

COURT FILE NUMBER 1701-11639
COURT COURT OF QUEEN'S BENCH OF ALBERTA
JUDICIAL CENTRE CALGARY
APPLICANT NATIONAL BANK OF CANADA
RESPONDENT SCOLLARD ENERGY INC.
DOCUMENT **FIRST REPORT OF FTI CONSULTING
CANADA INC., IN ITS CAPACITY AS COURT
APPOINTED RECEIVER AND MANAGER OF
SCOLLARD ENERGY INC.**

November 23, 2017

ADDRESS FOR SERVICE AND
CONTACT INFORMATION OF
PARTY FILING THIS
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RECEIVER

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INTRODUCTION

1. On September 1, 2017 (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**” or the “**Assets**”) of Scollard Energy Inc. (“**Scollard**” or the “**Company**”) pursuant to an Order of the Honourable Madam Justice B.E.C. Romaine (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 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/Scollard/>.
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 preliminary update with respect to the marketing efforts to solicit offers to purchase the Property;
 - (c) To provide the Receiver’s views and comments with respect to the application (the “**Firenze Application**”) by Firenze Energy Ltd. (“**Firenze**”) to assume the operatorship of certain wells and facilities that Scollard is currently the operator of that are located in:
 - (i) West Pembina, Alberta (“**West Pembina**”);
 - (ii) Bigoray, Alberta (“**Bigoray**”); and

(iii) Approximately 8% of Westeros, Alberta (“**Westerose**”)

(West Pembina, Bigoray and Westeros are collectively referred to as the “**Firenze JOA Properties**”)

5. The Receiver is requesting the following relief from this Honourable Court:
 - (a) That leave not be granted to Firenze and that the Firenze Application be dismissed in its entirety; and
 - (b) That the Receiver’s Confidential Appendix be sealed.

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 Firenze Application scheduled to be heard on November 29, 2017. 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, Osler, Hoskin & Harcourt 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. Scollard is a privately held entity incorporated under the laws of the Province of Alberta. 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 Alberta.

13. The following table provides a break-down of Scollard’s production and reserves by major area. Production is presented in barrels of oil equivalent per day (“BOE/day”) based on March 2017 production figures and reserves are presented in million barrels of oil equivalent (“MBOE”) based on Scollard’s December 2016 reserve reports completed by an independent reserve engineer. The purpose of the table is to provide a high level overview of the Company’s Assets and which areas represent the highest percentage of the total. The areas of West Pembina, a portion of Westerose¹ and Bigoray, comprising the Firenze JOA Properties comprise a total of 3,928 MBOE or approximately 57% of the reserve total.

Property	Total Proved Reserves (MBOE)	% of total Reserves	Daily Production (BOE/day)	% of Total Production
West Pembina	3264.6	47%	195	18%
Gilby	578.8	8%	220	21%
Westerose	1062.1	15%	97	9%
Knobhill	553.2	8%	28	3%
Ferrybank	313.8	5%	46	4%
Rimbey	120.3	2%	62	6%
Bigoray	292.1	4%	85	8%
Bashaw/Mikwan	17.8	0%	14	1%
Pine Creek	396.8	6%	185	17%
Watelet	323.5	5%	105	10%
Others	0.1	0%	32	3%
Total	6,923	100%	1,069	100%

14. Prior to the Receivership Proceedings, the Company experienced various financial challenges due to production declines and lower commodity price environment.
15. The Company’s unaudited consolidated financial statements as at March 31, 2017:
- (a) book value of property, plant and equipment of approximately \$48.1 million;

¹ Note Firenze’s owns approximately a working interest in approximately 8% of the Westeros property.

