



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

**February 7, 2014**

ADDRESS FOR SERVICE AND CONTACT INFORMATION OF PARTY FILING THIS DOCUMENT

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## INTRODUCTION

1. On December 19, 2012, FTI Consulting Canada Inc. was appointed receiver and manager (the “Receiver”) of the assets, undertakings and properties of Solara Exploration Ltd. (“Solara” or the “Company”) pursuant to the order (the “Receivership Order”) of this Honourable Court.
2. As described in the Receiver’s First Report dated November 1, 2013, the Receiver entered into an asset purchase and sale agreement with Incipient Exploration Ltd. (the “Incipient PSA”) dated October 28, 2013 for the sale of Solara’s Assets. The Incipient PSA was subject to Court approval.
3. On November 7, 2013 the Honourable Justice Hawco granted an Order (the “Approval and Vesting Order”) *inter alia* approving the Incipient PSA.
4. To date, the Receiver has filed one report on various aspects of the Receivership. Receiver’s reports and other information in respect of these proceedings are posted on the Receiver’s website at <http://cfcanada.fticonsulting.com/solara/>.
5. The purpose of this report, the Receiver’s second report (the “Second 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 for the period of December 20, 2012 to February 7, 2014;
  - (c) The Receiver’s analysis of certain liens and priority payments; and
  - (d) The Receiver’s recovery analysis and recommended interim distribution of the proceeds; and

- (e) To request the granting of an Order authorizing the Receiver to distribute certain proceeds from the sale of the Assets (the “Interim Distribution Order”).

## **TERMS OF REFERENCE**

- 6. In preparing this report, the Receiver has relied upon unaudited financial information, other information available to the Receiver and, where appropriate, Solara’s books and records and discussions with various parties (collectively, the “Information”).
- 7. Except as described in this 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 report is based on assumptions regarding future events; actual results may vary from forecast and such variations may be material.
- 9. The Receiver has prepared this Report in connection with the motion described in the Receiver’s Notice of Application dated February 7, 2014, returnable February 14, 2014. The Report should not be relied on for any other purposes.

10. The information and advice described in this Report as being 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. Capitalized terms not otherwise defined herein are as defined in the Receivership Order, other Order's granted in the Receivership proceedings or in the Receiver's previous reports.

## **STATUS OF RECEIVERSHIP MATTERS**

### ***OIL AND GAS OPERATIONS***

12. The Receiver continued to operate the Solara's oil and gas assets without any material changes from the date of the Receivership Order until the closing of the Incipient PSA.
13. Significant improvements in heavy oil prices throughout the Receivership proceedings led to increased cash flow from Dewberry allowing the Receiver to operate without drawing on a receiver's certificate to fund Solara's operations.

### ***CLOSING OF THE INCIPIENT TRANSACTION***

14. On November 12, 2013 the Receiver closed the sale of the Assets to Incipient as approved by this Honourable Court on November 7, 2013 and received the remaining net funds of \$2,569,291 (the "Sale Proceeds") as set out in the Incipient PSA.
15. The Receiver has continued to work with Incipient and the relevant government agencies to facilitate the requisite title and license transfers to Incipient.

16. On December 16, 2013 the Receiver sent direction to pay notices to Solara's oil and gas marketers advising of the Approval and Vesting Order and requested that revenues be forwarded directly to Incipient as of the binding date of February 1, 2014.
17. On December 24, 2013 and January 24, 2014 the Receiver collected revenues related to the Assets for the months of November and December.
18. On January 13, 2013 the Receiver prepared a second interim statement of adjustments and transferred \$197,633 to Incipient for receipts and disbursements relating to funds received subsequent to the effective date in the Incipient PSA.
19. On February 4, 2014 Incipient requested a transfer of funds for revenues collected by the Receiver on January 24, 2014. The Receiver notes that it did not make disbursements for December operating costs and therefore the Receiver contemplates transferring the full amount of revenues collected for December production to Incipient, as discussed in further detail below.
20. In accordance with the Incipient PSA a Final Statement of Adjustments will be prepared within 180 days of the closing, estimated to be completed by May 7, 2014.

#### ***EMPLOYEES AND CONTRACTORS***

21. The Receiver has retained the necessary office staff in order to help facilitate the transition of the Assets to Incipient on an hourly and as-needed basis.

#### ***OFFICE LEASE AGREEMENT***

22. The Receiver made arrangements with its landlord to terminate Solara's lease agreement effective February 6, 2014.

## SUMMARY OF RECEIPTS AND DISBURSEMENTS

23. A summary of the Receiver's receipts and disbursements for the period of December 20, 2012 to February 7, 2014 is present below.

