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Mastering Service Levels in the Digital Age

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Technology Transactions Practice

- More than 50 lawyers around the world are focused on helping clients develop and manage relationships with suppliers of critical services and technology

- Experience in 400 critical services that are sourcing deals with a total contract value exceeding $200 billion, including data, digital, outsourcing and software

DATA RIGHTS, USE, PRIVACY AND PROTECTIONS

DIGITAL SERVICES

OUTSOURCING

SOFTWARE DEVELOPMENT, LICENSING AND INTEGRATION

Market Recognition

"Band 1" ranking in IT/Outsourcing for 15 consecutive years
~ *Chambers 2004-2019*

"We have never been disappointed. They are worth their weight in gold." ~ *Chambers USA 2018*

"They have current cutting-edge knowledge and are savvy about attuning their counsel to the needs of the client to arrive at a satisfactory solution to many sticky issues."
~ *Chambers USA 2017*

"They are very good at being able to communicate and synthesize information in a useful and easily understandable way."
~ *Chambers USA 2016*

***Law360* 2016 Technology Practice Group of the Year**

Ranked as one of the top law firms 2009 - 2018 on World's Best Outsourcing Advisors list for The Global Outsourcing 100™

**Named "MTT Outsourcing Team of the Year"
in 2014 and ranked in the top tier from 2010 - 2018**

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Speakers

BRAD PETERSON
Brad Peterson is a partner in Mayer Brown's Chicago office. He leads Mayer Brown's global Technology Transactions practice. Brad's practice focuses on data, digital, outsourcing and software transactions, with a particular emphasis on financial technology. His experience includes data licensing and analytics; digital services such as IaaS, PaaS, and SaaS; outsourcing of the full range of information technology (IT) and business process functions; and core systems modernization, ERP and other software licensing, development and integration transactions. His experience also includes projects in emerging technologies such as artificial intelligence (AI), robotic process automation (RPA), and blockchain and other distributed ledger technologies (DLTs).

QI CHEN
Qi Chen is an associate in the Mayer Brown's Chicago office. Qi recently completed a six month secondment at Mayer Brown's Hong Kong office, where he practiced as a Registered Foreign Lawyer. Qi focuses his practice on business and technology sourcing transactions and other technology licensing and development transactions. Qi has represented clients in outsourcing matters that include information technology services, business processes and functions, facilities management services, and cloud computing. Prior to joining Mayer Brown in 2013, Qi worked as an Atomic Force Microscope applications engineer helping semiconductor manufacturers solve complex technical issues and develop novel processes.

ALAN VELASCO
Alan Velasco is an associate in Mayer Brown's Palo Alto office. He is a member of the Technology Transactions practice and the Corporate & Securities practice. Alan advises clients in all types of complex transactions relating to digital services, outsourcing and information technology, including IT outsourcing, business process outsourcing, implementation of automation solutions and cloud computing transactions. Prior to joining Mayer Brown in 2013, Alan Velasco worked as a process engineer over a seven-year period for two different medical device companies, specializing in applications of both hydrogen peroxide and steam sterilization.

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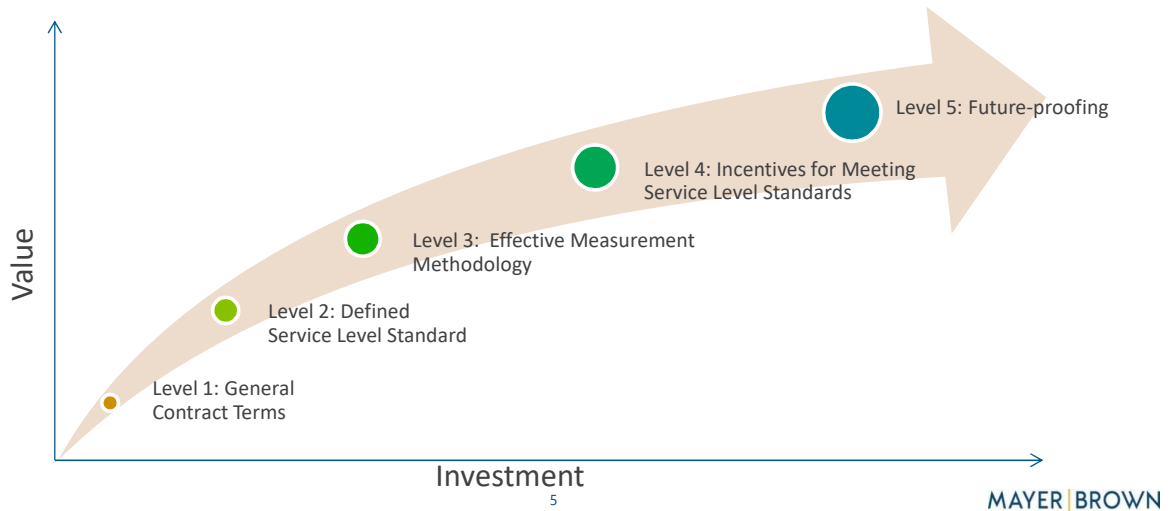**MAYER | BROWN**

