Service Levels for SAAS

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Customers are rapidly increasing their use of software-as-a-service ("SAAS") solutions and other cloud services as part of their sourcing strategy. Cloud solutions offer the flexibility to quickly ramp services up and down, with typically little or no exit costs. However, cloud providers are able to offer flexible and cost-effective solutions because their offerings are standardized. Accordingly, customers find that providers of SAAS solutions are less likely than traditional outsource providers to negotiate services levels (as well as other contract terms) to meet the customer's particular business needs. Accordingly, customers should understand the limited negotiating flexibility with cloud providers and how to mitigate the service level limitations, where possible.

In a traditional outsourcing transaction, a customer typically has the flexibility to negotiate the service levels it needs to meet its business requirements. The customer can usually negotiate a reasonably expansive set of metrics, with desired target performance levels within a reasonable range. By contrast, cloud providers typically have a standard set of metrics and performance levels, with little negotiability. Typically, the number and type of service levels offered are quite limited. Cloud providers may offer customers the choice of platinum, gold or silver service levels, but all are based upon pre-set standards determined by the provider.

Traditional outsourcing transactions include a service level methodology pursuant to which the provider will put a certain percentage of its monthly charges at risk, typically in the range of 10 to 15 percent of the monthly charges. The customer has the right to over-allocate the at-risk amount across service levels, typically in the range of 150 to 200 percent. Such a methodology allows the customer to impose higher credits for individual service level failures.

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Further, in traditional outsourcing, the customer can add and delete service levels, promote key performance indicators to critical service levels and reallocate the percentages of the at-risk amount assigned to individual service levels. Often, credits increase following a specified number of consecutive failures of the same critical service level to incentivize the provider to resolve underlying systemic issues. Credits are not the sole and exclusive remedy, thus allowing the customer to seek damages and terminate for material service level failures. These tools allow the customer to focus the provider's attention on those service levels most important to the customer and incentivize suppliers to quickly resolve performance deficiencies.

By contrast, these tools are typically unavailable to customers in cloud transactions. Cloud providers give nominal credits for service level failures. The customer has no flexibility to add, delete or promote service levels or reallocate credits. Providers will push hard to make service level credits the exclusive remedy. In addition, service levels are often set forth in service offerings that are incorporated by reference into the services agreement. Providers reserve the right to change the terms of their service offerings from time to time without the customer's consent.

In traditional sourcing transactions, service levels set forth clear guidelines as to when a provider is or is not in compliance with its service obligations. Nevertheless, because service levels cannot possibly cover every aspect of a provider's performance, the outsourcing agreement will contain additional representations and warranties as to the quality and performance of the services. In public cloud agreements, services are often described at a high level with little detail. Providers are reluctant to give general performance warranties, which limit the customer's ability to bring claims for damages for deficient services.

What is a customer to do? First, be thoughtful in selecting what services you put on the cloud. Understand your business's needs and the provider's ability to meet those needs through its cloud offering. A customer can often protect itself against deficient performance through its right to terminate the services with little to no exit costs. However, whether or not a termination right is an effective remedy for deficient performance depends in large part on how critical the services are to the customer's business and how disruptive a change in providers will be.

Further, the lack of flexibility in cloud contract terms and conditions does not mean a client should not push for the tools available in traditional outsourcing transactions. Cloud providers have different levels of flexibility, depending upon the size and negotiating leverage of the provider. The customer should continue to push for the agreement to provide, among other things, that service level credits are not the sole and exclusive remedy for service level failures.

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Include warranties about general performance standards in the services agreement, at least with respect to core features and functionality. Then, if the provider's services are deficient, the customer can use those warranties to hold the provider accountable for breach of contract in cases where there is no service level to cover the deficient performance. Unilateral changes to service offerings by providers should not have a materially adverse impact on customers. Even if service level credits are the sole and exclusive remedy, it is important to make clear that such credits will not affect any right of the customer to claim damages arising from the provider's failure to meet its other obligations under the agreement.

You can successfully use cloud solutions if you make informed decisions about the services you decide to place on the cloud and the cloud solution selected and if you seek to minimize the limitations of cloud contract terms to the extent possible. ◆