<b>Schedule of Receipts and Disbursements</b>		<b>Notes</b>
<b>December 19, 2012 to February 7, 2013</b>		
Oil and Gas Revenue Collections	2,571,456	a
Proceeds from Sale of Company	2,569,291	b
Opening Cash	220,500	c
GST Collected	130,091	d
Other Collections	77,233	
<b>Total Receipts</b>	<b>5,568,571</b>	
Operating Expenses	1,467,474	e
Lease & Royalty Payments	438,958	f
Receiver and Legal Fees	330,881	g
Contracted Employees	256,985	h
Interim Statement of Adjustments	197,533	i
Taxes	192,623	j
Other Misc. Expenses	139,501	
GST Paid	113,424	
Rent and Utilities	70,503	
Insurance	28,275	
<b>Total Disbursements</b>	<b>3,236,157</b>	
<b>Net Cash on Hand</b>	<b>2,332,414</b>	k

24. The following is a description of the major receipts and disbursements from the table above:
- (a) Oil and gas revenues – revenue collected by the Receiver from Solara's operating oil and gas assets;
  - (b) Sale Proceeds – net proceeds received from the sale of Solara's Assets;
  - (c) Opening cash – upon the Receiver's appointment, Solara's bank account had \$220,500 of cash that was transferred to the Receiver's account;

- (d) GST collected – relates to GST collected on oil and gas revenues;
- (e) Operating expenses – to date, the Receiver has paid \$1,467,474 in operating expenses relating to the Assets;
- (f) Lease & Royalty Payments – the Receiver paid \$438,958 for royalties and lease rentals relating to the Assets;
- (g) Receiver and legal fees – \$330,881 in receiver and legal fees have been incurred to the end of December 2013;
- (h) Contracted employees – \$256,985 has been paid by the Receiver to contracted employees;
- (i) Interim Statement of Adjustments – \$197,533 was transferred to Incipient for revenues collected subsequent to the Incipient PSA;
- (j) Taxes – \$192,623 in property and municipal taxes have been paid by the receiver for 2012 and 2013; and
- (k) As at February 7, 2014, the Receiver currently holds \$2,332,414 in funds.

## **ANALYSIS OF SECURED AND PRIORITY CLAIMS**

### ***VALIDITY AND ENFORCEABILITY OF NATIONAL BANK'S SECURITY***

25. National Bank's security has been reviewed by the Receiver's Counsel who has advised that the security creates a valid security interest in favour of National Bank in the right, title and interest of Solara in its real and personal property.

***LIENS AND PRIORITY CLAIMS***

26. The Builders' Lien Act, R.S.A. 2000, c. B-7, as amended (the "BLA"), requires a lien claimant to, amongst other things:
- (a) register a statement of lien in the prescribed form at the land titles office (section 34);
  - (b) register its lien with respect to improvements to an oil and gas well or site, within 90 days from the date the contract is completed or abandoned (section 41); and
  - (c) commence an action with respect to its lien and register a certificate of lis pendens at the land titles office within 180 days from the date on which the statement of lien is registered at the land titles office (section 43).
27. The Receiver, in consultation with the Receiver's Counsel, performed a review of liens and priority claims relating to the Assets. The Receiver has determined that there are ten (10) claims (collectively the "Liens") totaling approximately \$1.2 million that are registered against certain lands of Solara.
28. The Liens were filed against Solara for work performed on the following properties:
- (a) the lands associated with the well on section 22 ("Section 22 Lands"); and
  - (b) the lands associated with the Dewberry property (the "Dewberry Lands").



30. A summary of the Liens is presented in the table below.

<b>Creditor</b>	<b>Claim Amount (\$s)</b>
<b>Section 22</b>	
Cal Frac Well Services Ltd.	331,053.22
Cameron Construction Services Ltd.	258,655.95
Essential Well Service Partnership	117,150.18
Apex Distribution	96,655.01
Trican Well Service Ltd.	48,568.94
Platinum Pumpjack Services Corp.	43,243.13
Wilf Brandt Trucking Ltd.	20,563.00
	915,889.43
<b>Dewberry Lands</b>	
Eagle Well Servicing Corp.	152,828.93
CE Franklin Ltd.	96,145.48
Heavy Crude Hauling LP	73,399.51
	322,373.92
<b>Total</b>	<b>1,238,263.35</b>

31. Based on information reviewed by the Receiver the Liens are in compliance with the requirements set out in the BLA and the claimants hold valid and subsisting builders' liens which were either registered prior to the National Bank's charge or were registered on lands or mineral interests against which the National Bank has not registered a specific charge but over which National Bank merely has general security in all present and after acquired property of Solara.
32. The Receiver in consultation with the Receiver's Counsel determined the following liens are subordinate to National Bank's security because they were registered after the Bank had registered a specific charge against the subject land or mineral interest.

