
Enhancing service contracts to minimize dispute risk

Manufacturers, dealers and resellers are increasingly 'servitizing' their business model, thereby moving from selling a product to offering a service. This whitepaper clarifies which contract elements could and should be addressed to help you reduce the risk of any disputes arising with your customers.

See what counts.

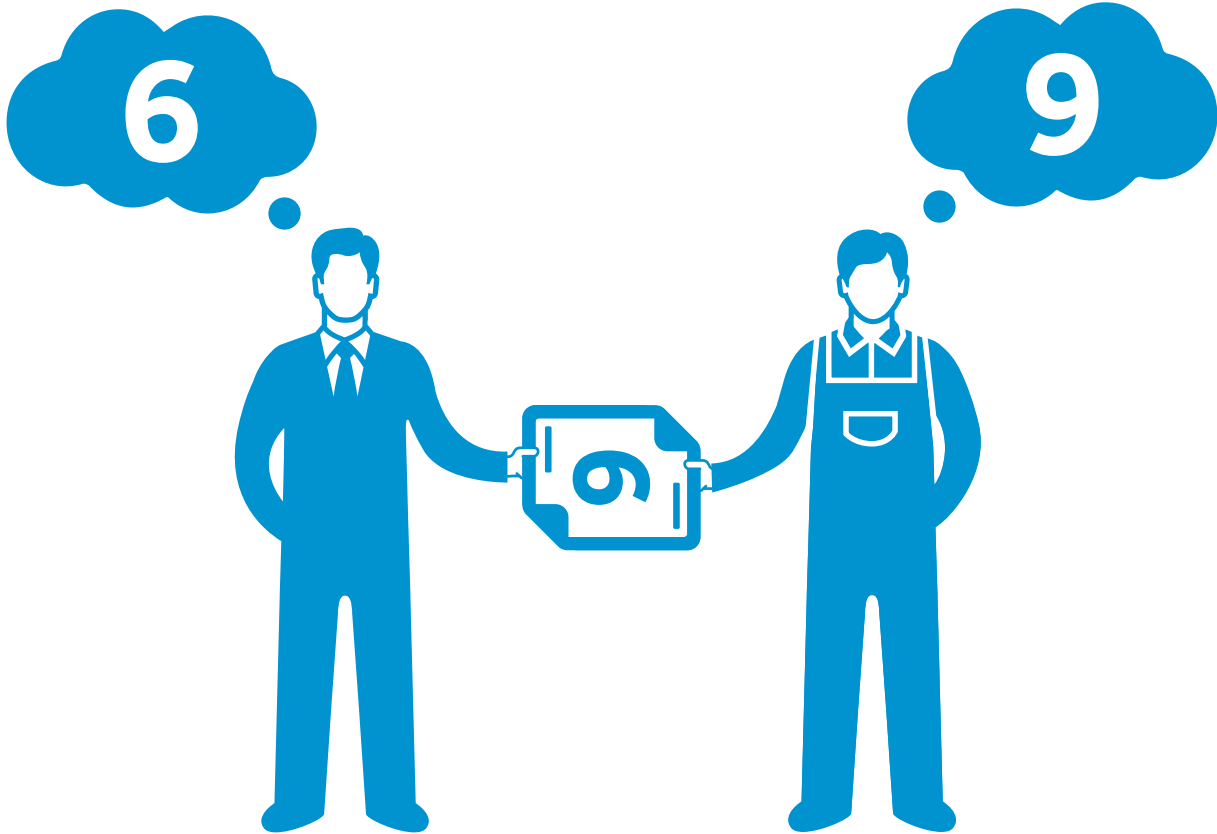


Figure 1: Dispute risk is often a matter of different interpretations where a contract isn't specific enough.

Introduction

The rise in usage-based business models enables manufacturers¹ to move from the sale of a product to the sale of a comprehensive service that can include the core asset² as well as a variety of services, such as tangible (installation, maintenance, wear parts and extended warranty) and intangible (training, consultancy, performance guarantees) services.

Adding services to an asset sale is a common strategy to add value to a product. It enables manufacturers, dealers and resellers to move from a transactional to a contractual long-term relationship with their customers³, and requires a service contract that describes which services are included and under which Terms & Conditions.