- (b) bank indebtedness of approximately \$16.97 million (\$16.8 million as of August 31, 2017) owed to National Bank of Canada (the “**National Bank**”). The Company had a revolving operating demand credit facility with the National Bank. National Bank is the largest creditor under the Receivership Proceedings; and
 - (c) \$3.02 million of accounts payable and accrued liabilities.
- 16. On August 22, 2017, 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 Karen Koury sworn August 30, 2017.
- 17. Prior to the Receivership on March 2, 2017, Scollard had retained GMP Securities L.P. (“**GMP FirstEnergy**”) to complete a sale and investor solicitation process (the “**Pre-Receivership SISP**”). The Pre-Receivership SISP was launched on March 20, 2017 with an initial bid deadline of April 26, 2017. The following summarizes the major aspects of the Pre-Receivership SISP:
 - (a) 47 potential purchasers were specifically identified and contacted;
 - (b) 11 parties signed confidentiality agreements in order to gain access into the virtual data room;
 - (c) 6 potential purchasers attended management presentations; and
 - (d) 3 non-binding letters of intent were received however none of them were ultimately consummated into definitive agreements.

Custody & Control

18. On September 1, 2017, and following the granting of the Receivership Order, the Receiver attended the Company's leased premises located at Suite 1400, 202 6th Ave SW, Calgary, Alberta to meet with Scollard'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.
19. At the Date of Appointment, substantially all employee-related obligations and statutory deductions were current. The Receiver made arrangements to continue the Company's payroll service during the Receivership Proceedings.
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, Scollard'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 \$300,000 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;
- (e) communicated with numerous creditors and stakeholders regarding the Receivership Proceedings; and
- (f) launched a formal sale and investor solicitation process, as discussed in further detail below.

Employees

- 23. At the Date of Appointment, the Company had five employees. The Receiver retained the services of all employees to assist the Receiver through the Receivership Proceedings, and each agreed to continue their employment under the existing terms (the "**Employees**").
- 24. The Employees agreed to assist the Receiver with the operations of the Company, 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.

Statutory Compliance

- 25. On September 8, 2017, 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.

26. The Receiver established a website at <http://cfcanada.fticonsulting.com/Scollard/> (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.

SUMMARY OF RECEIPTS AND DISBURSEMENT

27. Receipts and Disbursements from the Date of Appointment to November 22, 2017, are summarized as follows:

Schedule of Receipts and Disbursements	
As of November 22, 2017	
Receipts	
Oil & Gas Revenue	745,664
Receiver's Borrowings	300,000
JV Receipts	209,501
Hedging Revenue	105,434
Equipment Sales	118,641
Other Receipts	4,407
Net Taxes	1,400
Total - Receipts	1,485,047
Disbursements	
Operating Expenses	234,678
Employee Costs	119,842
Non-Op JV	182,964
Outside Consulting	68,773
Royalty and Lease Payments	104,624
Software Expenses	10,224
Rent and Utilities	27,081
Insurance	9,605
Interest on Receiver's Borrowings	2,106
Bank Charges	639
Other Miscellaneous Expenses	429
Receiver's Fees	78,767
Other Professional Fees	25,000
Legal Fees	18,127
Transfer to Pre-Receivership Account	160,000
Total - Disbursements	1,042,858
Net Cash on Hand	442,189

- (a) Oil and Gas Revenue – revenue collected by the Receiver in respect to the Company’s oil and gas production;
- (b) Receiver’s Borrowings – amounts borrowed to date under terms of the Receivership Order;
- (c) JV Receipts – receipts from joint venture billings invoices;
- (d) Equipment Sales – proceeds collected from the sale of the Surplus Equipment;
- (e) Hedging Revenue – revenue from the Company’s hedging contracts;
- (f) Other Receipts – miscellaneous receipts collected by the Receiver;
- (g) Net Taxes – GST collected and paid on receipts and payments including amounts remitted to the CRA for GST filings;
- (h) Operating Expenses– operating expenses relating to the Company’s production activities;
- (i) Non-Op JV – amounts paid to joint venture partners for operations expenses paid by the operator of wells in which the Company has a working interest;
- (j) Employee Costs – amounts disbursed by the Receiver relating to payroll and employee deductions and consultants;
- (k) Royalty and Lease Payments – amounts disbursed in respect of the Company’s petroleum and natural gas leases;
- (l) Outside Consulting – amounts paid to outside consultants for services provided. This includes amounts paid to former CEO Ken Moen;

