

COURT FILE NUMBER 1601-03113

COURT COURT OF QUEEN'S BENCH OF ALBERTA

JUDICIAL CENTRE CALGARY

APPLICANTS IN THE MATTER OF THE COMPANIES' CREDITORS
ARRANGEMENT ACT,
R.S.C. 1985, c. C-36, AS AMENDED

AND IN THE MATTER OF A PLAN OF COMPROMISE
OR ARRANGEMENT OF QUICKSILVER RESOURCES
CANADA INC. , 0942065 B.C. LTD., and 0942069 B.C.
LTD.

DOCUMENT **FIFTH REPORT OF FTI CONSULTING CANADA INC.,
IN ITS CAPACITY AS MONITOR OF QUICKSILVER
RESOURCES CANADA INC., 0942065 B.C. LTD., and
0942069 B.C. LTD.**

June 23, 2016

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INTRODUCTION

1. On March 8, 2016 Quicksilver Resources Canada Inc. (“QRCI”), 0942065 B.C. Ltd. (“LNG Co”), and 0942069 B.C. Ltd. (“LNG Subco”) (collectively the “Applicants”) sought and obtained protection under the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, as amended (the "CCAA") pursuant to an order granted by this Honourable Court (the "Initial Order").
2. The Initial Order granted, *inter alia*, a stay of proceedings against the Applicants until April 7, 2016, (the "Initial Stay Period") and appointed FTI Consulting Canada Inc. (“FTI”) as Monitor (the “Monitor”). The proceedings commenced by the Applicants under the CCAA will be referred to herein as the CCAA proceedings (the “CCAA Proceedings”).
3. On March 29, 2016, this Honourable Court granted a sale approval and vesting order which, *inter alia*, approved the transaction contemplated by the asset purchase agreement for the Applicants’ Horseshoe Canyon Assets.
4. On April 5, 2016, this Honourable Court granted an order which, *inter alia*, extended the stay of proceedings provided in the Initial Order until and including June 2, 2016 and authorized the Applicants to distribute the net proceeds from the sale of the Horseshoe Canyon Assets to the Secured Creditor.
5. On April 22, 2016, this Honourable Court granted the following Orders
 - (a) a sale approval and vesting order which, *inter alia*, approved the transaction contemplated by the asset purchase agreement for the Applicants Horn River Assets;

- (b) a sale approval and vesting order which, *inter alia*, approved the transaction contemplated by the asset purchase agreement for the LNG Facility; and
 - (c) an order, which *inter alia*, approved the distribution of sale proceeds to JPMorgan Chase Bank N.A. as agent of the Secured Creditor.
6. On May 26, 2016 this Honourable Court extended the Stay Period until August 5, 2016 and authorized QRCI to commence a claims process as further set out in the Claims Procedure Order.

PURPOSE

7. The purpose of this report (the “Fifth Report”) is to provide this Honourable Court with the Monitor’s comments with respect to:
- (a) the activities of the Applicants since the Monitor’s Fourth Report dated May 20, 2016;
 - (b) QRCI’s request for the following relief from the Court:
 - i. the authorization of QRCI, by way of shareholder resolution, to assign Makarios Midstream Inc. (“MMI”) into bankruptcy;
 - ii. extending the claims bar date for the Fortune Creek Gathering & Processing Partnership (the “Partnership”) to submit a claim against QRCI pursuant to the Claims Procedure Order in the event an extension is necessary;

- iii. the authorization of QRCI to pay certain amounts to the Oil and Gas Commission of British Columbia (the “OGC”) and granting a first ranking priority charge in favour of QRCI to secure the amount of this payment over the assets of the Partnership;
 - iv. the authorization of QRCI to transfer, and directing the British Columbia Oil and Gas Commission (the "OGC") to register the transfer of, certain licenses and permits to the Partnership (which are beneficially owned by the Partnership but still registered in the name of Quicksilver Canada) and
 - v. the approval of representative counsel for all employees of QRCI who have been terminated in these proceedings and the funding of the representative counsel by QRCI.
4. Further background and information regarding the Applicants and these CCAA proceedings can be found on the Monitor’s website at <http://cfcanada.fticonsulting.com/qrci/>.

TERMS OF REFERENCE

5. In preparing this report, the Monitor has relied upon unaudited financial information of the Applicants’ books and records, certain financial information prepared by the Applicants and discussions with the Applicants' management. The Monitor has not audited, reviewed or otherwise attempted to verify the accuracy or completeness of the information. Accordingly, the Monitor expresses no opinion or other form of assurance on the information contained in this report or relied on in its preparation. Future oriented financial information reported or relied on in preparing this report is based on management's assumptions regarding future events; actual results may vary from forecast and such variations may be material.