Describing the who, what, where, when and how of a service contract is crucial to managing the expectations of your customers, while incomplete service contracts and vague clauses are one of the main triggers for a dispute. A dispute is a disagreement between the service provider and a customer.

This whitepaper illustrates; (i) which elements can and should be addressed in a service contract, (ii) pinpoints areas requiring particular attention when it comes to minimizing potential dispute risks and (iii) concludes with a checklist that manufacturers can consider when drafting an effective service contract.

This whitepaper was conducted by researching a range of service contracts from different industries across the globe.

In addition, DLL internal experts have been consulted on various topics.

"As long as you're friends, you don't feel a need to write anything down. But once there's a discussion or problem, suddenly you need to have everything on paper."

Balazs Lukacs-Toth
Legal Counsel, DLL Hungary

1. The term 'manufacturers' refer in this paper to all companies designing, producing and/or offering assets to end-users.
2. The term 'assets' refers in this paper to equipment, devices, systems, units or products produced by a manufacturer.
3. The term 'customers' refers in this paper to the end-users of assets.

The importance of service contracts

A service contract defines which services are going to be performed (on an asset) over a predefined period of time. With a growing share of services included in the total offering, service contracts are becoming more important, more complex and lengthier than ever.

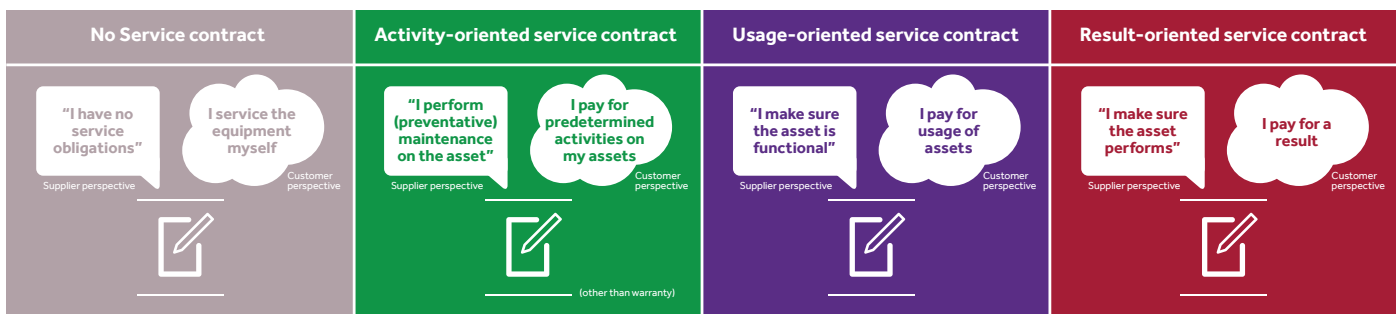


Figure 2: Different service-based business models and their connection to service contracts

Theory describes three different service-based business models: an activity-, a usage- and a result-oriented model. These models differ in the proportion of services each includes in its solution. Each has its own peculiarities, which in turn have an impact on how the service contracts should be drafted. Organizations drafting service contracts for more 'advanced' models will need more highly developed legal capabilities. For example: guaranteeing in a service contract that an asset is safe to use is more complex than contracting a predefined set of maintenance and safety check activities.

In an **activity-oriented service contract**, the customer buys the equipment with the option to add a separate service contract. The main focus of a service contract in a product-oriented system is to define which services are to be performed under what circumstances, without making the service provider responsible for either the functionality or the performance of the asset.

In a **usage-oriented service contract**, a variety of services are included to ensure 'hassle-free' usage. These services are combined with the equipment and contracted together. A usage-oriented service contract doesn't focus on the delivery of specified activities that will be performed by the service provider, but on the desired quality of the services in order to ensure the equipment operates as specified.

In a **result-oriented service contract**, the customer is invoiced based on the results of any contracted service level agreements. These are generally the most lengthy and complex contracts, as there are no individual activities described.

"A service contract describes what **both** contracting parties can reasonably expect from each other."