- (m) Rent and Utilities – amounts disbursed relating to occupation rent and office utilities;
 - (n) Software Expenses – amounts disbursed relating to software programs necessary for operations;
 - (o) Insurance – insurance costs including operators extra insurance, general liability and employee benefits;
 - (p) Interest on Receiver’s Borrowings – amounts disbursed in respect of interest on amounts borrowed under the terms of the Receiver’s Certificate;
 - (q) Bank Charges – wire payment fees, and other miscellaneous bank fees;
 - (r) Other Miscellaneous Disbursements – amounts disbursed including filing fees paid to the Official Receiver, and off-site storage;
 - (s) Receiver’s Fees – Receiver’s fees and disbursements in respect of the Receivership Proceedings;
 - (t) Other Professional Fees – fees paid to the selling agent in respect of the marketing process for the Company’s Assets;
 - (u) Legal Fees – Receiver’s Counsel’s fees and disbursements in respect of the Receivership Proceedings; and
 - (v) Transfer to Pre-Receivership Account – amounts transferred to the Company’s pre-Receivership Account for cheques cut by the Company prior to the Date of Appointment.
28. Cash on Hand – at November 22, 2017, the Receiver currently holds \$442,189 in funds.

MARKETING PROCESS

29. Subsequent to the Date of Appointment, the Receiver engaged in discussions with Management and the National Bank regarding the marketing of the Property. As discussed above, in the Pre-Receivership SISP, Scollard retained GMP FirstEnergy as its financial advisor. While no successful transaction resulted from the Pre-Receivership SISP process, after discussions with Management and National Bank and given GMP FirstEnergy's familiarity with the Property and prospective purchasers, the Receiver retained GMP FirstEnergy on September 20, 2017 to complete a marketing of the assets on behalf of the Receiver (the "**Receivership SISP**").
30. The Receivership SISP is currently underway. Non-binding expressions of interest have been received and ongoing negotiations with the highest bidders are currently being completed. The goal is to arrive at definitive binding agreements with the highest and most financially qualified bidding parties and seek Court approval for these agreements in the near term.
31. A summary of the Receivership SISP to date is presented below:
 - (a) GMP FirstEnergy was retained on September 20, 2017;
 - (b) GMP FirstEnergy commenced its preparation and updating of the marketing materials (that had been used in the Pre-Receivership SISP) immediately upon its appointment;
 - (c) On September 28, 2017, GMP FirstEnergy sent marketing materials to 1,150 individuals, at 591 companies, as well as publicly posting the opportunity on GMP FirstEnergy's website;
 - (d) A total of 39 parties signed confidential agreements and were provided access to the confidential data room;

- (e) The bid date for non-binding letters of intent was set for November 1, 2017; and
 - (f) Since the initial bid deadline of November 1, 2017, the Receiver and GMP FirstEnergy have been in negotiations and discussions with the superior bids received (“**Superior Bids**”).
32. At the date of this Report, the Receivership SISP is continuing with negotiations with the Superior Bids in an attempt to arrive at binding agreements.

FIRENZE APPLICATION

33. On September 18, 2017, counsel to Firenze contacted the National Bank’s counsel advising of its intent to become operator of certain wells and facilities that were operated by Scollard; however, this letter did not set out the specific wells and facilities. National Bank’s counsel forwarded this correspondence to the Receiver’s Counsel. On September 19, 2017, the Receiver’s counsel replied to Firenze’s counsel advising of the general stay provisions under the Receivership Order and that Firenze would be required to seek leave of the Court to lift the stay of proceedings.
34. While conversations continued with respect to this matter, Firenze provided its formal notice requesting the change in operator and the specific wells and facilities on October 18, 2017 (the “**Replacement Operator Notice**”). The Replacement Operator Notice indicated that, pursuant to the terms of the Joint Operating, Farmout and Royalty Agreement between Firenze and Scollard dated November 6, 2014 (the “**Firenze JOA**”), Firenze was requesting to “immediately replace Scollard as Operator” of certain wells and facilities located in West Pembina, Bigoray and Westrose, Alberta, referred to as the “Firenze JOA Properties”. The Receiver understands that Firenze holds between 11.5% and 50% working interests in the Firenze JOA Properties, however the details are more fully set out in Exhibit “D” of the Debra Waterhouse Affidavit dated November 15, 2017.

