



COURT FILE NUMBER 1201-16124

COURT COURT OF QUEEN'S BENCH OF ALBERTA

JUDICIAL CENTRE CALGARY

PLAINTIFF NATIONAL BANK OF CANADA

DEFENDANT SOLARA EXPLORATION LTD.

DOCUMENT **FIRST REPORT OF FTI CONSULTING CANADA INC., IN ITS CAPACITY AS COURT-APPOINTED RECEIVER AND MANAGER OF SOLARA EXPLORATION LTD.**

**November 1, 2013**

ADDRESS FOR SERVICE AND CONTACT INFORMATION OF PARTY FILING THIS DOCUMENT

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## INTRODUCTION

1. FTI Consulting Canada Inc. was appointed Receiver and Manager (“Receiver”) of the property, assets and undertakings (the “Assets”) of Solara Exploration Ltd. (“Solara” or the “Company”) pursuant to an Order (the “Receivership Order”) of this Honourable Court granted on December 19, 2012.
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 of the Company, and to make such arrangements or agreements as deemed necessary by the Receiver.
3. The purpose of this first report (the “First Report”) of the Receiver is to advise this Honourable Court with respect to:
  - a) the activities of the Receiver since its appointment;
  - b) the Receiver’s statement of receipts and disbursements since its appointment to November 1, 2013;
  - c) the Receiver’s comments on the marketing efforts to solicit offers to purchase Solara’s assets, as defined below; and
  - d) an offer to purchase Solara’s oil and natural gas properties from Incipient Exploration Ltd. (“Incipient”).
4. All references to currency in the First Report are in Canadian Dollars.
5. Capitalized terms not otherwise defined herein have the meanings set out in the Receivership Order.

## BACKGROUND

6. Solara is an oil and gas company engaged in the production, exploration, development and acquisition of petroleum and natural gas properties in the Provinces of Alberta. Solara is a public company listed on the TSX Venture Exchange with its head office located in Calgary, Alberta.
7. Solara's oil and gas operations can be divided into the following three core areas (collectively the "Assets"):
  - a) operated and non-operated oil properties located in central Alberta near Buck Lake ("Buck Lake");
  - b) a heavy oil play known as Dewberry located in northeast Alberta ("Dewberry"); and
  - c) miscellaneous operated and non-operated properties throughout Alberta.

The Buck Lake and Dewberry properties make up a large percentage of Solara's total asset value. In addition to Buck Lake and Dewberry, Solara has various working interests in operated and non-operated properties in 20 areas consisting of approximately 180 wells (the "Negative Value Wells"). Large majorities of the Negative Value Wells are natural gas wells that have been shut-in or suspended, as they are not economical to operate due to poor production volume and/or depressed natural gas prices. Apart from a drastic increase in natural gas prices the majority of the Negative Value wells will require abandonment in the near future. Throughout the marketing process the Negative Value Wells caused significant difficulties for the Receiver as a purchaser of the Assets would be taking on the abandonment liability of the Negative Value Wells, as discussed in further detail below.

8. Solara's unaudited September 30, 2012 financial statements indicated the following:
  - a) Book value of oil and gas assets totaling approximately \$21.0 million;
  - b) Secured debt of \$15.3 million primarily owed to the National Bank of Canada ("National Bank"). National Bank provided Solara with an operating line of credit and is the most significant secured creditor with respect to this Receivership; and
  - c) Unsecured creditors totaling \$7.6 million.
9. At the date of the Receivership Order, the Assets were producing approximately 110 barrels of oil equivalent ("BOE") per day of oil and natural gas.

## **ACTIVITIES OF THE RECEIVER SINCE DECEMBER 19, 2012**

### ***CUSTODY & CONTROL***

10. On December 19, 2012, in accordance with the Receivership Order the Receiver froze Solara's bank accounts.
11. On December 20, 2012 the Receiver attended the leased head office of Solara located at 1800, 555-4th Avenue S.W. in Calgary, Alberta to meet with the Company's consultants/staff in order to discuss the transition of operations from management to the Receiver.

## ***INSURANCE***

12. The Receiver requested a copy of the current insurance coverage from Aon Reed Stenhouse (“AON”) in order to review its adequacy and discuss the current status of insurance coverage. The insurance policy was set to expire on July 31 2013, however, the Receiver worked with Aon to coordinate ongoing monthly insurance premium payments (excluding payments for Directors & Officers insurance) to ensure Solara’s Assets were adequately insured.