Lee Thompson
Chief Legal Counsel, DLL UK

The impact of **disputes**

There is a thin line between creating a service contract that is too 'technical' for your customer to understand and creating one that is too 'simple', and thus fails to cover key items. Both can be triggers for a dispute; but what is a dispute and how can your organization reduce the risk of them occurring?

Disputes between service providers and customers are frequently triggered by clauses in a service contract that are vaguely described or missing altogether. Disputes can cause a customer to stop paying for their services, and if a dispute comes to court both contracting parties may face financial penalties.

The following six questions can help your organization determine what level of detail a service contract should address:



Who

Who's going to perform the services? The manufacturer themselves, or a subcontracted third party?



What

What services are going to be carried out? A service frequently consists of many different service components. When

stating in a contract that maintenance is included, one also needs to consider whether it's preventative and/or corrective maintenance. A manufacturer should define each service-related activity that will be performed under the contract, and even more importantly, be clear about what is not included. For example, software updates are included, but new releases of the same software might come at an additional cost.



Where

Where are the services going to be performed? This could be in a specialized facility on-site at the customer. Either way, the customer

will need to ensure the asset is accessible and available at the scheduled time of service. This is particularly important for remote or secured areas that may be difficult for the service provider's technicians to access.

"Case law dictates that it's the responsibility of the party creating the service documents to be crystal clear in their wording of the content of the contract. Courts tend to rule in favor of the customer over the service provider."

Diana van de Ven

Legal Counsel, DLL Netherlands



When

When are the services going to be carried out? Are they pre-scheduled, (e.g. annually or bi-annually), or do the time and

date of service have to be agreed by both parties? Is the service subject to regulatory constraints (e.g. safety, privacy or security regulations)? Have you defined the timeframe within which the servicing party has to repair the asset if it breaks down and is no longer functional (i.e. how soon can the customer expect the asset to be working again)?



How

How are the services going to be carried out? Would a temporary spot-repair be acceptable if a machine breaks down? Or does

the customer expect a temporary replacement asset from the service provider?



Price

Are service activities that come at an additional cost explicitly mentioned in the contract? Does the contract provide one general

service fee, or break up costs per component?

A number of services included in **one contract**

In the business-to-business world, the term 'service' is frequently associated with the maintenance of assets. However, a service contract often consists of many different service components.

Figure 3 shows various service components that might be included in a service contract. Some of these services are hardware-related, others software- or support-related.



Figure 3: Identified service components that might be covered in a service contract.



The following six services are most commonly specified in an asset-related service contract:



Preventative maintenance

The goal of preventative maintenance is to avoid downtime and corrective repairs of assets.

Preventative maintenance activities might include software updates, oil changes, lubrication refills or calibration of the asset. Unlike corrective maintenance activities, preventative maintenance activities are easy for the service provider to predict. The contract should state which specific activities are included, and at what intervals these services will be carried out.



Corrective maintenance

Corrective maintenance refers to repair activities carried out after machine failure has been detected.

Corrective maintenance activities are focused on restoring an asset to an operational state. They are not only harder than preventative maintenance for a service provider to predict, but they are also much harder to price correctly.



Extended warranty

This provides an extension of the standard warranty for a specified period. When an extended warranty clause is included in the service contract you need to describe under which circumstances the extended warranty applies.



Complementary software services

This term is often used to describe a whole range of IT services, such as cloud storage, anti-virus management and systems monitoring. As a large number of different services could potentially fall under this term, it is important to specify exactly which services are included.



Safety checks / inspections

Periodic safety checks are often required by law for a machine to be allowed to continue its operations. The contract may need to specify when the customer is liable for failing to provide access to the machine in order that the service provider can carry out the required safety checks.



Wear parts

This refers to parts that become worn through usage of the asset and as a result have to be replaced over time (e.g. brake pads or tires). In some cases, this service can overlap with preventative maintenance (e.g. for brake pads, which should always be replaced before the brakes actually fail). But it is important to specify what exactly falls under the 'wear parts' service, and when and in which circumstances or cases these wear parts will be replaced.

Topics to be addressed in a service contract

A service contract frequently consists of two main components: general Terms & Conditions (T&Cs) and customer specific Terms & Conditions. Whereas the customer T&Cs includes party-specific details that typically differ per transaction, the general T&Cs are more universal by nature.