Service Level Fundamentals

- Service levels can create value for customers by:
  - Creating a commitment
  - Building trust
  - Aligning incentives
  - Facilitating agility and innovation
- To get that value, you must invest time and energy in negotiating and governing service level provisions.

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Service Level Value Curve

- Level 5: Future-proofing
- Level 4: Incentives for Meeting Service Level Standards
- Level 3: Effective Measurement Methodology
- Level 2: Defined Service Level Standard
- Level 1: General Contract Terms

Value

Investment

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Level 1 - General Contract Terms

- Performance obligations
  - "Supplier will [perform] [deliver] ..."
  - What the supplier will do, but not how well the supplier will do it
- Performance warranties
  - "... in a good and workmanlike manner in accordance with industry standards..."
  - Directionally right but difficult to enforce
- Right to recover damages or terminate
  - Amount of damages may be difficult to prove
  - Key damages may be waived as consequential or indirect
  - Termination may involve substantial cost and operational risk
  - Litigation is costly in time, money and effect on relationship
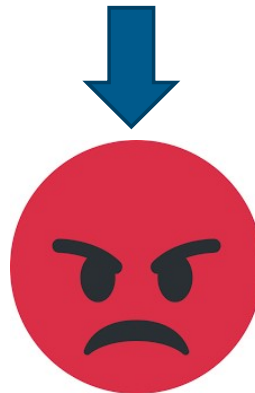
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Level 2 – Service Level Standard

Service Level Definition **+** Service Level Requirement **=** Service Level Standard

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What to Avoid

Service levels show: Customer faces are:

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Selecting a Service Level Standard

1. Identify the customer's desired outcomes, such as increased revenue or a productive workforce
2. Determine how and how much the supplier will influence those desired outcomes
3. Identify measureable aspects of services that can act as a proxy for the supplier's influence on the customer's desired business outcomes, such as:
   – Timeliness
   – Quality
   – Reliability
   – Availability
   – User satisfaction

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Goals in Drafting Service Level Definitions

• Clear and unambiguous
• Easy to administer
• Plain English
• Consistent with Statement of Work or other contract requirements, including defined terms
• Active voice
• Mathematical formula with numerator and denominator
• Contract language rather than notes in a spreadsheet

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Drafting Example: Service Level Definition

- Starting Point: Response
  - % Supplier response time <~15 minutes * 100
- Revised version: Timely Incident Response

  The number of Incidents that Supplier Responds to Customer in the applicable calendar month within [15 minutes] of Supplier's receipt of the Incident ***divided by*** the number of Incidents received by Supplier in the applicable calendar month, expressed as a percentage.

  "Incident" means … [request, system report, escalated problem?]

  "Response" means … [email, telephone call, system response?]

  [For this purpose, the time from when Supplier has escalated the Incident to a third-party hardware vendor in accordance with the Procedures Manual to the time when Supplier receives a response will be excluded from the calculation.]

