

COURT FILE NUMBER 1501-01523  
COURT COURT OF QUEEN'S BENCH OF ALBERTA  
JUDICIAL CENTRE CALGARY  
APPLICANT NATIONAL BANK OF CANADA  
RESPONDENT **PALLISER OIL & GAS CORPORATION**  
DOCUMENT **FIRST REPORT OF FTI CONSULTING CANADA INC., IN ITS CAPACITY AS COURT APPOINTED RECEIVER AND MANAGER OF PALLISER OIL & GAS CORPORATION**

**July 4, 2016**

ADDRESS FOR SERVICE AND CONTACT INFORMATION OF PARTY FILING THIS DOCUMENT

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## INTRODUCTION

1. On February 12, 2015 (the “**Date of Appointment**”), FTI Consulting Canada Inc. was appointed as receiver and manager (the “**Receiver**”) of all the assets, undertakings and properties (the “**Property**”) of Palliser Oil & Gas Corporation. (“**Palliser**” or the “**Company**”) pursuant to an Order of the Honourable Mr. Justice S.J. LoVecchio (the “**Receivership Order**”).
2. The Receivership Order authorized the Receiver, among other things, to carry on the business of the Company, to market and solicit offers to purchase the Assets (as defined below) of the Company, and to make such arrangements or agreements as deemed necessary by the Receiver.
3. The Receiver’s reports and other information in respect of these proceedings (the “**Receivership Proceedings**”) are posted on the Receiver’s website at <http://cfcanada.fticonsulting.com/palliser/>.
4. The purpose of this report, which is the Receiver’s first report (this “**First Report**”), is to inform the Court on the following:
  - (a) the status of various aspects of the Receivership Proceedings;
  - (b) the Receiver’s receipts and disbursements from the Date of Appointment to June 9, 2016;
  - (c) the Receiver’s summary and comments on the marketing efforts to solicit offers to purchase Palliser’s Assets (as defined below), including the offer received from Petrocapita Oil and Gas LP (“**Petrocapita**”) to purchase Palliser’s Assets; and
  - (d) Alberta Energy Regulator Bulletin 2016-16 (as defined below).
5. The Receiver is requesting the following relief from this Honourable Court:

- (a) approval of the activities of the Receiver since the Date of Appointment including its receipts and disbursements; and
- (b) approval of the Petrocapita Oil and Gas APA (as defined below).

## **TERMS OF REFERENCE**

- 6. In preparing this First Report, the Receiver has relied upon unaudited financial information, other information available to the Receiver and, where appropriate, the Company's books and records and discussions with various parties (collectively, the "**Information**").
- 7. Except as described in this First Report:
  - (a) the Receiver has not audited, reviewed or otherwise attempted to verify the accuracy or completeness of the Information in a manner that would comply with Generally Accepted Assurance Standards pursuant to the Canadian Institute of Chartered Accountants Handbook; and
  - (b) the Receiver has not examined or reviewed financial forecasts and projections referred to in this report in a manner that would comply with the procedures described in the Canadian Institute of Chartered Accountants Handbook.
- 8. Future oriented financial information reported or relied on in preparing this First Report is based on assumptions regarding future events. Actual results may vary from forecasts and such variations may be material.
- 9. The Receiver has prepared this First Report in connection with the motion described in the Receiver's Application dated July 4, 2016. This First Report should not be relied on for other purposes.

10. Information and advice described in this First Report has been provided to the Receiver by its counsel, Blake, Cassels & Graydon LLP (the “**Receiver’s Counsel**”) and has been provided to the Receiver to assist it in considering its course of action and is not intended as legal or other advice to, and may not be relied upon by, any other stakeholder.
11. Unless otherwise stated, all monetary amounts contained herein are expressed in Canadian Dollars.