Contract

The following table describes the most common elements in a service contract.

	Clause	Description	Questions to ask yourself
1	Parties involved	Defines which legal entities are involved in the service contract.	1. Which parties are directly involved in the service agreement?
2	Subject of the agreement	Defines the assets that are to be serviced and specifies to which serial numbers the servicing applies.	1. Which assets are subject to the agreement? 2. How can these assets be identified?
3	Term of the agreement	Describes the duration of the service contract, with specific start and (if relevant) end dates.	1. For what duration are the services contracted? 2. Are there any extension options or periods possible?
4	Scope of the agreement	Defines which services are part of the agreement, and when these services will be carried out, and under what circumstances.	1. Which services are provided in the contract? 2. What will trigger these services to be performed?
5	Payment structure	Specifies the service fees, payment frequency and handling of non-payment.	1. What is the fee for the service agreement? 2. What is the term of payment? 3. What happens in the event of the customer not paying on time?
6	Signatures of contract party representatives	The service contract has to be signed by representatives from both contracting parties.	1. Are the individuals authorized to sign the contract on behalf of their organizations?

Table 1: Service contract elements to address in a service contract.

“One of the key factors in a service contract is to make it clear which service-related activities are included, rather than focusing too much on the exclusions.”

Mikael Gomes
Chief Legal Counsel, DLL France

General Terms & Conditions

The following table covers the clauses commonly addressed in the general T&Cs.

	Clause	Description	Questions to ask yourself
7	Glossary and abbreviations	Describes certain business-related terms and abbreviations used in the service contract.	1. What business-related terms will be used in the service contract that might complicate the contract for a less specialized reader?
8	Exclusions	Defines what specific activities are not included in the service offering.	1. What service activities are excluded from the agreement?
9	Service levels	Describes if there is any guaranteed uptime of the asset and what response times are in the case of servicing being required.	1. How much uptime can be guaranteed? 2. What are the response times in case a service call is logged? 3. Is it necessary to develop a buffer between expected and contracted service levels?
10	Customer obligations	Defines the obligations of the customer.	1. What are the obligations of the customer to successfully execute on the contracted service activities?
11	Limitation of liability	Defines in which cases the service provider is not liable for certain activities.	1. In the case of which events does the service provider not want to be held liable?
12	Changes to the services or monthly fee	Defines if and how the service contract can be amended, and how these changes will be agreed upon.	1. What changes should either party be able to make in the future?
13	Dispute resolution	Defines what happens in the event of a dispute between the contracting parties.	1. Does the dispute have to be resolved via a third party or in court?
14	Governing law	Defines which jurisdiction is applicable to the service contract. If nothing specific is mentioned in the contract by the service provider, the jurisdiction of the customer will apply.	1. What is the preferred jurisdiction that should apply to the service contract?
15	Remedies	Defines the financial remedies or corrective actions that have to be carried out in the event of a condition in the service contract being breached.	1. What penalties would apply in the event of either party not being able to live up to their responsibilities in the agreement?
16	Termination of agreement	Defines the circumstances in which the service contract may be terminated by either side, and the consequences.	1. In what circumstances would the service contract be allowed to be terminated? 2. What penalties apply when the service contract is terminated?
17	Personal data/Confidential information	Defines if, how and in accordance with which laws the personal data has to be handled and processed.	1. How is confidential or privacy-sensitive data stored on the asset handled?
18	Force majeure	Defines for which events (e.g. events of nature) neither party will be held liable.	1. What events or circumstances need to be included?
19	Intellectual property rights	Describes who will be the owner of specific software or data for which exclusive rights are recognized.	1. For which software or data should ownership reside with the service provider rather than the customer?

Table 2: General Terms & Conditions to address in a service contract.

The most dispute sensitive clauses explained

Even though it is important to cover all of the 19 clauses mentioned before in your service contract, some tend to trigger disputes more easily than others.

