

## Drafting Notes – Managing Services Agreement

This Managed Services Agreement is drafted with a slight pro-supplier bias but is nevertheless intended to be a reasonably balanced document. It draws on elements from application service provision (ASP) agreements and also from outsourcing contracts.

The document assumes that there will be an initial “set-up” phase consisting of the Supplier undertaking a due diligence exercise after which there will be a transfer of assets, software and contracts to the Supplier. It assumes that there will be no transfer of staff. When acting for the Customer it may be sensible to suggest separating these two phases so that an initial contract provides only for the due diligence exercise, at the end of which a detailed list (or “map”) of assets and infrastructure will be produced and this list can then be used to assist a procurement exercise for the second, full service, phase.

Some specific observations on particular clauses follow:

### *Clause 2 and Schedule 2 - Set-Up Services*

This clause deals with the initial phase of service consisting of the steps set out at schedule 2. In summary the Supplier has an obligation to perform a due diligence exercise and to agree a project plan with the Customer. Prior to beginning the service there will be a transfer of equipment, third party software, Customer software and other intellectual property to the Supplier. The document assumes that this transfer will be made for a nominal consideration since, even though these assets will have some value, this will be factored in to the overall commercial deal (including the set-up fees). The Customer excludes any warranties in respect of the assets transferred.

The clause includes a simple acceptance procedure in respect of the entire service (rather than in respect of individual element of it, which would be another option).

### *Clause 3 - Assumed Contracts and Assets*

This clause deals with the transfer to the Supplier at the start of the benefit of any contracts which are needed to provide the service.

### *Clause 4 - Service Provision*

Note that the Service Level Arrangements apply only from 30 days after the acceptance date. Also note that by clause 4.4 the Customer is prohibited from providing the Managed Service onto third parties.

### *Clause 5 – Customer Data*

This clause refers to any archiving and security procedures for Customer Data as described at schedule 4 and also makes clear that in the event of loss or damage to Customer Data the Customer’s exclusive remedy will be for the Supplier to use commercially reasonable efforts to restore that data from the latest backups.

### *Clause 6 – Supplier Obligations*

Under this clause the Supplier warrants that the Managed Service will be performed with reasonable care and skill and substantially in accordance with the specification. All other warranties or implied terms are excluded. The Customer’s exclusive remedy for breach of this provision is that the Supplier will use reasonable efforts to correct any non-conformance.

### *Clause 7 – Customers' Obligations*

Under this clause the Customer has a general obligation to co-operate and provide information. Note also that this contract contemplates that specific named Project Managers will be the main interfaces between the Customer and the Supplier.

### *Clause 8 – Charges and Payment*

The template assumes a simple fee structure with one fee for set-up services and another set monthly fee for the Managed Service itself. Other, more sophisticated options are certainly possible such as per-unit (e.g. per desktop) pricing, "pay as you go" (for use where the Customer only pays for processing power or storage that it is actually using) or even on "cost plus" model.

Note that by clause 8.2 the Supplier is reimbursed for expenses incurred during the set-up phase but nothing is stated about any expenses during the ongoing service provision phase. This is consistent with the idea that the Supplier is taking over responsibility for the entire service and the Customer is simply paying a fixed monthly fee.

There is no provision for the monthly fees to change other than as set out at clause 10 (price reduction or benchmarking) during the life of the contract.

### *Clause 9 – Change Control*

The template includes a simple change control mechanism whereby changes are recorded. Note that by clause 9.3 the Customer cannot unreasonably withhold or delay consent to a change request.

### *Clause 10 – Price Reduction or Benchmarking*

Clause 10 offers two alternatives. One is simply that prices fall by a fixed percentage every year. This will only be useful in very specific situations. The second alternative is that the parties may undertake a Benchmark Review in accordance with schedule 7. If that review determines that the Fees are not "Good Value" (defined at schedule 7 to mean no more than 10% above the median price in the market) then the Supplier is obliged to propose changes to the agreement – including a new Initial Term, such that under the revised Fees *would* represent Good Value. This proposal may include changes to the Managed Service Specification or to the Service Level Arrangements.

There are, of course, many other alternatives which the parties may agree as a consequence of the benchmark review. A Supplier might, for example, be obliged to reduce its prices down to a level representing Good Value or, at the other extreme, a determination that the fees are not Good Value may simply trigger a discussion between the parties.

Also note that the suggested definition of "Good Value" is one which will usually favour the Supplier.

### *Clause 11 – Continuous Improvement*

Often one of the main reasons Customers enter into Managed Services contracts is exactly to ensure that their use of technology will remain up-to-date throughout the life of the agreement. Clause 11 suggests a very simple way to try to achieve this – under this clause the Supplier will report to the Customer annually identifying any new technologies which could improve the Managed Service. The report will give sufficient detail to enable the Customer to evaluate the new technology. If the Customer then wishes to incorporate any improvements they will submit a change request in accordance with clause 9.

Clause 11.2 tries to incorporate an element of sharing the costs and benefits of technology change as between the parties. By 11.2(a) if the Supplier's costs in providing the service are reduced then there will be a proportionate reduction in the fees and, conversely, if the charges payable by Customer are reduced as a result of a change then there will be a proportionate increase in the Fees. Of course the negotiation process may produce many permutations of this provision.

#### *Clause 12 – Service Review and Governance*

This clause sets up a fairly simply governance process with monthly meetings of Project Managers and then bi-annual meetings with more senior representatives.