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Sample Pitfalls in Service Level Definitions

1. Using metrics designed for an internal operation for an external service provider
2. Assuming that metrics from one deal work for another deal
3. Ignoring what happens to the misses
4. Ambiguity on where measurement starts and ends
5. Broad exceptions and exclusions
6. Deferring issues for later dispute with words such as "reasonable," "appropriate" or "significant"
7. Measuring multiple suppliers performing similar services with inconsistent definitions
8. Service levels as the only obligation of the supplier or the sole indicator of value to the customer

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Setting the Service Level Requirements

Expected Service Level	Minimum Service Level
Regularly achievable	Floor
A miss in a month is a service level breach in that month if there have also been X prior misses in the Y prior months	A miss in a month is a service level breach in that month

Sample Pitfalls:

1. Assuming that historic service levels are the right service levels
2. Agreeing to agree on service levels after signing has reduced your options and thus leverage
3. Setting requirements based on initial performance (baselining)

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Level 3 – Measurement Methodology

- Goals:
  - Verify that the service level works operationally
  - Accurately measure actual performance based on definition
  - Minimize expense across supplier base
  - Permit audit
- Approaches:
  - End user reporting
  - Monitoring by the supplier's employees
  - Automated monitoring
  - Sampling

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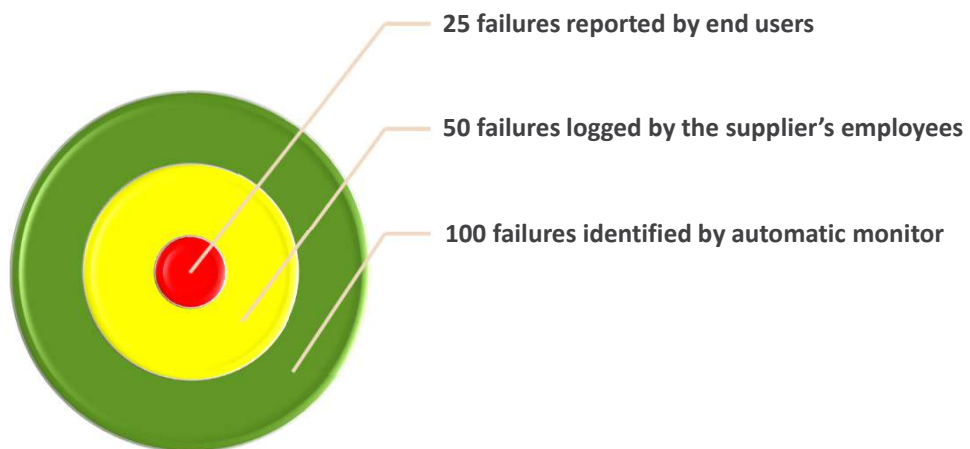## Level 3 – Measurement Methodology *(cont.)*

- Challenges:
  - Aligning service levels to desired business outcomes
  - Lack of flexibility
  - Monitoring and reporting service levels on a consistent basis
  - Selecting a monitor and reporter
    - Options:
      - Allow Supplier to measure
      - Select a third party to monitor
      - Automated monitoring

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Methodology Can Determine Reported Performance

25 failures reported by end users

50 failures logged by the supplier's employees

100 failures identified by automatic monitor

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Automated Monitoring

- Ideal for companies undergoing digital transformation and taking on massive amounts of data
- Uses a combination of big data, artificial intelligence, and machine learning to automate service level management
  - Basic examples include:
    - Automatically identifying Service Level Defaults
    - Creation of new Service Level Reports
    - Automating escalations
- Can also be used to create more advanced issue resolution tools

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Automated Monitoring *(cont.)*

- Opportunities
  - Reduces the potential cost of gathering and presenting new data related to the Services
  - Promotes consistent monitoring and alerts, such as real-time Service Level dashboards
  - Allows for predictive modeling prior to Service Level Default
- Potential risks
  - May be incompatible with legacy systems
  - Lack of correct feedback
  - Debate over predictive models can lead to disagreements on what the appropriate response should be to "at risk" Service Levels

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Measurement Methodology Example

- Data Source = ServiceNow

- Detailed Filename = <RESPONSE date> Summary.pdf on SharePoint

- Summary = Incident count, actual response duration (calculated), average response duration (calculated)