This table ranks the earlier defined clauses on two criteria, the probability and the severity of a dispute. The clauses identified as 'high impact' (red section on the heatmap) are discussed in more detail below:

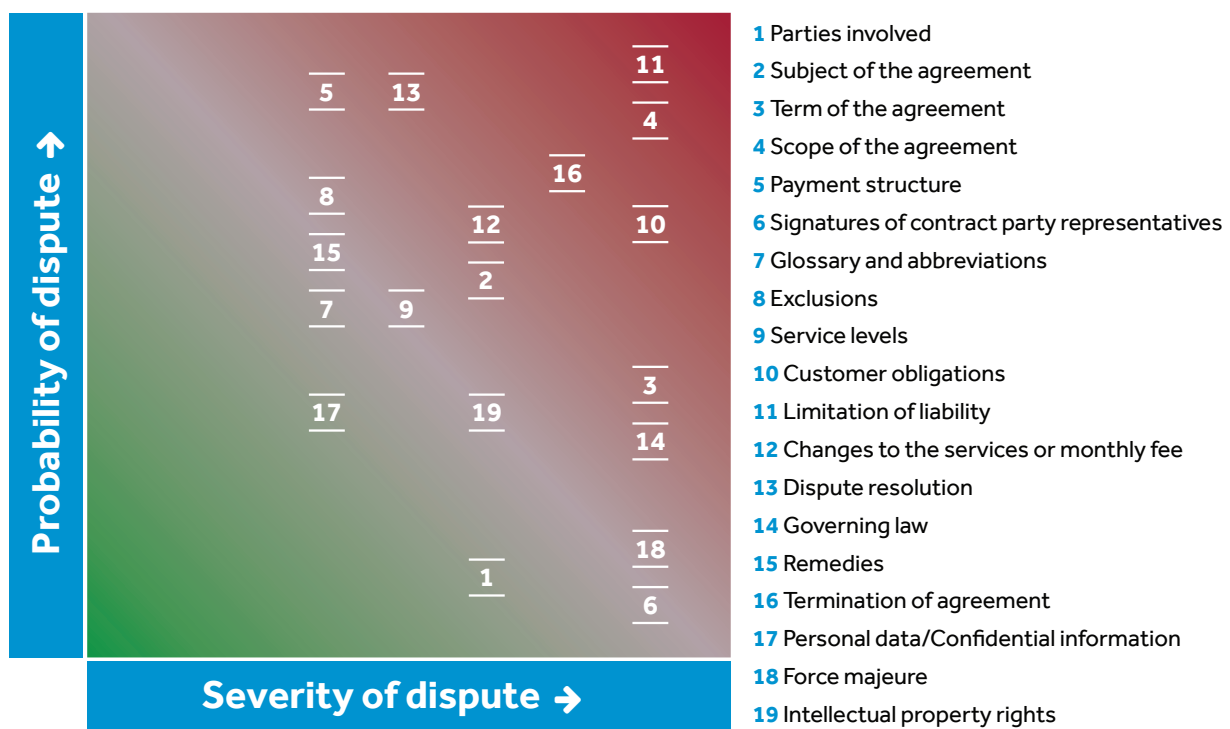


Figure 4: The link between specific clauses in a service contract and disputes.

Scope of the agreement

Clause 4

This clause determines which services are part of the agreement. This is an extremely important clause as it 'defines' the service contract. Customers tend not to bother if they receive more service than anticipated, but will definitely bother if service levels are lower than expected. In which case, the service contract is the only formal document that can prevent a dispute from occurring.

Customer obligation /Limitation of liability

Clause 10 & 11

These clauses determine the customer obligations and describe in what cases the service provider is not liable for specific events or activities. It may, for example, state that the customer has to provide the service provider with access to the customer's premises, or allow technicians to use local utilities to perform the services. If specific wording on the customer obligations is excluded from a contract, various situations can arise where customers might seek to avoid having to pay their service fees by denying technicians appropriate access to the asset (e.g. the asset is no longer utilized; the customer is in financial problems). Alternatively, an asset could be intentionally or accidentally 'abused', leading to disproportionate wear and tear, and thus an increased service need in order to keep the asset in an operative state.



Changes to services/fees

Clause 12

It's easy to imagine how not factoring in annual indexing or inflation into a 10-year service contract could trigger a dispute. In- or decreases to service fees over the duration of the contract have to be explicitly mentioned. In addition to that the service package might change, triggered by either the service provider or the customer. Instead of having to draft a completely new contract, the two parties can agree to add an appendix to the existing one.