## **CURRENT STATUS OF THE RECEIVERSHIP PROCEEDINGS**

### **Background**

12. Palliser is a public entity incorporated under the laws of the Province of Alberta and was formally listed on the Toronto Stock Venture Exchange and its shares traded under the ticker symbol “PXL”. The Company’s principal line of business is the acquisition of, exploration for, and development and production of petroleum and natural gas reserves in Western Canada. The Company’s operations include high working interest and operatorship in multi-zone oil and liquids rich natural gas and associated infrastructure in the Granlea, Lloydminster, Marwayne and Swimming areas of Alberta as well as the Edam, Manitou and Marsden areas of Saskatchewan (collectively, the “**Assets**”).
13. Prior to the Receivership Proceedings, the Company experienced various financial challenges due production declines, lower commodity price environment, and unsuccessful capital programs.
14. The Company’s unaudited consolidated financial statements as at September 30, 2014 indicated the following:
  - (a) book value of property, plant and equipment of approximately \$67.3 million;

- (b) bank indebtedness of approximately \$42.3 million owed to National Bank of Canada (the “**National Bank**”). The Company had a revolving operation demand loan and an acquisition and development demand loan facility with the National Bank. National Bank is the largest creditor under the Receivership Proceedings; and
  - (c) \$10.4 million of accounts payable and accrued liabilities.
15. On January 27, 2015, National Bank issued a demand for payment and a notice of intention to enforce security pursuant to section 244(1) of the *Bankruptcy and Insolvency Act*, RSC 1985, c B-3 (“**BIA**”) as described in the Affidavit of Elizabeth Pineda sworn February 2, 2015 (the “**Pineda Affidavit**”).
  16. All directors of the Company resigned prior to the Date of Appointment.

#### **Custody & Control**

17. On February 12, 2015, the Receiver attended the Company’s leased premises located at 600, 255 – 5<sup>th</sup> Ave SW, Calgary, Alberta to meet with Palliser’s employees and consultants to advise that the Receivership Order had been granted and to take possession of the Company’s Property in accordance with the terms of the Receivership Order. The Receiver indicated its intent to maintain the Company’s operations in order to facilitate an orderly sale of the Assets to maximize the return for all stakeholders.
18. At the Date of Appointment, substantially all employee related obligations and statutory deductions were current and employees the Company’s payroll services had been funded to be distributed on February 15, 2015. The Receiver made arrangements to continue the Company’s payroll service during the Receivership Proceedings.

19. The employee obligations which were not paid, related to vacation pay due to four employees. The Receiver provided these employees with information regarding their rights with respect to the Wage Earner Protection Program (“WEPPA”).
20. On the Date of Appointment, the Receiver met with the Company’s senior management (“**Management**”) in order to ensure the continued service of the Company’s critical suppliers and contract operators. With the assistance of Management, the Receiver was able to successfully maintain the services of the Company’s critical suppliers and as a result, Palliser’s operations have continued without any material disruptions since the Date of Appointment.
21. In order to complete the foregoing and other administrative costs associated with the Receivership Proceedings, the Receiver has drawn \$500,000 in Receiver Certificates in accordance with the terms of the Receivership Order. None of those amounts have been repaid as of the date of this First Report.
22. On or around the Date of Appointment, the Receiver also completed the following administrative tasks:
  - (a) prepared the notice and statement of the receiver as required under section 245 and 246 of the *BIA* and mailed the notice to all known creditors as well as posting all relevant documents to the Receiver’s website;
  - (b) in accordance with the Receivership Order, froze the Company’s bank accounts and transferred the remaining balance to the Receiver’s account;
  - (c) notified the Company’s oil and gas marketers to facilitate the payment of the Company’s oil and gas revenue to the Receiver’s trust account going forward;
  - (d) investigated the status of the Company’s insurance coverage; and

- (e) communicated with numerous creditors and stakeholders regarding the Receivership Proceedings.

### **Insurance**

- 23. The Receiver contacted the Company's insurance broker, Willis Global Energy, to amend the Company's existing insurance policies to reflect the Receiver's interest in the Assets, review its adequacy and discuss the current status of insurance coverage.
- 24. The Company's insurance policy had expired on February 4, 2015. The Receiver subsequently extended the policy on three separate occasions. The current policy is set to expire on August 4, 2016.