<b>Creditor</b>	<b>Claim Amount (\$s)</b>
Bidell Equipment Limited Partnership	186,996.08
Nelson Bros. Oilfield Services Ltd.	123,697.30
Driven Energy Ltd.	15,842.00
<b>Total</b>	<b>326,535.38</b>

33. The Receiver completed an analysis in order to determine the distribution to each lien holder (the "Lien Holders") with a valid claim against the Assets. The Incipient PSA listed a single purchase price for all of Solara's Assets and did not list the purchase price by property or assign a specific value to each property purchased. Therefore, in order to determine the value of the Section 22 Lands and the Dewberry Lands for the purposes of calculating distribution to the Lien Holders the Receiver completed an analysis to assign a value to these specific properties.
34. In completing its analysis to determine a value of the Section 22 Lands and the Dewberry Lands the Receiver relied upon following information:
- (a) the most recent reserve report available, Solara's December 31, 2011 reserve report (the "Reserve Report") conducted by GLJ Petroleum Consultants;
  - (b) value of the Section 22 Lands and the Dewberry Lands based on the information presented in the Reserve Report; and
  - (c) the purchase price paid by Incipient.
35. Based on the Reserve Report the Receiver calculated the recovery value (the "Recovery Value") from the proceeds of Solara's Assets to be approximately 19% of total proved reserves ("Proved") and 12% of total proved plus probable reserves ("2P").

Solara December 31, 2011 Reserve Report NPV 10% (000's)		
	Total Proved (000's)	Total 2P (000's)
Solara Total Asset Value per Reserve Report	14,020	22,125
Purchase Price per Incipient PSA	2,640	2,640
<b>Recovery Value</b>	<b>18.8%</b>	<b>11.9%</b>

36. The Receiver calculated the property value (the "Property Value") of the Section 22 Lands and the Dewberry Lands by multiplying the Recovery Value by the value of the Section 22 Lands and the Dewberry Lands in the Reserve Report. Applying this methodology results in the Section 22 Lands and the Dewberry Lands being assigned their proportionate share of the Incipient PSA purchase price based on the Recovery Value of each property.

Property with Valid Lien	NPV at 10% (000's)		Property Value (000's)	
	Total Proved	Total 2P	If valued on Proved	If valued on 2P
Section 22	243	368	46	44
Dewberry Lands	3,729	9,028	702	1,077

37. Based on this analysis the Receiver determined the Property Value of the Section 22 Lands was between \$44,000 and \$46,000 and the Property Value of the Dewberry Lands was between \$702,000 and \$1,077,000.
38. In calculating the proposed distribution to the Lien Holders from the Property Value for the Section 22 Lands and the Dewberry Lands the Receiver understands that Section 61(5) of the *Builders Lien Act*, RSA 2000 c B-7, provides that each class of lienholders, as between themselves, rank without preference with respect to the value of the lien claimed with respect to the subject property. In accordance with the BLA, the proceeds realized from the sale of that property are to be distributed to each Lien Holder proportionately according to the value of their respective proven lien claim. To the extent that multiple properties are sold, a lien claimant may only have recourse to the proceeds realized from the sale of

the property against which its lien was registered. The lien claimant does not have recourse to the entire pool of funds if the proceeds realized from the sale of the property against which its lien is registered are insufficient to satisfy that lien in full.

39. The Receiver notes that the Sale Proceeds realized from the sale of the Dewberry Lands are sufficient to satisfy the priority claims of the Lien Holders filed against that property in full. However, the proceeds realized from the sale of the Section 22 Lands are insufficient to satisfy the priority Liens in full.
40. As such the Receiver recommends the following distribution to the Lien Holders based on the claim amounts and amount available for distribution:

<b>Creditor</b>	<b>Claim Amount</b>	<b>Available for Distribution</b>	<b>% of Total Liens</b>	<b>Proposed Distribution</b>
<b>Section 22</b>				
Cal Frac Well Services Ltd.	331,053.22	45,757.49	36%	16,539.29
Cameron Construction Services Ltd.	258,655.95	45,757.49	28%	12,922.35
Essential Well Service Partnership	117,150.18	45,757.49	13%	5,852.78
Apex Distribution	96,655.01	45,757.49	11%	4,828.85
Trican Well Service Ltd.	48,568.94	45,757.49	5%	2,426.49
Platinum Pumpjack Services Corp.	43,243.13	45,757.49	5%	2,160.41
Wilf Brandt Trucking Ltd.	20,563.00	45,757.49	2%	1,027.32
	915,889.43		100%	45,757.49
<b>Dewberry Lands</b>				
Eagle Well Servicing Corp.	152,828.93	322,373.92	47%	152,828.93
CE Franklin Ltd.	96,145.48	322,373.92	30%	96,145.48
Heavy Crude Hauling LP	73,399.51	322,373.92	23%	73,399.51
	322,373.92		100%	322,373.92
<b>Total</b>	<b>1,238,263.35</b>	<b>368,131.41</b>		<b>368,131.41</b>