35. The Receiver believes the following facts should be considered by this Honourable Court with respect to the Firenze Application:

- (a) The Receiver has retained Scollard's senior management and operational staff and has been operating the assets in the normal course with no reported issues or concerns from Firenze, or any other working interest party or regulatory agency. Furthermore, as set out in the schedule of receipts and disbursements, the Receiver has sufficient funds to operate in the normal course;
- (b) The Receivership SISP has marketed the properties and assets of Scollard based on the situation and facts in place at the Date of Appointment. At that time, Scollard was the operator of the Firenze JOA Properties and the properties have been marketed as such. The Receiver has had no discussions or negotiations with Firenze to exclude the operatorship from any sale nor has the Receiver agreed that operatorship would be transferred to Firenze upon closing of any sale resulting from the Receivership SISP;
- (c) The Replacement Operator Notice was received by the Receiver on October 18, 2017. Firenze did not provide the Replacement Operator Notice until after the formal launch of the Receivership SISP by GMP FirstEnergy. As discussed, GMP FirstEnergy's initial marketing materials were sent to prospective parties on September 28th and GMP FirstEnergy has confirmed to the Receiver that such materials were sent to Firenze. Furthermore, GMP FirstEnergy have advised that Firenze was contacted during the Pre Receivership SISP;

- (d) Firenze has actively participated in the Receivership SISP and submitted an offer (the “**Firenze Offer**”) on certain of the wells and facilities included in the Replacement Operator Notice, which properties include the assets located in the West Pembina area. However, the Firenze Offer is not considered a Superior Bid. Firenze also participated in the Pre-Receivership SISP;
- (e) The Receiver is currently in negotiation with a potential purchaser (the “**West Pembina Superior Bidder**”) for the West Pembina assets that would provide for a recovery significantly in excess of the Firenze Offer. (The Firenze Offer and the West Pembina Superior Bidder offer include comparable properties.) A summary of the offers received to date by the Receiver with respect to the West Pembina assets is summarized at Confidential Appendix “A” to this Report (the “**Confidential Appendix**”);
- (f) The Receiver has confirmed with the West Pembina Superior Bidder that they would not pursue the acquisition of the West Pembina assets if Firenze is successful in assuming operatorship of the Firenze JOA Properties, (which include the West Pembina assets);
- (g) It is the Receiver’s, Management’s and GMP FirstEnergy’s opinion that the removal of operatorship of the Firenze JOA Properties from Scollard to Firenze would materially and adversely impact the recovery to the Scollard estate;

- (h) Based on its experience, and discussions with Scollard's management, GMP FirstEnergy and the West Pembina Superior Bidder, the Receiver understands that prospective bidders will often place incremental value in being the 'operator' of certain wells and facilities. This incremental value is due to the ability to manage the assets including controlling operating costs and drilling programs. Furthermore, prospective purchasers value operational control to maximize value over time of the asset according to their own technical insights, and derive value from being able to schedule drilling programs and other operational decisions this as they see fit vis a vis their other portfolio assets;
- (i) The Receiver has attempted to address Firenze's stated concern with respect to the qualification of the potential purchaser of the West Pembina assets as Firenze has previously indicated to Scollard management that one of Firenze's concerns is that they wanted to ensure that the operatorship of the Firenze JOA Properties be transferred to a legitimate and financially sound operator. As only a non-binding agreement has been reached at this time, the Receiver has certain confidentiality requirements and is unable to disclose the specific identities of the West Pembina Superior Bidder. But the Receiver has advised Firenze, and does hereby advise this Honourable Court, that the West Pembina Superior Bidder is "well capitalized, an active horizontal driller producing over 10,000 boepd with an LMR over 10";
- (j) The Receiver continues to work with interest parties with respect to the properties located in Westeros and Bigoray; and