### **Employees**

- 25. At the Date of Appointment, the Company employed thirteen employees. The Receiver retained the services of five of the employees to assist the Receiver through the Receivership Proceedings, and each agreed to continue their employment under the existing terms (the "**Employees**"). The remaining eight employees were terminated shortly after the Date of Appointment.
- 26. The Employees agreed to assist the Receiver with the operations of the Companies, maintain the books and records, and assist with the marketing process. The Employees retained by the Receiver included the financial controller, production manager, exploitation manager, accounts payable clerk and field superintendent.
- 27. In addition to the Employees, the Company had six contractors. The Receiver continued to utilize the services of five of contractors on an as needed basis.

28. Effective December 1, 2015, the Receiver transitioned the daily operational tasks and engaged Veracity Energy Services Ltd. (“**Veracity**”) to assist the Receiver with all operational tasks. Through the transition period all remaining Employees were terminated.
29. At the date of this First Report, one consultant’s services have been retained by the Receiver, with the remainder of operational tasks being handled by Veracity, under the supervision of the Receiver.

### **Office Lease**

30. At the Date of Appointment, the Company was leasing its head office space located at 600, 255-5<sup>th</sup> Avenue SW, Calgary, Alberta. The Receiver vacated the leased premises on March 15, 2015.
31. After exiting the leased premises, the Receiver moved the Company into a shared office space on a month to month basis. The move downsized the Company’s office space to reflect the reduced number of employees as well as reduced G&A expenses significantly.
32. In connection with the transition to Veracity, the Receiver moved the Company’s operations out of the shared office space and into Veracity’s office. This further reduced the G&A expenses.

### **Statutory Compliance**

33. On February 20, 2015, the Receiver mailed its notice and statement of affairs in accordance with subsection 245(1) and 246(1) of the *Bankruptcy and Insolvency Act* to the Superintendent of Bankruptcy and to all known creditors of the Company.



34. The Receiver established a website (the “**Receiver’s Website**”) where it has posted periodic updates on the progress of the Receivership Proceedings, material filed in connection with the Receivership Proceedings and other relevant information.
35. The Receiver notified the Canada Revenue Agency (“**CRA**”) of the Receiver’s appointment and established new remittance accounts for the goods and sales tax (“**GST**”) and employee source deduction obligations arising subsequent to the Date of Appointment.

### **SUMMARY OF RECEIPTS AND DISBURSEMENT**

36. Receipts and Disbursements from the Date of Appointment to June 9, 2016, are summarized as follows:

<b>Schedule of Receipts and Disbursements</b>	
As of June 9, 2016	
Receipts	
Oil Revenue	7,762,074
Gas Revenue	128,250
JIB Revenue	874,247
Receiver's Certificate	500,000
GST Collected	311,723
Other Receipts	217,273
<b>Total - Receipts</b>	<b>9,793,566</b>
Disbursements	
Operating Expenses	(4,643,999)
Royalty and Lease Payments	(2,392,017)
Employee Costs	(921,960)
JIB Payable	(206,300)
Bank Charges	(27,548)
Rent and Utilities	(290,930)
Taxes Paid	(502,488)
Professional Fees	(511,947)
Insurance	(163,090)
Other Miscellaneous Expenses	(31,313)
<b>Total - Disbursements</b>	<b>(9,691,593)</b>
<b>Net Cash on Hand</b>	<b>101,973</b>

- (a) Oil Revenue – revenue collected by the Receiver in respect of the Company’s Oil producing Assets;
- (b) Gas Revenue – revenue collected by the Receiver in respect of the Company’s Gas producing Assets;
- (c) JIB Revenue – revenue collected by the Receiver in respect of the Company’s joint interest billing partners;
- (d) Receiver’s Certificate – amounts borrowed to date under terms of the Receivership Order;
- (e) GST Collected – GST amounts collected relating to the Company’s Revenue;
- (f) Other Receipts – receipts from GST refunds and other miscellaneous collections;
- (g) Operating Expenses – operating expenses relating to the Assets;
- (h) Royalty and Lease Payments – amounts disbursed in respect of the Company’s petroleum and natural gas leases;
- (i) Employee Costs – amounts disbursed by the Receiver relating to payroll and employee deductions and consultants;
- (j) JIB Payable – amounts disbursed by the Receiver payable to joint interest partners;