***CANADA REVENUE AGENCY***

41. On November 5, 2013 Canada Revenue Agency notified the Receiver with respect to a deemed trust claim of \$34,031.35 for GST payable and penalty interest for the months of June through November 2012.
42. The Receiver estimates its net GST payable position throughout the receivership proceedings to be approximately \$17,000 and the Receiver is in the process of filing GST returns for the receivership period.

***ANTERRA CLAIM***

43. Solara has joint interests in lands located in in Section 17 of Buck Lake with Anterra Energy Inc. ("Anterra"). Anterra is the operator of all joint interest wells in Section 17.
44. The Receiver understands that Anterra may have a claim in respect of an operator's lien which it was exercising prior to the appointment of the Receiver of approximately \$350,00 over Section 17. However, to date no formal claim has been submitted by Anterra.
45. The Receiver recommends a hold back to deal with the claim amount and an additional percentage for costs, until such time that the Receiver receives further instructions from the Court with respect to this matter.

***COUNTY OF VERMILION RIVER***

46. On December 5, 2013 the County of Vermilion River (the "County") submitted an amended proof of claim (the "Amended Proof of Claim") and the Receiver is prepared to accept the Amended Proof of Claim as:
  - (a) A secured claim in the amount of \$36,863.65; and

(b) An unsecured claim under section 136 of the *Bankruptcy and Insolvency Act* in the amount of \$139,365.20.

47. The Receiver's Counsel has advised the County that it is only contemplated that payments will be made by the Receiver to secured creditors of Solara and that no priority claimants will be in a position to receive funds. The \$36,863.65 will be paid by the Receiver to the County.

***ALBERTA ENERGY***

48. On November 25, 2013 Alberta Energy notified the Receiver with respect to claim it may have against Solara. The Receiver has discussed the claim with Alberta Energy and has been advised that the claim is unsecured with the exception of the Minister holding a non-interest bearing deposit of \$1,526.79. Accordingly, the Receiver anticipates that no further funds are required to be held back with respect to this claim.

***OTHER PRIORITY CLAIMS***

49. The Receiver has received a number of other claims asserting a claim to funds of the estate in priority to the secured creditors. These claims generally relate to amounts outstanding for gross overriding royalties that were unpaid by Solara prior to the date of the receivership. The Receiver proposes to hold back approximately \$30,000 for these claims until the Receiver has obtained the proper documentation to complete its analysis of the priority claimed. The claims process has been completed in respect of each of the claims and a final determination of what, if any, priority such claims might have is rendered.

## RECOVERY ANALYSIS & PROPOSED INTERIM DISTRIBUTION

50. A summary of the Receiver's proposed interim distribution is present below.

Recovery Analysis and Proposed Distribution (\$s)		Note
Funds Available for distribution		
Cash on hand	2,332,414	a
Holdbacks		
Anterra claim	350,000	b
Final Statement of Adjustments	100,000	c
Operating Expenses	50,000	d
Professional fees	50,000	e
GST	<u>51,031</u>	f
Total Available for distribution	<u>1,731,383</u>	
Proposed Interim Distributions		
Proposed Distribution to National Bank	1,326,415	
Proposed Distribution to Lien Holders	368,131	
County of Vermilion Amended Proof of Claim	<u>36,837</u>	
Net funds available for unsecured creditors	(0)	

51. A summary of the Receiver's recovery analysis and proposed interim distributions is present below.

- (a) Cash on hand – net cash available for distribution as of February 7, 2014;
- (b) Anterra claim – estimated amount held back for the full amount of the Anterra claim;
- (c) Final Statement of Adjustments – estimated amount held back for the Final Statement of Adjustments to be completed in accordance with the Incipient PSA;
- (d) Operating expenses – amount held back for potential operating expenses;

- (e) Professional fees – amount held back for accrued and future professional fees; and
- (f) GST – amount held back for GST trust claim and net GST position for the receivership.

### **RECEIVER'S RECOMMENDATIONS**

49. The Receiver recommends that this Honourable Court approve the following:

- (g) The Receiver's receipts and disbursements;
- (h) The distribution to the Lien Holders; and
- (i) The proposed interim distribution to National Bank.

50. All of which is respectfully submitted this 7<sup>th</sup> day of February, 2014.

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



Name: Deryck Helkaa  
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FTI Consulting Canada Inc.