## ***EMPLOYEES AND CONTRACTORS***

13. As at December 19, 2012 Solara did not have employees on staff, as all employees had been terminated prior to the receivership. On December 20, 2012 the Receiver met with the Company’s consultants at head office to advise them of the receivership and discuss on-going operations. All consultants whose services were deemed necessary to assist the Receiver going forward agreed to continue working on an hourly basis as needed. The consultants retained by the Receiver consist of a financial/joint venture accountant, production accountant, oil and gas marketing agent, operations engineer, and office assistance. The Company’s CEO and CFO also agreed to assist the Receiver on an as needed basis.

## ***OFFICE LEASE AGREEMENT***

14. At the date of the receivership Solara was leasing its head office space located in Calgary, Alberta. The Receiver made arrangements with the current landlord to move to a smaller office space in the current building and agreed to allow the Receiver to occupy the space until such time that the Receiver gives 30 days’ notice to terminate the agreement.

### ***STATUTORY NOTICES***

15. On December 27, 2012 the Receiver mailed the statutory notice and statement of Receiver in accordance with subsections 245(1) and 246(1) of the *Bankruptcy and Insolvency Act*. Additionally, the Receiver set-up a website <http://cfcanada.fticonsulting.com/solara/> to post information related to the receivership. The Receiver has posted all relevant documents relating to these proceedings to this website.

### ***OPERATIONAL REVIEW***

16. On December 20, 2012 the Receiver met with Solara's operations engineer to discuss the current status of Solara's operations, any urgent operational issues that required immediate attention and discretionary work-overs that could potentially increase production prior to commencing a sales process.
17. The Receiver, with the assistance of the operations engineer, compiled a list of critical suppliers to contact and assure the continuation of critical services throughout there receivership. The Receiver successfully arranged the continuation of all critical services and consequently the Company's operations proceeded without disruption.
18. The Receiver contacted Solara's field operators to discuss their continued involvement in operating Solara's producing wells. All required field operators agreed to work for the Receiver on an hourly and as needed basis.
19. The Receiver has continued to operate the Assets without any material changes since the date of the receivership. Production throughout the receivership has averaged approximately 110 BOE per day.

20. Significant improvements in heavy oil prices over the duration of the receivership have led to increased cash flow from the Dewberry property allowing the Receiver to operate without drawing on a receiver's certificate to fund operations.

### SUMMARY OF RECEIPTS AND DISBURSEMENTS

21. The table below summarizes the receipts and disbursements of the Receiver from December 20, 2012 to November 1, 2013:

Schedule of Receipts and Disbursements December 19, 2012 to November 1, 2013		Notes
Opening Cash	220,500	a
Oil and Gas Revenue Collections	1,939,158	b
GST Collected	95,310	c
Other Collections/Interest	11,108	
<b>Total Receipts</b>	<b>2,266,075</b>	
Operating Expenses	1,348,923	d
Contracted Employees	222,750	e
Receiver and Legal Fees	183,102	f
Taxes	9,516	g
Insurance	25,991	
Rent and Utilities	55,566	
GST Paid	73,766	
Other Misc. Expenses	35,644	
<b>Total Disbursements</b>	<b>1,955,259</b>	
<b>Net Cash on Hand</b>	<b>310,816</b>	h

22. The following is a description of the major cash receipts and disbursements in the above table:

- a) Opening cash – upon the Receiver's appointment, Solara's bank account had \$220,500 in opening cash that was transferred to the Receiver's account;

- b) Oil and gas revenues – receipts received by the Receiver from Solara’s operating oil and gas assets;
- c) GST collected – relates to GST received on oil and gas revenues;
- d) Operating expenses – to date, the Receiver has disbursed \$1,348,923 in operating expenses relating to the Assets;
- e) Contracted employees – \$222,750 has been disbursed by the Receiver relating to payments to contractors;
- f) Receiver and legal fees – \$183,102 in receiver and legal fees have been incurred to date;
- g) Taxes – 9,516 in property and municipal taxes have been paid by the receiver; and
- h) As at November 1, 2013, the Receiver currently holds \$310,816 in funds.

