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## Service Level Agreements: A Better Mousetrap

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Why have buyers and suppliers of outsourced technology services come to the conclusion that service level agreement (SLA) credits are “adequate compensation” to a buyer for its supplier’s failure to satisfy one or more performance standards? When it comes to catching your supplier in the maze of service level agreement strategies, is there a better mousetrap? We believe that there is, and we have put such a *Performance Decrements* model in place in a mid-size regional medical center in the Pacific Northwest.

### **The Performance Decrements Model: An End to Baseline SLAs**

In the Performance Decrements model, the emphasis is on making sure the supplier corrects problems in a timely manner rather than generating credits that are inconsequential to both the buyer and supplier. The buyer and supplier agree on quantitative levels of performance (performance standards) for one or more attributes of each of the services (service level specifications). When a service has one or more associated service level specifications, the supplier agrees to meet or exceed the performance standards for the service level specification.

In the Performance Decrements model, the supplier does not use buyer’s existing inhouse service level performance to arrive at the supplier’s required performance. Traditional SLAs often allow the supplier to merely meet the buyer’s performance levels ostensibly because there’s no other data on which to rely. In the Performance Decrements model, however, the buyer requires the supplier to propose performance standards that are consistent with industry best practices. (Buyers require this during the pre-award RFP, proposal, and supplier selection process). Thus, the buyer trades its current performance levels for greatly improved performance over the longer term. This is a trade that almost every buyer should make.

### **It’s the Performance, Stupid – Not the Money!**

This method replaces the buyer’s customary recovery of monetary credits for the supplier’s failure to meet required service levels with the ability to assess performance decrements (i.e. points) for the supplier’s failure to do so.

If the total amount of performance decrements points assessed in any consecutive twelve month period exceeds a certain threshold, the buyer has the contractual right to convene an immediate and mandatory meeting of the parties’ Executive Committee. Also invited are the supporting personnel necessary to identify the causes of

each performance standard failure.

At this meeting the supplier must propose a solution for such failures. If necessary, the supplier must obtain outside consulting assistance to resolve these failures. The supplier’s account manager now must provide weekly updates to both the buyer’s and supplier’s management, and the Executive Committee will continue to meet monthly until three consecutive months have passed with no performance decrements.

Rather than collecting what are typically nominal financial credits from the supplier for its monthly service level failures (which are usually insignificant from the buyer’s perspective), the first threshold where something happens in the Performance Decrements model is at the point where there has been an accumulation of performance standard failures over a rolling period of time.

The buyer’s remedy in this instance is of much greater value to the buyer than minor billing credits. The buyer gets the time and attention of the supplier’s executives on an immediate and continuing basis until performance improves, and the supplier’s account manager gets the same attention—a far greater incentive for the supplier’s services delivery team to perform well than merely reimbursing the buyer some nominal portion of the fees.

### **Strike Two—Pricing Benchmark**

If the total amount of performance decrements assessed in any consecutive twelve month period exceeds the second threshold, the buyer has the contractual right to require that the supplier pay for a buyer-selected technology advisory or outsourcing consulting firm. Their job: to perform an analysis and determine the reasonable fees for the services provided in light of technological and market conditions and the supplier’s relative performance against the performance standards (an SLA benchmarking).

In the Performance Decrements model, an SLA benchmarking takes the place of traditional service level credits as a financial remedy to the buyer in the event of the supplier’s poor performance. However, in contrast with the traditional SLA model, the SLA benchmarking found in the Performance Decrements model provides:

Greater visibility of performance issues to both the buyer and the supplier

A more direct and more rational relationship between the quality of service and the prices paid for those levels

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## Service Level Agreements: A Better Mousetrap (continued)

A potentially material economic remedy to the buyer for material failures instead of nickel-and-dime credits for periodic failures.

As everyone knows, no one in an outsourcing relationship generally cares much about small lapses in performance or the minor billing credits that go along with those. However, both parties care when you mention the word benchmarking.

### Strike Three–You’re Out!

Finally, if the total amount of performance decrements assessed in any consecutive twelve month period exceeds the third threshold, the buyer has the contractual right at its sole discretion to:

- Modify or terminate one or more of the services
- Modify or terminate the entire agreement for cause

The buyer at this stage does not have to give the supplier any opportunity to cure its cumulative failures to satisfy the performance standards (a performance decrement default).

The buyer’s right to declare a performance decrement default is in addition to its more general right to terminate the outsourcing agreement in the event of a material breach by the supplier. This approach has several built-in advantages as a hammer to encourage the supplier to perform as agreed:

- The supplier knows exactly and precisely how it is expected to perform.
- The buyer may only elect this course of action after measuring the supplier’s satisfaction of its contractual obligations against a totally objective and clearly quantified standard of performance, so neither party can argue (or need go to court to decide) whether such a default has truly occurred.
- The supplier has no right to cure once the buyer has determined that a performance decrement default has occurred (assuming that this determination has been made correctly).

In other words, the supplier has already had the twelve months of the rolling measurement period to fix anything that was leaking. It cannot, after months of water seeping out, ask to now replace the pipe once it has burst entirely.

### Summary

When it comes to constructing a methodology to ensure your outsourcing supplier’s performance against meaningful service level specifications, we’ve built a better mousetrap. Unlike the traditional SLA, the Performance

Decrements model:

- Replaces the receipt of nickel-and-dime service level credits with immediate and continuing executive-level attention to material or persistent service lapses
- Adjusts and correlates the pricing of charges and fees for the supplier’s services with the actual levels and quality of the services provided
- Provides the buyer with an objective and irrefutable right to modify or terminate the services arrangement if the supplier fails to meet these performance standards.

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