- Supporting Data = Incident ID, Reported Severity, Incident Start Date/Time, Service Response Date/Time, Suspend Duration (for exceptions only), Response Method, Service Level Compliance (Yes/No)

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Service Level Dashboard Example
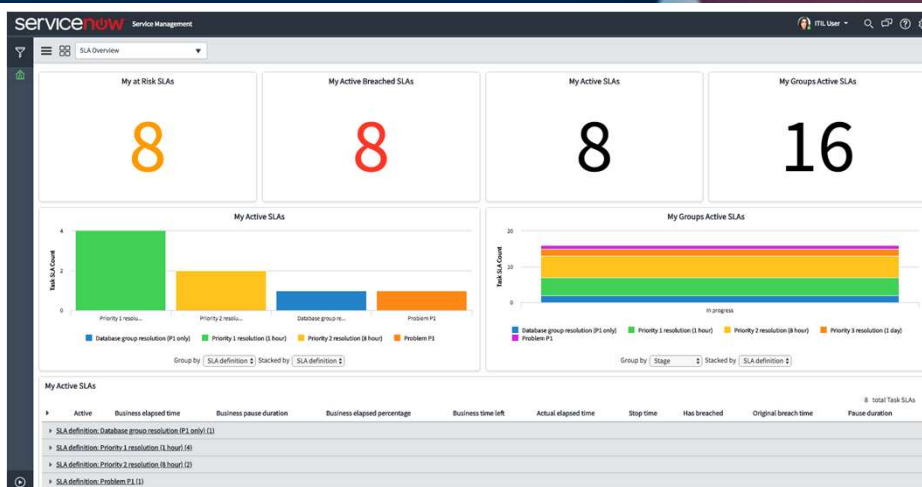
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Level 4 – Incentives to Meet Service Level Standards

> Obligation to report service level performance

> Obligation to identify and correct root cause

> Service level credits

> Right to terminate for cause

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Obligation to Report: Sample Report

IT Service Desk – Performance Category	Expected SL	Minimum SL	Actual Value	Comply
Timely Incident Resolution – Severity 1	99%	98%	99.1%	Yes
Timely Incident Resolution – Severity 2	97%	95%	94.2%	No
Timely Incident Resolution – Severity 3	95%	93%	93.5%	Missed Expected
Timely Incident Response – Severity 1	99%	95%	100%	Yes
Timely Incident Response – Severity 2	97%	95%	99.3%	Yes
Timely Incident Response – Severity 3	95%	93%	93.2%	No

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Obligation to Correct Root Cause of Failure Sample Contract Provision

- **Supplier shall** (after restoring service or otherwise resolving any immediate problem):
    i.   **Promptly investigate** the underlying causes of the failure (the "**Root Cause**")
    ii. **Provide an analysis of the Root Cause** as soon as practicable and in any event within 15 days
    iii. **Correct the Root Cause** as soon as practicable if Supplier is responsible for the Root Cause or coordinate the correction of the Root Cause if Supplier is not responsible for the Root Cause
    iv. **Advise Customer of the status** of remedial efforts being undertaken with respect to the Root Cause
    v.   **Demonstrate to Customer's reasonable satisfaction that the Root Cause has been permanently corrected**
    vi. Take commercially reasonable actions to **prevent any recurrence** of the failure

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Illustrative Service Level Credit Methodology

- "At-Risk Amount" equals x% of the month's charges
- Each service level has a percentage that we call the "Allocation"
- If the supplier fails to meet a service level in a month, the supplier shall grant a credit equal to its Allocation multiplied by the At-Risk Amount
- Example:
    - At-Risk Amount = 15% x $1,000,000 = $150,000
    - Percentage = 40%
    - Credit = $150,000 x 0.40 = $60,000
- Total of all service level credits in any month cannot exceed the At-Risk Amount
- Credits do not limit other remedies

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Example Service Level Matrix

- A = At Risk Amount = 15%

- B = Estimated "Monthly At Risk Charge" = $1,000,000

- At Risk Pool Percentage Available for Allocation = 250%

IT Service Desk – Performance Category	SL Effective Date	Expected	Minimum	Allocation (C)
Timely Incident Response – Severity 1	01-Feb-2020	99%	95%	40%
Timely Incident Response – Severity 2	01-Feb-2020	97%	95%	30%
Timely Incident Response – Severity 3	01-Feb-2020	95%	93%	20%