## **MARKETING PROCESS**

23. The Receiver, in consultation with National Bank, determined that a selling agent should be retained to assist in the marketing of the Assets in order maximize the value of the Assets. The Receiver discussed potential selling agents with Solara’s management and was advised that NRG Divestitures Inc. (“NRG”) had previously been engaged by Solara to market certain of the Company’s Assets. The Receiver determined NRG would be the most effective agent to lead the sale’s process based on the following:

- a) overall marketing process contemplated;
- b) knowledge of the Assets;



- c) general experience and knowledge of the industry; and
  - d) fee structure.
24. National Bank agreed with the decision to retain NRG to assist in marketing the Assets.
25. The Receiver consulted with NRG to gather updated information for the electronic data room and marketing brochures. The timeline for the marketing process was as follows:
- a) January 11, 2013- all marketing materials ready for review;
  - b) January 15, 2013- NRG sent marketing material to over 1,900 oil and gas contacts and placed targeted phone calls to known strategic buyers;
  - c) January 21, 2013- marketing materials posted on NRG's and the Receiver's website;
  - d) On January 31, February 5, 7, 12, 14 and 19, 2013 NRG placed ads in the Daily Oil Bulletin;
  - e) NRG and Solara's operations engineer provided presentations for interested parties as requested as well as access to information via an electronic data room. A copy of NRG's sales brochure can be found on the Receiver's website at <http://cfcanada.fticonsulting.com/solara/>; and
  - f) February 14, 2013- bid deadline for offers to be submitted in the form of a letter of intent.

26. The marketing process resulted in a total of 16 offers (the "Bids") from potential purchasers for varying packages of the Assets. The Bids did not result in a reasonable transaction for the Receiver to close as there were no bids for a large majority of the Negative Value Wells. The Receiver notes that all offers received, and a combination of best offers by property, were significantly less than the amounts owed to National Bank.
27. The Receiver considered options to accept the highest offers for certain of the Assets and use the proceeds to abandon or pay a party to take over the Negative Value Wells that did not receive a bid, however, given the composition of the offers received and related estimated sale proceeds, the Receiver was unable to structure sales that it believed would have resulted in a transaction that was acceptable to the various key stakeholder groups including the Alberta Energy Regulator (the "AER") and National Bank.
28. The Receiver concluded that it was necessary to re-open the bid process and search for a potential purchaser who would be willing to purchase the Negative Value Wells along with the Buck Lake and Dewberry properties.
29. The Receiver advised potential purchasers it was seeking a transaction (the "Revised Bids") to purchase all of the Assets, including the Negative Value Wells, so all properties could be dealt with concurrently or in one transaction. This strategy would also assist in obtaining support and approval of the sale from the AER who will ultimately have to approve oil and gas well license transfers to the purchaser of the Assets.
30. The process of soliciting Revised Bids was led by NRG commencing on or about March 11, 2013 and included the following:
  - a) updating the marketing materials with current financial and production information; and

- b) contacting parties who had previously expressed interest and additional parties who had been identified by NRG via phone and email.
31. During the process of soliciting Revised Bids the Receiver considered further options such as holding the Assets and remarketing at a later date and the related cash needs associated with this process.
32. The Receiver engaged a third party oil and gas engineering firm to perform a review of Solara's Assets and provide a report identifying potential capital projects to potentially increase Solara's production. The Receiver used this report to consider the option of investing additional funds into Solara's Assets in an effort to increase production. The belief was that increased production may assist in attracting additional potential purchasers and ultimately optimize the value of Solara's Assets.
33. Two Revised Bids were submitted to the Receiver in June, 2013. The Receiver reviewed and assessed the Revised Bids in order to determine which offer would maximize value to the stakeholders. The Receiver considered the following criteria to assess the Revised Bids:
- (a) Purchase price;
  - (b) Assets included in the LOI;
  - (c) Financing conditions;
  - (d) Due diligence period and timing of closing;
  - (e) Initial deposit contemplated; and
  - (f) Closing risk.

34. After discussion with National Bank and analysis of the Revised Bids, the Receiver accepted the highest Revised Bid and executed a letter of intent with the highest bidder. However, after completing its final due diligence the potential purchaser was financially unable to complete the transaction. The Receiver, in consultation with National Bank, determined that no other Revised Bids submitted would provide an adequate return for the Assets.
35. It was determined that Receiver would continue to operate the the Assets in the interim, however, advised NRG to continue its marketing efforts with respect the assets. NRG continued to market Solara's assets throughout July and August.