- (k) The Receiver also has certain concerns over Firenze's ability to complete the transfer and operation of the Firenze JOA Properties. The Alberta Energy Regulator's ("AER") November 4, 2017 Liability Management Program Results indicate that Firenze has a liability management rating ("LMR") of 2.07 which is only marginally above the 2.0 required for the AER to allow the transfer of licenses without special permission. We note the Firenze JOA Properties carry a negative LMR.;
36. It is the Receiver's concern that Firenze is using the Replacement Operator Notice to extract value from the estate for its own benefit at the expense of the other creditors, as illustrated in the offers in the Confidential Appendix and timing of the receipt of the Replacement Operator Notice. As discussed above, the Replacement Operator Notice was issued after the launch of the Receivership SISP and as discussed above, Firenze was a participant in both the Pre-Receivership SISP and the Receivership SISP.
37. In the Receiver's view, Firenze would not be prejudiced through the Receivership Proceedings by not allowing them to take over operatorship. They are in the same position they were in as of the Date of Appointment (not being operator) and the Receiver has continued with no material changes to operations. Furthermore, it is the Receiver's view that Firenze will be in a better position than they were in as of the Date of Appointment if the West Pembina Superior Bidder is successful in purchasing the West Pembina assets as the West Pembina Superior Bidder is much stronger financially than Scollard was as at the Date of Appointment.
38. The Receiver and its counsel have reviewed in detail the *Bank of Montreal v Bumper Development Corporation Ltd.* (the "**Bumper Case**") on which Firenze relies. However, the Receiver notes the following relevant factual items that differentiate the current matter from the facts before the Court in the Bumper Case:

- (a) In the Bumper Case, the Receiver had advised the non-working interest partner and potential purchasers during its sale process that they were not transferring operatorship in the sale process and that the Receiver would not entertain offers purporting to convey operatorship of the assets. That is not the case in the Scollard Receivership SISP, as the Receiver has not advised and potential purchasers that it would not entertain offers that included operatorship;
- (b) There was no discussion in the Bumper Case of the financial effect on the estate of the transfer of operatorship – perhaps because the contest for operatorship was only between a purchaser of assets and the non-operating working interest owner (and did not involve the Receiver). Based on the results of the non-binding bids received in the Receivership SISP and from discussions with Scollard management and GMP FirstEnergy as well as direct discussions with the West Pembina Superior Bidder, the financial effect on the Scollard estate and on Scollard creditors will be materially negative if Firenze is successful in its efforts to replace Scollard as operator of the West Pembina assets;
- (c) There was no stay of proceedings that needed to be considered in the Bumper Case, as the contest was between a non-operating working interest partner and the purchaser of the asset after the Court had approved the sale. Accordingly, the Receiver was not a party to the application, and there was no issue with respect to the lifting of the stay; and

- (d) If this Court was to follow the result in the Bumper Case (notwithstanding the factual differences between that case and this one) the result would be that the Receiver would need to consider recommending that proceedings under the *Companies' Creditors Arrangement Act* ("CCAA") be commenced in order to stay the Firenze Application and preserve significant value in the estate that would otherwise be lost. The loss of value due to the change in operator would be significantly greater than the costs of running a CCAA proceeding.
39. Furthermore, the Receiver is of the view that the stay provisions at paragraph 9 of the Receivership Order provide a broad definition of stay of 'rights and remedies'. The provision under the 2007 CAPL for transfer of operatorship is such a right and remedy that, in the Receiver's view should be stayed under the Order. The Receiver believes a level playing field should remain in place as it was at the Date of Appointment. The Receiver is attempting to sell the rights and interests that Scollard had at the time of the granting of the Receivership Order and any purchaser of the assets would receive nothing more and nothing less. At the time of the Receivership Order, Scollard was the owner and operator of Firenze JOA Properties and as such is attempting to sell such assets. Any purchaser of the assets would be assigned the various operating agreements and would be required to abide by those terms post-closing.

RECEIVER'S RECOMMENDATIONS

40. The Receiver respectfully recommends that this Honorable Court dismiss the Firenze Application and allow the completion of the Receivership SISP.

All of which is respectfully submitted this 23rd day of November, 2017.

FTI Consulting Canada Inc. in its capacity as
Receiver of the assets, property and undertaking
of Scollard Energy Inc.


Name: Deryck Helkaa
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