6. Unless otherwise stated, all monetary amounts contained herein are expressed in Canadian dollars.
7. This report should be read in conjunction with the affidavit of Mr. David Rushford sworn on June 21, 2016 (the “Rushford June 21st Affidavit”) and the Applicants’ Application filed concurrently with the Rushford June 21st Affidavit.
8. Capitalized terms not otherwise defined herein have the meaning given to them in the previous reports of the Monitor.

ACTIVITIES OF THE APPLICANTS

9. Since the date of the Fourth Report, the Applicants have cooperated with the Monitor to facilitate its monitoring of the Applicants' business and operations including the following tasks:
 - (a) completing the March 21, 2016 transaction entered into between 1069130 B.C. Ltd. with respect to the Applicants’ Horn River Assets and the March 22, 2016 transaction entered into between 1069130 B.C. Ltd., 0942065 B.C. Ltd. and 0942069 B.C. Ltd. with respect to the LNG Facility, which Orders were granted on April 22, 2016;
 - (b) distributed the net sales proceeds to the Applicants’ Secured Lender in accordance with the Order of this Honourable Court granted on April 22, 2016;
 - (c) implementing the steps set out in the Claims Procedure Order including:
 - i. On June 3, 2016 the Monitor sent out Claims Packages by prepaid mail to each of the Known Claimants and Employees of QRCI;

- ii. A Newspaper Notice to Claimants was published in the Calgary Herald and the Globe and Mail (National Edition) on Tuesday, May 31, 2016 and Thursday, June 2, 2016; and
 - iii. On May 26, 2016 electronic copies of the Newspaper Notice to Claimants, the Proof of Claim and the Approved Claims Procedure Court Order were posted on the Monitors website.; and
 - (d) assisting the Applicants in continuing to operate and manage their business in the ordinary course, subject to the terms of the Initial Order.
10. As previously reported to this Honourable Court, on May 18, 2016, QRCI sent notices to the Partnership advising of its intention to disclaim the following agreements:
- (a) The Contribution Agreement dated December 23, 2011; and
 - (b) The Gathering Agreement dated December 23, 2011.
11. Since the Fourth Report, QRCI continued discussions with respect to various options related to its obligations to MMI and the Partnership, as is discussed in further detail below. On May 31, 2016, QRCI send a notice to the Partnership advising of its intention to disclaim the Services Agreement dated December 23, 2011.
12. The Monitor has not received any notices of objection to the disclaimer notices.

CASH FLOW BUDGET TO ACTUAL

13. The Monitor has continued to work with QRCI management with respect to its budget to actual cash flow. The Monitor notes that there have been no material negative variances with respect to QRCI's cash flow since the date of the Fourth Report. Accordingly the Monitor notes that the Applicants have not revised the cash flow forecast presented in the Monitor's Fourth Report as it continues to represent management's best estimate.

ASSIGNMENT OF MMI INTO BANKRUPTCY

14. QRCI is seeking an Order authorizing it to assign MMI into bankruptcy by way of shareholder resolution.
15. As set out in the June 21st Rushford Affidavit, MMI is a wholly owned subsidiary of QRCI. MMI and QRCI entered into a series of agreements with a subsidiary of Kohlberg Kravis Roberts & Co. L.P. ("KKR") which effectively comprised the following:
 - (a) The contribution by QRCI of certain compressor assets and pipelines located in the Horn River Basin of British Columbia to the Partnership;
 - (b) KKR contributed \$125 million to the Partnership, of which \$112 million was paid to QRCI;
 - (c) QRCI transferred its 50% interest in the Partnership to its wholly-owned subsidiary MMI;
 - (d) KKR (through a subsidiary) owns the remaining 50% of the Partnership;
 - (e) QRCI entered into a Contribution Agreement with the Partnership and KKR whereby QRCI agreed to:

- i. spend \$300 million in drilling from 2012 to 2015
 - ii. repurchase the compressor assets for \$33 million at certain future dates (QRCI did not complete the repurchase of the compressors); and;
 - iii. enter into a take-or-pay gathering agreement with the Partnership (“Gathering Agreement”).
16. MMI and the Partnership are parties to an operating agreement (the “Operating Agreement”) whereby MMI was engaged by the Partnership to manage, operate and maintain the assets of the Partnership. As MMI has no employees, MMI entered into a services agreement with QRCI (the “Services Agreement”) such that QRCI provided the services to MMI to allow it to meet its obligations under the Operating Agreement (paid by the Partnership on a cost plus basis).
17. In summary, the assets of the Partnership comprise the pipeline and compressors located in the Horn River Basin which were used to transport the gas produced from QRCI’s Horn River Assets. As discussed above, QRCI has sold its Horn River Assets to Rockyview Resources Inc. (“Rockyview”); however, Rockyview did not acquire MMI or any of the Partnership’s assets. MMI’s only asset is its 50% interest in the Partnership.
18. QRCI has repudiated the Gathering Agreement and Contribution Agreement with the Partnership and the Services Agreement with MMI. No gas is currently flowing in the pipelines and compressors owned by the Partnership given the low price of natural gas and the overall economics of production in the Horn River Basin. No other third party gas is being transported by the Partnership.

