the agreement and was therefore not limited by the consequential damage exclusion clause contained in the license agreement.
- Court held that since the software company was seeking indirect damages based upon the customer's unlicensed use of the software, such damage claims were barred by the agreement's prohibition on consequential damages.

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Claims that commonly give rise to consequential damages

- Infringement
- Breach of Confidentiality
- Data Security Breach
- Claims that may impact reputation (product liability etc.)

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Common Limitation of Liability Clauses to Consider

- Caps on the “type” of damages
  - Direct vs. Consequential vs. Incidental
- Caps on the “amount” of damages
  - Different categories of damages may require different amounts.
- Caps on remedies
- Exceptions to one or both of the caps?
  - See preceding slide

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Exemplary Pro Vendor Liability Cap

TO THE GREATEST EXTENT PERMITTED BY APPLICABLE LAW, EVEN IF SUCH DAMAGES COULD HAVE BEEN FORESEEN OR IF VENDOR HAS BEEN APPRAISED OF THE POSSIBILITY OF SUCH DAMAGES, AND REGARDLESS OF WHETHER SUCH DAMAGES ARE ARISING IN CONTRACT (INCLUDING ARISING UNDER THIS AGREEMENT OR THE BUSINESS ASSOCIATE AGREEMENT), TORT, NEGLIGENCE, STRICT LIABILITY, BREACH OF ANY STATUTORY DUTY OR OTHERWISE, IN NO EVENT WILL: (A) VENDOR BE LIABLE FOR DAMAGES FOR LOSS OF PROFIT OR REVENUE, DATA THAT IS LOST OR CORRUPTED, LOSS OF GOODWILL, OR ANY SPECIAL, INCIDENTAL, INDIRECT, PUNITIVE OR CONSEQUENTIAL DAMAGES; AND, (B) VENDOR'S TOTAL AND CUMULATIVE LIABILITY, FOR ALL CLAIMS OF ANY NATURE ARISING OUT OF THIS AGREEMENT EXCEED THE TOTAL FEES PAID OR PAYABLE BY CLIENT TO VENDOR IN THE TWELVE (12) MONTHS IMMEDIATELY PROCEEDING THE OCCURRENCE OF THE FIRST EVENT GIVING RISE TO A CLAIM UNDER THIS AGREEMENT.

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Exemplary Vendor Liability Cap (sample edits)

TO THE GREATEST EXTENT PERMITTED BY APPLICABLE LAW, EVEN IF SUCH DAMAGES COULD HAVE BEEN FORESEEN OR IF VENDOR HAS BEEN APPRAISED OF THE POSSIBILITY OF SUCH DAMAGES, AND REGARDLESS OF WHETHER SUCH DAMAGES ARE ARISING IN CONTRACT (INCLUDING ARISING UNDER THIS AGREEMENT OR THE BUSINESS ASSOCIATE AGREEMENT), TORT, NEGLIGENCE, STRICT LIABILITY, BREACH OF ANY STATUTORY DUTY OR OTHERWISE, WITH THE EXPRESS EXCEPTION OF VENDOR'S INDEMNIFICATION OBLIGATIONS UNDER SECTION [X], DEATH, BODILY INJURY, PROPERTY DAMAGE, FRAUDULENT MISREPRESENTATIONS, BREACH OF CONFIDENTIALITY OR DATA OBLIGATIONS UNDER SECTION [Y], USE OF CUSTOMER'S DATA OR INTELLECTUAL PROPERTY IN VIOLATION OF THIS AGREEMENT, VENDOR'S GROSS NEGLIGENCE OR WILLFUL MISCONDUCT, IN NO EVENT WILL: (A) VENDOR BE LIABLE FOR ~~DAMAGES FOR LOSS OF PROFIT OR REVENUE, DATA THAT IS LOST OR CORRUPTED, LOSS OF GOODWILL, OR~~ ANY SPECIAL, INCIDENTAL, INDIRECT, PUNITIVE OR CONSEQUENTIAL DAMAGES; AND, (B) VENDOR'S ~~TOTAL AND CUMULATIVE~~ LIABILITY, FOR ~~ALL~~ CLAIMS OF ANY NATURE ARISING OUT OF THIS AGREEMENT EXCEED THE GREATER OF FIVE (5) TIMES THE TOTAL FEES PAID OR PAYABLE BY CLIENT TO DCI IN THE TWELVE (12) MONTHS IMMEDIATELY PROCEEDING THE OCCURRENCE OF ~~THE FIRST EVENT GIVING RISE TO A~~ SUCH CLAIM UNDER THIS AGREEMENT OR $2,500,000.

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Insurance

- Contract may require a party to carry certain levels of insurance.
- CGL policy may not be enough to cover many cyber liability issues.
- Cyber liability policy may have lower limits for certain categories of damages (e.g., breach notification, credit reporting services).
- Requires consultation with broker/agent.

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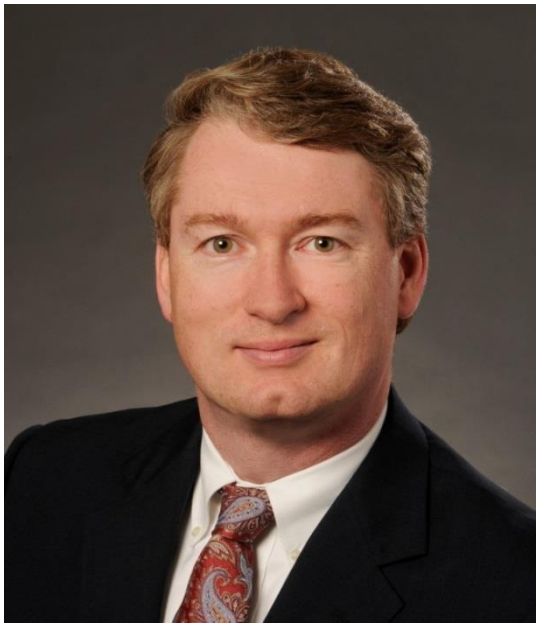
Thanks!



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