Blake, Cassels & Graydon LLP May 2010

Blakes Bulletin

Outsourcing

Anatomy of an Outsourcing Agreement – Best Practices in Suncor Energy's ITO Initiative

MATTHEW FLYNN

In 2009, two of Canada's leading players in the oil and gas sector, Suncor Energy Inc. and Petro-Canada, merged in the year's top transaction, creating the country's largest energy company. One of the first action items was the creation of an outsourcing deal to support the newly combined information technology (IT) assets of both enterprises.

Blakes represented Suncor Energy in the C$150-million outsourcing initiative – thought to be Alberta's largest information technology outsourcing (ITO) agreement and one of Canada's most significant outsourcings in recent memory.

The scope of Suncor's ITO encompassed its entire technology infrastructure and applications components, including:

- Service Desk (Level 1 support, on-site support, desktop software support and BlackBerry support)
- Application maintenance (SAP and non-SAP applications)
- Middleware application maintenance
- Server and infrastructure support (mainframe, Unix, Intel and virtual servers)
- Storage and back-up (PCs and Servers)
- Data network (LAN and WAN)

The transaction is notable not only for its size and complexity, but also as a learning tool for current trends and outsourcing best practices.

STAGE 1: PREPARATION AND STRATEGY DEVELOPMENT

Several best practices were key to effective strategizing and staging of the ITO:

Committing to a Competitive Process. Suncor committed to and followed through with a competitive process for service provider selection and contract negotiation. This included running a negotiation process with multiple service providers that substantially enhanced Suncor's negotiating leverage, and helped drive cost savings and service level commitments.

Investing in a Quality Request for Proposal (RFP). Suncor augmented the expertise of its internal stakeholders with outside legal and consulting experts who were retained early on to scope out the deal. This team produced a high-quality RFP with buy-in from all Suncor stakeholders. The early work and investment in the RFP process enabled Suncor to clearly set the expectations of service providers, and stay focused on its objectives throughout the negotiations and eventual closing of the ITO agreements.

The RFP included a comprehensive term sheet of Suncor-preferred legal terms and conditions that each of the RFP-recipient service providers had to accept or reject on a provision-by-provision basis. The term sheet focused on key elements including services, expected service levels and performance standards, and financial models and pricing. The responses provided important evaluation criterion which helped Suncor to determine its preferred service providers.

STAGE 2: DEAL STRUCTURE

The deal structure revealed two current trends in ITOs:

Shorter-Term Contracts. In what could also be considered a best practice, the average term of ITO contracts in recent years has diminished from about 10 years to the three-to-five year range. This is owing to constant business changes, costs, innovation and declining asset lifecycles. To the customer's benefit, shorter terms result in contracts with greater flexibility. Suncor chose a three-year term for its ITO Agreements.

Multi-Sourcing. Suncor also made an early decision to shift from a broad-based, single service provider contract to a series of smaller contracts with multiple service providers focused on discrete functions of infrastructure, applications and data network.

CONT'D ON PAGE 2

CONT'D FROM PAGE 1

A potential benefit in multi-sourcing is that there is no single incumbent service provider with a monopoly on the outsourced services. A potential challenge, however, posed by multi-sourcing is the need for the customer to manage multiple service providers, and the potential scope overlap among service providers.

Suncor mitigated this challenge with a strong focus on governance provisions and with its IT department taking a rigorous approach to defining the scope of work for the various service providers.

STAGE 3: NEGOTIATIONS AND THE RESULTING CONTRACTS

At least half a dozen best practices emerged from this stage:

Building the Right Negotiation Team. Suncor built the "right" team of expert internal and external resources to negotiate the best business deal possible. The company's subject-matter experts had the appropriate knowledge and authority to make required decisions. Subject matter experts included:

- Information services (applications, infrastructure and network)
- Suncor procurement
- Financial modelling
- Human resources
- Legal

Robust Approach to Transition. Transition is arguably the riskiest period of an outsourcing transaction. Suncor's agreement specifically requires:

- Detailed transition and knowledge transfer plan
- Specific obligations set out for both parties
- Schedule for transition deliverables and milestones
- Transition milestone credit mechanism to incentivize timely performance
- Acceptance testing procedures and criteria for deliverables
- Suncor's termination right for a service provider's failure to complete the transition in a timely manner

Contracting to Account for Change. The one constant in an outsourcing relationship is change — change in service requirements, service delivery methods, business and technical environments, and laws and regulations, to name a few.