19. Continued discussions with KKR have resulted in the conclusion that the most efficient manner to deal with the orderly wind-up of MMI and the Partnership is to bankrupt both partners to the Partnership, allowing the bankrupt estate of the Partnership to be administered by a single Trustee in Bankruptcy. Accordingly QRCI is seeking the approval to assign MMI into bankruptcy and the Monitor understands that KKR is considering doing the same with its subsidiary that owns the remaining 50% interest in the Partnership.
20. The Monitor supports the conclusion of QRCI that the bankruptcy of MMI would allow for an orderly windup of MMI and the Partnership.

PARTNERSHIP CLAIM AGAINST QRCI

21. To facilitate the orderly transition following the bankruptcy of MMI and the Partnership, QRCI has held discussions with KKR regarding the claim of the Partnership (“Partnership Claim”) as against of the QRCI with respect to QRCI disclaiming the Gathering Agreement and Contribution Agreement. QRCI is seeking an order setting the amount of the Partnership Claim. As of the time of this report the Partnership Claim has not been agreed to. If no agreement is reached by the return of QRCI’s application the Monitor recommends the claims deadline for the Partnership to submit a claim against QRCI be extended by a month to August 5, 2016, to allow the MMI Trustee adequate time to review the Partnership Claim.

QRCI RECOVERY FROM MMI's INTEREST IN THE PARTNERSHIP

22. Given the Partnership's remaining assets¹, the Monitor does not anticipate any material recoveries for QRCI with respect to its ownership of MMI. However, ultimate recoveries will depend on the results of the bankruptcy and the quantum of any potential distribution from QRCI related to the ongoing claims process.

PAYMENT OF DEPOSIT TO THE OGC

23. The June 21st Rushford Affidavit sets out the details of a proposed payment by QRCI of approximately \$449,400 to the OGC with respect to an invoice received from the OGC relating to additional liquid required in respect to the Compressor License. The Monitor understands that the Compressor License remains in the name of QRCI, however, the compressor is for the benefit of the Partnership (it was never transferred from QRCI to the Partnership).
24. The Monitor understands that the OGC is not willing to approve the transfer of certain well licenses that relate to QRCI's sale of its Horn River Assets until the payment of the \$449,400 relating to the Compressor License is paid. QRCI requires the well licenses to be assigned to Rockyview pursuant to the Horn River APA approved by this Honourable Court on March 21, 2016.
25. Accordingly, QRCI is seeking authorization to pay the \$449,400 to the OGC to allow for the transfer of the well licenses relating to the Horn River APA.

¹ Partnerships' assets comprise the compressors and pipeline and its claim against QRCI for the repudiated Gathering Agreement and Contribution Agreement.

26. The Monitor understands that KKR does not object to QRCI being granted a first charge to QRCI over the assets of the Partnership with respect to the amount paid to the OGC (as QRCI is essentially paying the OGC on behalf of the Partnership). The Monitor understands that the \$449,400 will be repaid by setting off the same against the distribution made to the Partnership from QRCI with respect to the Partnership Claim, which claims is anticipated to exceed the amount paid to the OGC.

APPROVAL OF REPRESENTATIVE COUNSEL

27. The Monitor has reviewed the June 21st Rushford Affidavit which sets out that Miles Davison LLP be appointed as counsel for all employees of QRCI who have been terminated in these proceedings and not rehired by CPC Resources (“Representative Counsel”) and that Representative Counsel be funded by the Applicants.
28. The Monitor agrees with the appointment of Representative Counsel and the funding by the Applicants of reasonable amounts.

CONCLUSIONS AND RECOMMENDATIONS

29. The Monitor respectfully recommends that this Honourable Court:
- (a) authorize QRCI, by way of shareholder resolution, to assign MMI into bankruptcy;
 - (b) extend the claims bar date for the Partnership to submit a claim against QRCI if required;

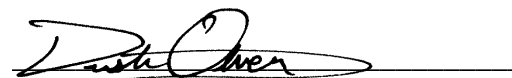
- (c) authorize QRCI to pay certain amounts to the OGC and grant a first ranking priority charge in favour of QRCI to secure the amount of this payment over the assets of the Partnership; and
- (d) approve of the appointment of Representative Counsel for all employees of QRCI who have been terminated in these proceedings and not rehired by CPC Resources, and approve the funding of the Representative Counsel by QRCI.

All of which is respectfully submitted this 23rd day of June, 2016.

FTI Consulting Canada Inc.
in its capacity as the Court-Appointed Monitor
of Quicksilver Resources Canada Inc.



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