#### *Clause 13 – Proprietary Rights*

This clause says that all IPRs in anything specifically developed for the Customer are owned by the Supplier. Strictly speaking this clause is not needed since it is a re-statement of the applicable law anyway but it may be helpful to have it nevertheless, if only to ensure that both parties have a common understanding at the outset.

#### *Clause 15 – Limitation of Liability*

Under this clause the Supplier excludes all liability for loss of profit or for indirect and consequential loss and limits its total aggregate liability to a fixed amount.

#### *Clause 16 – Term and Termination*

Clause 16.1 states that the agreement will continue until the expiry of the Initial Term and thereafter will automatically renew, unless terminated on notice, for successive yearly periods. A more Customer-friendly alternative might be that after the expiry of the Initial Term the agreement becomes terminable on notice at any time by either party.

Clause 16.3 sets out circumstances whereby the agreement can be terminated early. Note that this includes, at sub-paragraph (h), where there has been a change of control of the other party. This is likely to be resisted by a Supplier.

Also note the optional text at clause 16.2 which gives the Customer a right to terminate early for "convenience" in return for termination compensation.

#### *Clause 17 – Exit assistance and Asset Transfer*

This clause sets up a simple process where the Supplier is obliged, within six months of the start of the contract, to prepare an Exit Plan setting out how the services will be transitioned at the end of the contract. The Supplier is entitled to charge an additional fee for this assistance.

Under clause 17.3 the Supplier will, on termination or expiry, produce a list of equipment or contracts which are to be transferred back to the Customer. The clause continues that the Supplier will sell these things and the Customer will buy them for net book value. Note that this clause gives the Customer no discretion as to whether to buy these and therefore there may be some further negotiation on this point.

#### *Clause 18 – Force Majeure*

This is a fairly standard force majeure clause – note that it expressly includes industrial relations disputes involving the workforce of the Supplier. This may be resisted by Customers.

#### *Clause 19 – Audit*

This clause sets out an audit obligation whereby the Supplier is obliged to allow the Customer to confirm compliance with its obligations under the contract. Generally in a Managed Services arrangement the service is provided almost as a “black box” – that is the Customer should have little need to see granular detail of exactly how the service is being provided. Nevertheless it may be useful to have some provision like this e.g. to ensure compliance with security policies. In situations where audit is more important than Customers may ask for further provisions here – e.g. a mechanism to claw-back audit costs if an audit reveals a breach of contract by the Supplier.

#### *Clause 23 – Assignment*

Note that this is not a mutual clause – the Customer may not assign the contract without the Supplier’s consent but the Supplier is permitted to assign or sub-contract any of its rights and obligations under the agreement.

#### *Schedule 4 – Managed Service Specification*

This schedule should contain details of the service which is to be provided. The template sets out, in square brackets, examples of some of the provisions which may be relevant.

#### *Schedule 5 – Maintenance and Support*

This schedule should set out details of any maintenance service provided by the Supplier – including fault resolution times. Note that, by paragraph 3.3, the Supplier determines the priority of fault.

When acting for the Customer it may be important to try to ensure that the Customer and the Supplier agree on a fault priority together, with some sort of mechanism for determining any dispute. A possible solution to this problem is a provision which requires the Supplier to treat the priority in accordance with the Customer’s own designation and then allow the Supplier the option of charging the Customer its incremental costs of doing so if formal dispute resolution ultimately finds that the Supplier was correct in the first place.

#### *Schedule 6 – Service Level Arrangement*

Generally with Service Levels the availability percentage will be by far the most significant Service Level. The template agreement, then, has just this one. Note that the service credit entitlement at paragraph 2 is simply a proportional refund of the fees for downtime.

Suppliers may sometimes request an “earn-back” for over-performance. Text for this provision has not been included here – this will be a matter for negotiation but generally Customers will not consider this unless they themselves will in fact receive a benefit from better-than-expected performance on service levels. For example it may not be appropriate to consider an “earn-back” for a measure of voice quality (so long as the quality is good enough, the customer gets little benefit from very high quality voice).

#### *Schedule 7 – Benchmarking*

It may in many cases be difficult to conduct a meaningful benchmarking exercise if the Managed Service is highly tailored to a particular Customer. Nevertheless this schedule includes a fairly even handed benchmarking provision which may be used where it is helpful (though see the notes to clause 10 above for a comment on the definition of “Good Value”).

#### *Other clauses*

There are some other provisions which are not included in this template but which may be considered in some situations:

- a minimum revenue guarantee may be relevant where there is an element of the services which whose fee is not fixed in advance.
- Suppliers sometimes offer a “most favoured Customer” clause of which the promise not to offer some of the services to other similarly situation Customers for a lower price;
- A clause obliging the Supplier to draw-up and maintain a specific business continuity or disaster recovery plan may be helpful in some cases – although in a pure “end-to-end” managed service context the Supplier might legitimately claim this has nothing to do with the Customer.
- A “step-in” provision would allow the Customer temporarily to take-over the service (either directly itself or via a third party) if the Supplier is failing or is unable to provide the service itself. Step-in provisions are usually strongly resisted by the Supplier and, where they are agreed, there will usually be a lengthy series of steps to be taken before they can be invoked.

*This document was prepared for a Kemp Little seminar and does not constitute legal advice.*