- SL Credit = A x B x C = 15% x 1,000,000 x 20% = $30,000

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Earnback and Service Level Bonus

- Earnback
  - Right to "earn back" credits from a failure in one month based on over-performance in later months

- Service Level Bonus
  - Additional payment for over-performance

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Termination Rights for Service Level Failure

- Goal is to establish "bright lines" that allow the customer to terminate for cause without needing to prove a material breached not timely cured
- Sample contract language:
  - Customer may terminate for cause if …
  - Supplier incurs Service Level Credits that, in the aggregate, exceed 50% of the cumulative At-Risk Amount during any rolling six-month period;
  - Supplier fails to perform in accordance with the same Critical Service Level for three consecutive months or has more than five failures to meet one or more Critical Service Levels over any period of three consecutive months; or
  - Supplier fails to meet any Service Level identified as a "One-Strike" Service Level in the Service Level Matrix

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Level 5 – Future Proofing

- Continuous improvement to reflect:
  - Percentage of any over-performance over prior year
  - Automatic increases by a percentage or market standard
- Reallocation rights:
  - Common reallocations:
    - Right to reallocate Percentages between service levels
    - Right to move CPIs to KPIs and KPIs to CPIs
    - Right to add or modify service levels under a defined process for determining service level requirement
  - Ability to change upon notice (and not mutual agreement) to adapt to contractual situation
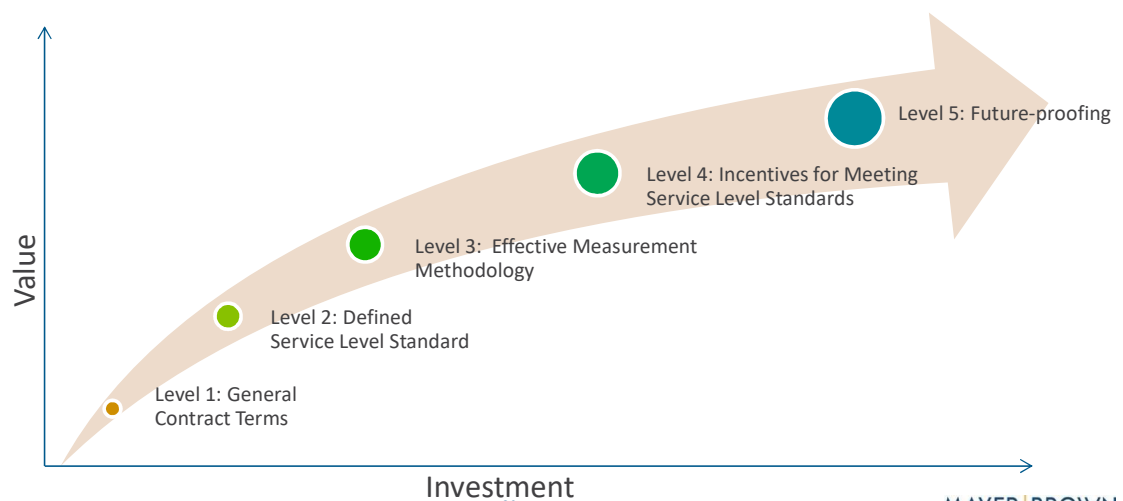
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Advanced Future Proofing

- Post-transformation service levels
  - Accounts for improvements and investments made by the Customer during the term of the Agreement
  - Contract for automatic step change (either upon completion of Transformation or a set period) rather than needed agreement to change the Service Levels
- Designing service levels to measure business value instead of talent or effort
  - Service Levels discussed in the majority of this presentation focus on **outputs** from the Services: For example, incident response, incident resolution, and availability
  - However Customers care about business **outcomes**: Was there a revenue loss due to the Services?
  - ITIL Version 4 emphasizes the principle of "Focusing on Value"

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Service Level Value Curve

Level 5: Future-proofing

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Questions?

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