- (k) Bank Charges – amounts disbursed in respect of interest on amounts borrowed under the terms of the Receiver Certificate, wire payment fees, overdraft and interests in respect of the Company’s pre-receivership accounts and other miscellaneous charges.
  - (l) Rent and Utilities – amounts disbursed in respect of the rental of office space and utilities paid for continued operations;
  - (m) Taxes Paid – GST and PST amounts disbursed relating to invoices paid;
  - (n) Professional Fees – Receiver’s and Legal fees and disbursements in respect of the Receivership Proceedings.
  - (o) Insurance – amounts disbursed in respect of insurance for employees as well as operating insurance for field properties; and
  - (p) Other Miscellaneous Expenses – amounts disbursed including filing fees paid to the Official Receiver, off-site storage and moving expenses.
37. Cash on Hand – at June 9, 2016 [NTD: Do we want this updated to June 30?], the Receiver currently holds \$101,973 in funds.

## **MARKETING PROCESSES AND OFFERS TO PURCHASE**

### **Initial Marketing Process**

38. Subsequent to the Date of Appointment, the Receiver engaged in discussions with the Company and National Bank to discuss the effect of production which had previously been shut-in (due to Palliser’s lack of working capital during the pre-receivership period) on the potential recoveries for the Company’s stakeholders. As a result of these discussions, the Receiver implemented an optimization work-over plan to re-activate a number of wells to increase production and the potential value to be realized for the Assets.

39. With the assistance of the Company, the Receiver implemented the work-over plan (“**Work-over Plan**”) by examining the Assets on a well by well basis to determine if a particular well should be re-activated. A well was considering for the Work-over Plan under the following conditions:
- (a) the well had positive netback at the current market prices;
  - (b) wells had strong production prior to being shut-in; and
  - (c) payback time for the work completed was short to allow the Receiver to recoup the expenditures within the Receivership process.
40. After the Work-over Plan had been completed and production increases had been realized the Receiver began to market the Assets in late April, 2015 (“**Initial Marketing Process**”).
41. The Receiver, in consultation with the National Bank, determined that a selling agent was not necessary for the Initial Marketing Process. The Assets had been recently marketed by the Company through National Bank Financial, as Palliser’s selling agent.
42. Given that a selling agent had been previously engaged by the Company, the Receiver, in consultation with the National Bank, determined that completing the sales process without a selling agent would be the most effective method to continue with the Initial Marketing Process (the “**Continued Marketing Process**”) as the Assets had previously been exposed to the market prior to the Date of Appointment. The Receiver continued with the sale process by contacting all the parties that had expressed an interest in the Assets in the Initial Marketing Process. Furthermore, the Receiver expanded the contact list of previously interested parties to encompass the majority of parties likely to purchase the Assets by also contacting:

- (a) any companies operating in close geographical proximity to the Assets; and
  - (b) all parties previously known to be interested in this type of asset.
43. Working with the Company, the previously created marketing information located in the data room (“**Data Room**”) was updated to reflect the Work-over Plan.
44. A summary of the Receiver’s activities during the Continued Marketing Process was as follows:
- (a) the Receiver prepared and email out a teaser and a confidentiality agreement, which was reviewed by the Receiver’s Counsel, to 51 parties on May 6, 2015. Of these 51 contacted parties, 30 had previously expressed interest in the Assets and 21 were based on the Receiver’s research to expand the Marketing Process contact list;
  - (b) any interested party who responded with a signed confidentiality agreement was couriered a Data Room disc and was able to access the Assets’ seismic information at the Company’s office;
  - (c) a total of 23 confidentiality agreements (“**CAs**”) were signed; and
  - (d) there was a June 1, 2015 bid deadline for offers to be submitted in the form of non-binding letters of intent;
45. At the close of the bidding period, the Receiver had received 24 different offers from a total of 20 interested parties. Of these offers there were:
- (a) 4 offers to purchase the entirety of the Assets; and
  - (b) 19 offers to purchase a portion of the Assets.