Suncor's contracts are flexible and contain detailed procedures to account for changes, including:

- Right to in-source and re-source
- Right to reduce volume of services
- Right to benchmark and readjust pricing
- Right to adjust the contract in light of extraordinary drop in volumes
- Flexible termination rights
- Shorter-term lengths

Focus on Governance. Suncor recognized that a successful approach to an outsourcing arrangement would not entail handing off responsibility and authority for the outsourced services to the service provider(s), or taking a hands-off approach to the services and relationship. Neglecting an outsourcing relationship is at the customer's peril. A failure to govern outsourcing projects properly can lead to serious contract value "leakage."

To enable proper governance of Suncor's relationship with its service providers, the mechanisms in the Suncor ITO agreements include:

- Provisions regarding the establishment, membership, meeting requirements and responsibilities of various joint Suncor and service provider governance committees, including an executive committee, management committee and operations committee
- Provisions identifying required reports by service providers, including the content, media format, delivery and frequency of the reports, and requirements for service providers to provide *ad hoc* reports and attend any meetings at no additional charge to Suncor
- Identification of key governance personnel, including contract representatives and service delivery managers for Suncor and the service provider — tasked respectively as primary contacts for all matters relating to the outsourcing agreement — and with responsibility for the day-to-day operational relationships to ensure optimal service delivery

CONT'D ON PAGE 3

CONT'D FROM PAGE 2

- Provisions addressing the fact that IT services are contracted to multiple service providers, including establishment of a multi-provider joint outsourcing committee tasked with co-operating and sharing information to deliver all IT services in an integrated and open manner with minimal disruption to Suncor's business operations

Establishing Service Levels Upfront. Included in the eventual contract were Suncor's required service levels for the outsourced services, as set out in the RFP. This enabled Suncor to make an accurate determination on the value of pricing. It also avoided any loss of leverage that Suncor would have had in negotiating service levels after having awarded the work to service providers, or if it had deferred establishment of service levels to the post-contract execution phase.

Planning for the End of the Relationship. Responding to the fact that, at some point, the outsourcing relationship between Suncor and the service providers may end, Suncor requires broad ongoing (that is, post-termination and post-expiration) intellectual property rights to ensure service continuity (whether internally or from alternative or replacement service providers). Under the contract, the service provider is also required to provide comprehensive end-of-term assistance to facilitate transition of outsourced services back to Suncor, or alternative and replacement service providers, to ensure service continuity.

In the end, Suncor and its service providers collaborated to create a series of best-of-class ITO agreements, and the process they followed provides a shining example of best practices in negotiating and contracting for outsourcing.

For further information, please contact a member of the Blakes Outsourcing Group.

SUNCOR/PETRO-CANADA – A HISTORIC STRATEGIC MERGER

The C$22.5-billion union of Suncor Energy Inc. and Petro-Canada not only created Canada's largest oil and gas conglomerate by capitalization, it was also among the most complex and politically sensitive deals globally in 2009.

With Suncor represented by Blakes, a massive team of over 150 lawyers and business advisers assembled rapidly in early 2009 to work on the amalgamation (a Canadian form of merger). A significant complexity in the deal was navigating federally legislated ownership restrictions for Petro-Canada. To prevent any concentration of ownership in the one-time Crown corporation, no single shareholder could hold more than 20% of outstanding shares.

Blakes helped to successfully structure the deal and called upon its lawyers in almost every practice area to advise on other issues ranging from oil and gas rights to competition law to technology. The amalgamation itself was completed under a statutory plan of arrangement, which then had to be approved by a court. That approval was also contingent on shareholder votes and regulatory requirements. In addition, the transaction was scrutinized by U.S. authorities under its antitrust review provisions.

Despite an extremely tight timeline and numerous intricate legal issues, all stakeholders and regulatory authorities approved the deal by August 1, 2009, making Suncor Energy Inc. among the world's largest North American-based energy companies.