



## Service levels: avoid ambushes!

Two recent cases have highlighted the dangers of so-called service level "ambushes" in relation to outsourcing contracts and similar agreements.

### What is a service levels "ambush"?

The following cases illustrate the kind of behaviour which can be characterised as a service levels "ambush":

- In *Mid-Essex Hospital Services v Compass (t/a Medirest)* (2013), an NHS Trust wished to terminate a catering contract so that it could appoint another provider. It began to apply the service levels scheme to relatively minor failures, such as the discovery of butter sachets with no use-by date (for which 63,220 service failure points were awarded). The Trust's aim was to justify termination for cumulative failures to meet service levels.
- More recently, in *Portsmouth City Council v Ensign Highways* (2015), the Council wished to renegotiate a 25 year PFI contract for road maintenance. It adopted an approach where any failure, however minor, attracted the maximum number of service points (which could ultimately trigger various sanctions, including termination). This was with a view to pressuring the supplier into agreeing changes to the contract.

### Does the customer always win?

Where (as in these cases) the customer is in a position to take the lead on the assessment of any failure to meet service levels, it may appear to be in a strong position. Indeed, that was largely how matters played out in the *Medirest* case, where the

Court of Appeal ruled that the Trust was entitled to terminate on the basis of the supplier's failure to meet service levels.

That said, the Trust was criticised for initially applying the service levels scheme to relatively trivial matters such as butter sachets – a position from which it had retreated by the time the matter came before the court.



In *Ensign Highways*, however, the outcome was not as favourable to the customer. The Council argued that it was entitled to apply the service points as if they were a "fixed tariff" – so that minor failures could potentially attract maximum points. The court disagreed, noting that the Council had been content to operate the service points system much more flexibly in the past, having regard to the seriousness of the breach.

In addition, the Schedule where the service points were set out referred to "maximum" values, implying that the actual points awarded for each failure would often be lower. The court also took the view that the Council's interpretation "[did] not make [...] commercial sense" given the background to the contract.

## Limits on customer discretion

It will rarely be the case that customers are free to do exactly as they please in relation to service levels.

For example, in *Ensign Highways*, the court found that in exercising its discretion to award service points, the Council was under an implied obligation to act "honestly and on proper grounds and not in a manner that is arbitrary, irrational or capricious."

If the contract also contains a general obligation on both parties to act in good faith, the customer's freedom of action in relation to both service levels and threats to terminate may be subject to more significant constraints. However, in both *Ensign Highways* and *Medirest*, the court concluded that no such broader obligation of good faith applied.

## How we can help

We advise on a wide variety of commercial agreements including, outsourcing, joint ventures, distribution, franchising, supply of goods and/or services and manufacturing. We attach great importance to understanding our clients' businesses and looking after their interests in the long term.

### Key lessons for customers

- Be consistent in your interpretation and/or enforcement of service levels
- Resist the temptation to apply maximum points to minor service failures (unless there is very clear wording in the contract permitting such an approach).

### Key lessons for suppliers

At the contract drafting stage, make sure that:

- Sanctions for failure to meet service levels are in proportion to the gravity of the breach ; and
- The customer cannot award service failure points for matters beyond your reasonable control.

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## FOR FURTHER INFORMATION, PLEASE CONTACT

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