Dispute resolution /Governing law

Clause 13 & 14

The dispute resolution clause determines what happens in the event of a dispute or disagreement. Governing law is highly relevant here, as it describes the jurisdiction applicable to the contract. Where this is included in the contract, it could state that a third party will step in to resolve a disagreement before bringing the case to court. Whenever a case is brought to court, it will inevitably be costly and time-consuming for both contracting parties. Where it is not stated under which jurisdiction the contract falls, the jurisdiction of the customer will apply. This means that, as a service provider, you will need to have legal knowledge and experience in each of the countries in which the product is serviced.

Termination of agreement/penalty

Clause 16

This clause specifies under what circumstances the contract can be terminated, and free both parties from further actions. This is directly related to the termination penalty, which specifies what happens in the event of the contract being terminated. If not specified in the contract, the service provider will not be able to terminate the contract, even if payments from the customer are delayed or stopped.

Force majeure

Clause 18

Force majeure applies to various events, such as acts of nature, strikes and terrorist attacks. These events are extremely unlikely to happen, but could have a severe impact on the asset if they do. In the event of force majeure, neither party would be held liable for failing to honor the contract. This clause is to a certain extent covered by law, but could come with various exclusions. Where a force majeure clause is not included in the contract, it is likely that a court will rule in favor of the customer in the event of any of these unforeseen events occurring.

"The following clauses are often insufficiently addressed in a service contract: object of agreement, dispute resolution, termination of the agreement, and customer obligation/limitation of liability."

Noelia Montosa Moreno
Chief Legal Counsel, DLL Spain

Checklist for creating a dispute sensitive service contract



Realize that each service-based business model requires different legal alignment

Determine whether you are drafting a service contract for an activity-, usage- or result-oriented service offering. Each model has different contract needs, and requires different legal skills and capabilities.



Avoid broken promises

Make sure that the service promises made by your sales force are aligned with the content of the contract, and verify if the contracted activities can be delivered within the set parameters. Is a response time of 8 hours realistic? Always? What if it's a public holiday?



Minimize technical wording and legal jargon in the contract

Keep it simple, where you can.



A service contract is not a marketing tool

Remember that the goal of a service contract is to define what services are delivered under which circumstances. It isn't a nor does it have to be captured in one A4 commercial brochure.



Standardize as much as possible, but adapt where necessary

Minimize the complexity and content of the contract, and make use of the general Terms & Conditions.



Clarify the who, what, where, when and how in a service contract

Pinpoint who is performing what services; and where, when and how those services will be carried out.



Be crystal clear in your pricing

Make sure any service activities that come at an additional cost are explicitly mentioned in the contract.



Double-check that the right clauses have been included in the contract

Check if the necessary clauses that have been described in this whitepaper are included in the service contract.



Get the service contract reviewed by an appropriate expert

Ask a (third party) lawyer to review the contract before the first deal is closed in order to check how it would hold up in court under local legislation & regulations.

Closing note

Introduction DLL

DLL is a global vendor finance company with more than EUR 30 billion in assets. Founded in 1969 and headquartered in Eindhoven, The Netherlands, we provide asset-based financial solutions in the Agriculture, Food, Healthcare, Clean Technology, Construction, Transportation, Industrial and Office Technology industries. We work closely with global equipment manufacturers and their distribution partners – from authorized distributors and independent dealers to resellers – to provide financial products and services that help them achieve sustainable, profitable growth. By combining customer focus with deep industry knowledge, we deliver sustainable solutions for the complete asset life cycle, including commercial finance, retail finance, and used equipment finance. We are a wholly owned subsidiary of Rabobank, a Dutch bank, headquartered in Utrecht.

Our servitization solutions include bundling of services provided by our partners in DLL's solutions. This enables manufacturers, dealers, end users and DLL to extract more value from an asset's qualities. Customers are supplied with value-added services that enable them to outsource those activities that are less core to their business, or too complex to manage individually.



At DLL, we are passionate about finding original, integrated solutions that help to resolve real world challenges. We constantly think about how we can collaborate with our partners to rethink how we use our assets and get the most out of them together.

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Publication date

September 2017

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