46. The Receiver accepted LOI's for portions of the Assets based on the potential that a piece-meal offer would not result in the maximizing the value of the Assets.
47. After reviewing the offers, the Receiver identified three LOI's that would provide for the greatest recovery. The purchase price of all three LOI's consisted of a cash portion and a contingent value component. The Receiver then re-engaged those parties to better understand the non-cash component of each LOI.
48. After reviewing the LOI's, the Receiver attempted to negotiate a transaction with one party (the "Initial Bidder") as it represented the most value for the Assets and began the process to complete a binding offer to purchase.
49. The Receiver engaged in continuous discussions with the Initial Bidder in an effort to finalize a definitive agreement over the course of several weeks, however the Initial Bidder was ultimately unable to complete the transaction. The Receiver also attempted to re-engage the remaining interesting bidders but was unable to complete any transaction at that time.

### **Second Marketing Process**

50. Given the inability to close a transaction with the Initial Bidder, in order to ensure the valuation optimization of the Assets and the longer than anticipated sale process the Receiver retained a third party operator (as discussed above) in December 2015.
51. The Receiver met with Veracity to discuss the potential to transition the operational activities which were currently being conducted by the Receiver with the assistance of former Palliser employees. The Receiver determined Veracity offered the lowest cost operational alternative on a go forward basis as well as having valuable operational experience, which would be necessary to prepare the Assets for a second marketing process ("**Second Marketing Process**").

52. The Receiver, in consultation with Veracity, decided to focus operational efforts on reducing operating and G&A expenses and further shutting in uneconomic production (given the ongoing decline in commodity prices) with the intention of making the Assets as attractive to potential interested parties with positive, or as close to positive netback production.
53. In February, 2016, the Receiver engaged NRG Divestitures (“**NRG**”) to market the Assets. The Receiver chose to engage a marketing agent for the Second Marketing Process for the following reasons:
- (a) substantial time had passed since the Assets had been marketed and therefore it was important to expose the Assets to as many potential interested parties as possible;
  - (b) there had been significant changes in the number of producing wells and economic environment since the Initial Marketing Process; and
  - (c) NRG would provide a fully refreshed marketing process in order to determine the any potential buyers for the Assets.
54. A summary of the Second Marketing Process conducted by NRG is presented below:
- (a) The Second Marketing Process was launched on February 4, 2016
  - (b) NRG took the following steps to expose the Assets to the market:
    - i. Newspaper Ads – Calgary Herald Business Section – Feb. 23 – Mar. 11;
    - ii. Daily Oil Bulletin Ads – Feb. 9, 11, 17, 25 and Mar. 25;
    - iii. Email Blast – 1,200 Promotional Emails;

iv. Targeted Phone Calls – 200 plus from NRG data base including 50 heavy oil players; and

v. NRG website – generated 1,200 views per week.

(c) Bid deadline (“**Bid Deadline**”) was set at March 8, 2016.

55. Through the Second Marketing Process 27 companies signed confidentiality agreements and 12 offers to purchase the Assets were received.

56. In consultation with National Bank and NRG, the Receiver asked that the four top bidders (the “**Potential Bidders**”) to complete their respective due diligence, remove financing conditions by April 29, 2016, and to sign a form purchase and sale agreement along with a non-refundable deposit, subject only to Court Approval. The Potential Purchasers were advised that the Second Marketing Process was still competitive and offers may be revised to reflect their best and final offer.

57. On or around April 29, 2016 the Potential Purchaser submitted an offer to NRG after completing standard due diligence.

58. In consultation with National Bank and NRG, the Receiver determined the offer to purchase submitted by Petrocapita represented the highest value and was reasonable and fair given the circumstances.

#### **Petrocapita Offer to Purchase**

59. The Receiver has entered into an asset purchase agreement with Petrocapita (the “**Petrocapita APA**”) dated June 7, 2016. A redacted executed copy of the Petrocapita APA is attached hereto as Appendix A.

60. A summary of the key commercial terms of the Petrocapita APA are set on the Receiver’s confidential supplement to this Report along with an unredacted version of the Petrocapita APA.