#### **INCIPIENT OFFER TO PURCHASE**

36. On September 10, 2013, Incipient Exploration Ltd. ("Incipient") submitted an offer to the Receiver to purchase all of the Assets. The general terms of the offer are set out below and described in greater detail in the Receiver's confidential report dated November 1, 2013 (the "Confidential Report"):
  - a) conditional on Incipient completing financial, operational and environmental due diligence;
  - b) deposit of \$100,000 paid once due diligence is completed and a purchase and sale agreement is signed, refundable only if Court approval is not obtained;
  - c) the Assets to be purchased on an 'as is where is' basis;
  - d) effective date of September 1, 2013;
  - e) closing date of November 8, 2013; and
  - f) subject to approval of this Honourable Court.

37. On September 11, 2013, the Receiver entered into a letter of intent with Incipient based on the above noted terms.

***INCIPIENT DUE DILIGENCE FINDINGS***

38. Upon completing its due diligence, Incipient advised the Receiver that in order to move forward with the transaction they would require an adjustment to the purchase price due to the following:
- a) concerns related to significant lease cleanups on Negative Asset Value Wells;
  - b) the condition of the equipment on certain wells that will likely cause significant operational issues in the near future if not fixed immediately
39. The Receiver discussed these issues with Solara's operations engineer and was advised that these concerns were legitimate and as such a purchase adjustment may be warranted.
40. The Receiver negotiated a revised purchase price with Incipient and entered into an asset purchase and sale agreement with Incipient (the "Incipient PSA"). The Incipient PSA is attached as Appendix "A" to the Confidential Report of the Receiver that is filed in conjunction with this First Report and for which the Receiver is seeking a sealing order in respect thereof. The revised purchase price has been reflected in the Incipient PSA. The main terms of the Incipient PSA are set out below:
- a) the purchase price as set out in the Incipient APSA;
  - b) deposit of \$100,000 has been received and is only refundable to Incipient if Court approval is not obtained;

- c) no remaining conditions other than the approval of this Honourable Court;
- d) effective date of September 1, 2013; and
- e) closing date of November 8, 2013.

41. The Receiver, recommends that the Incipient PSA be approved by this Honourable Court for the following reasons:

- a) the Assets have been adequately exposed to the market based on the marketing process outlined above and the length of time (approximately 9.5 months) that Solara's Assets have been actively marketed;
- b) The Incipient PSA presents the highest return to Solara's creditors of all offers received to date while dealing with all of the Negative Value Wells.
- c) National Bank, the largest secured creditor is in agreement with accepting the Incipient offer.

## **RIGHT OF FIRST REFUSAL**

42. Solara has seven leases that include the right of first refusal ("ROFR") clause. The ROFR clause typically allows Solara's partner in the lease the option to purchase the Company's interest in the lease in the event Solara decides to sell to a third party, at the price negotiated by Solara and the third party. However, the ROFR clause in these leases has exclusionary provisions that apply if Solara is selling all or substantially all of its oil and gas assets. The Incipient PSA contemplates the sale of all of Solara assets and as such the Receiver has concluded that the transaction would be exempt under the exclusion clauses contained in the various leases from all of the ROFR clauses. Therefore, the Receiver would not have to serve Solara's partners with the standard ROFR notice. However, the Receiver has served all partners with ROFR clauses a copy of this First Report and all materials related to this application to inform them of this conclusion and allow them the opportunity to object should they disagree.

## **PRIORITY PAYMENTS, LIENS AND DISTRIBUTION**

43. The Receiver is aware of several liens that have been filed against the Assets and is in the process of completing a full review of the lien claims. The Receiver anticipates completing its analysis of liens and priority claims and making a further application to this Honourable Court with its recommendations with respect to the proposed distribution of the funds received from the Incipient PSA, should this Honourable Court approve this application.

## **SEALING ORDER**

44. The Receiver is seeking a sealing order in respect of the Confidential Report because if the information contained in the Confidential Report is made public it may detrimentally affect the Receiver's ability to remarket the Assets should the Incipient PSA not close.

## RECEIVER'S RECOMMENDATIONS

43. The Receiver recommends that this Honourable Court approve the Incipient PSA.

All of which is respectfully submitted this 1<sup>st</sup> day of November, 2013.

FTI Consulting Canada Inc.  
in its capacity as receiver and manager of  
the assets, property and undertaking of Solara  
Exploration Ltd.

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

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