61. The Receiver notes the following with respect to the Petrocapita APA:
- (a) A standard deposit (10% of the purchase price) has been received by the Receiver and is being held by the Receiver's Counsel in trust;
  - (b) The Petrocapita APA only remaining condition is court approval;
  - (c) The effective date is May 1, 2016; and
  - (d) The closing date is scheduled to occur two business days following the granting of the Sale Approval and Vesting Order;

**Receiver's Analysis of the Offer to Purchase**

62. The Receiver has concluded that the Petrocapita APA represented the best value that could be reasonably be obtained for those Assets in the present circumstances for all stakeholders based on following:
- (a) the Assets have been adequately exposed to the market through the Initial Marketing Processes, the Continued Marketing Process and the Second Marketing Process;
  - (b) the Petrocapita APA is fair and commercially reasonable in the circumstances; and
  - (c) National Bank, the largest secured creditor in the Receivership Proceeding, supports the Receiver closing the Petrocapita APA.

## ALBERTA ENERGY REGULATOR BULLETIN 2016-16

63. On June 20, 2016 the Alberta Energy Regulator issued Bulletin 2016-16 (“**AER Bulletin**”) in response to the Court of Queen’s Bench’s decision involving a dispute between the receiver of Redwater Energy Corporation, the Alberta Treasury Branches, the Alberta Energy Regulator (“**AER**”) and the Orphan Well Association.
64. The AER Bulletin, set out the following changes to the licensing requirements necessary for the AER to transfer well licenses when a sale of Alberta oil and gas assets are sold: (the following is taken directly from the AER Bulletin)
- (a) The AER will consider and process all applications for license eligibility under *Directive 067: Applying for Approval to Hold EUB Licenses* as nonroutine and may exercise its discretion to refuse an application or impose terms and conditions on a license eligibility approval if appropriate in the circumstances.
  - (b) For holders of existing but previously unused license eligibility approvals, prior to approval of any application (including license transfer applications), the AER may require evidence that there have been no material changes since approving the license eligibility. This may include evidence that the holder continues to maintain adequate insurance and that the directors, officers, and/or shareholders are substantially the same as when license eligibility was originally granted.
  - (c) As a condition of transferring existing AER licenses, approvals, and permits, the AER will require all transferees to demonstrate that they have a liability management ratio (LMR) of 2.0 or higher immediately following the transfer.

65. The Petrocapita APA was signed on June 7, 2016 and was in compliance with the AER's guidelines on the date of execution. Under the AER Bulletin, Petrocapita would not meet the AER's transfer conditions as Petrocapita's Alberta LMR post transfer would be less than 2.0.
66. In response to the AER Bulletin, Petrocapita presented an application to the AER to consider the license transfers as contemplated in the Petrocapita APA, for the purposes of allowing the transfer despite the fact that Petrocapita's post transfer LMR would be below 2.0.
67. On June 29, 2016, Petrocapita received an official response from a person of authority at the AER stating that the AER reviewed the Petrocapita APA and deemed the transaction to be acceptable and the AER would transfer the associated well licenses.
68. In connection with the formal response from the AER, the Receiver understands that no issues are anticipated in with completing the license transfers in Alberta associated with the Petrocapita APA.

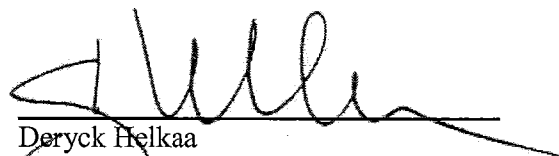
## **RECEIVER'S RECOMMENDATIONS**

69. As of the date of this report, the Receiver and the Receiver's Counsel are finalizing its views on the potential priority of creditor claims and any potential distributions to creditors. Accordingly, the Receiver is not seeking a distribution order at this time.
70. The Receiver respectfully recommends that this Honorable Court approve the following:
  - (a) the activities of the Receiver since the Date of Appointment including its receipts and disbursements; and

(b) the Petrocapita APA dated June 7, 2016 in the form attached hereto as Appendix A.

All of which is respectfully submitted this 4<sup>th</sup> day of July, 2016.

FTI Consulting Canada Inc.  
in its capacity as Receiver of  
the assets, property and undertaking of Palliser  
Oil & Gas Corporation.

A handwritten signature in black ink, appearing to read 'Deryck Helkaa', written over a horizontal line.

Name: Deryck Helkaa  
Title: Senior Managing Director,  
FTI Consulting Canada Inc.

# **Appendix A**