Clerk's Stamp

COURT FILE NUMBER	1201 06039
COURT	COURT OF QUEEN'S BENCH OF ALBERTA
JUDICIAL CENTRE	CALGARY
PLAINTIFF	CANADIAN WESTERN BANK
DEFENDANTS	COUGAR OIL AND GAS CANADA INC.
DOCUMENT	**SECOND REPORT OF ERNST & YOUNG INC., IN ITS CAPACITY AS COURT-APPOINTED RECEIVER OF COUGAR OIL AND GAS CANDA INC.**
ADDRESS FOR SERVICE AND CONTACT INFORMATION OF PARTY FILING THIS DOCUMENT	<u>**RECEIVER**</u> ERNST & YOUNG INC. 1000, 440 – 2nd Avenue S.W. Calgary, AB T2P 5E9 Neil Narfason/Peter Chisholm Telephone: (403) 206-5067/(403) 206-5061 Fax: (403) 206-5075 Email: neil.narfason@ca.ey.com peter.chisholm@ca.ey.com <u>**COUNSEL**</u> McCarthy Tetrault LLP 3300, 421 - 7th Avenue S.W. Calgary, AB, Canada T2P 4K9 Sean Collins / Walker MacLeod Telephone: (403) 260-3531 / (403) 260-3710 Email: scollins@mccarthy.ca wmacleod@mccarthy.ca

TABLE OF CONTENTS OF THE SECOND REPORT

INTRODUCTION

1. On February 3, 2012 (the "Initial Filing Date"), Cougar Oil and Gas Canada Inc. ("Cougar Oil and Gas" or the "Company") sought and obtained protection from their creditors under the Companies' Creditors Arrangement Act, R.S.C. 1985 c. C-36, as amended, (the "CCAA") pursuant to an order of this Honourable Court (the "Initial Order").

2. Pursuant to the Initial Order, Ernst & Young Inc. was appointed monitor of the Cougar Oil and Gas (the "Monitor").

3. Subsequent to the Initial Filing Date, Cougar Oil and Gas encountered multiple setbacks which prevented Cougar from being able to continue operating under the CCAA. These setbacks are described in two material adverse change reports prepared by the Monitor, the second report of the Monitor dated April 12, 2012 and the fifth report of the Monitor dated May 10, 2012.

4. On May 11, 2012 (the "Appointment Date"), this Honourable Court granted an order ceasing Cougar Oil and Gas's proceedings under the CCAA and an order (the "Appointment Order") appointing Ernst & Young Inc. as receiver and manager (the "Receiver") of the property, assets and undertakings (the "Property") of Cougar Oil and Gas.

5. The purpose of this second report (the "Second Report") of the Receiver is to advise this Honourable Court with respect to:

   a) the activities of the Receiver for the period of May 22, 2012 to October 18, 2012, 2012 (the "Reporting Period") and an overview of the sales process (the "Initial Sales Process Order") undertaken by the Receiver pursuant to an Order of this Honourable Court dated May 23, 2012 (the "Initial Sales Process Order");

b) a description of the second sales process ("Proposed Sales Process") proposed by the Receiver and the retention of NRG Divestitures Inc. as financial advisor to coordinate the Proposed Sales Process; and

c) the Receiver's recommendations.

6. Capitalized terms not defined in this Second Report are as defined in the Appointment Order.

BACKGROUND

7. Cougar Oil and Gas is a publicly traded oil and gas exploration and production company focussing on the exploration and development of Canadian based onshore oil and gas properties.

8. Cougar Oil and Gas's assets primarily consists of oil and gas properties including majority interests in what is known as the "Trout Property" located in north central Alberta, which Cougar operates, and interests in the Lucy Horn River Basin Mukwa shale gas project in northeast British Columbia. The head office of Cougar Oil and Gas is located in Calgary, Alberta.

9. For further background on Cougar Oil and Gas and the receivership please refer to the Receiver's website:

http://www.ey.com/ca/cougaroilandgas

ACTIVITES OF THE RECEIVER DURING THE REPORTING PERIOD

10. As described in the first report of the Receiver dated May 22, 2012 (the "First Report"), the Receiver took custody and control of Cougar Oil and Gas's assets immediately subsequent to the granting of the Appointment Order.

11. The Receiver retained two employees which had been employed by Cougar Oil and Gas on the Appointment Date, a junior landman and controller. The controller abruptly resigned on June 30, 2012 and the employment of the junior landman was terminated by the Receiver on July 31, 2012. The Receiver was required to retain a contract oil and gas production accountant to update Cougar Oil and Gas's books and records for the period of April 1, 2012 to September 30, 2012. The contract production accountant continues to be retained by the Receiver to perform accounting services for the period of October 1, 2012 to December 31, 2012. The Receiver occupied Cougar's corporate offices in Calgary, Alberta from the Appointment Date to September 30, 2012.

12. The Receiver has continued to operate Cougar Oil and Gas's oil wells during the Reporting Period with the assistance of two field operators who were responsible for overseeing the operations of Cougar Oil and Gas's four oil wells operating in Trout Lake, Alberta on the Appointment Date. One of the four operating oil wells ceased operating in late September 2012 and the Receiver is continuing to operate the three remaining operating oil wells.

13. A representative of the Receiver attended Cougar Oil and Gas's properties in Trout Lake, Alberta and Busby, Alberta in late May 2012 and toured the properties with one of the field contractors.

14. Further to the relief provided in the Appointment Order, the Energy Resources Conservation Board ("ERCB") has agreed to extend the relief for the Receiver to be required to fund the Liability Management Rating security deposit (the "LMR Security Deposit") until December 31, 2012. Should the closing of a transaction under the Proposed Sales Process extend beyond December 31, 2012, the Receiver will seek further relief from the ERCB.

15. The following table demonstrates the receipts and disbursements of the Receiver for the period of the Appointment Date to September 30, 2012.

Statement of Receipts & Disbursement
For the period of May 11, 2012 to September 30, 2012

	Notes	
Receipts		
Oil and Gas Revenue	*a*	**$ 332,723**
Receiver's Borrowings	*b*	**200,000**
Recovery of Joint Venture Expenses	*c*	**-**
GST Collected		**16,298**
Total Receipts		**549,022**
Disbursements		
Operating Expenses		
Field Operator Fees	*d*	**179,650**
Electricity for Facilities		**17,772**
Misc. Camp Expenses		**7,387**
Oil Transportation		**3,146**
Repair of well access roads		**18,438**
Deposits to Field Suppliers		**10,000**
Administrative and Other Costs		
Salaries and Wages	*e*	**46,640**
Office Lease	*f*	**44,245**
Utilities		**1,862**
IT Consultant and Software Licences		**7,895**
Environmental Remediation		**10,640**
Insurance	*g*	**32,836**
2012 ERCB Admin Fee (8 months)		**3,315**
Well and Mineral Surface Leases		**6,950**
GST Paid		**14,963**
Interest on Receiver's Borrowings		**4,121**
Bank charges		**208**
Total Disbursements		**410,068**
Net Change in Cash		**138,953**
Opening Cash Balance		**-**
Ending Cash Balance		**$138,953**

16. The notes to the statement of receipts and disbursements above are as follows:

a) Production has been consistent through May 2012 to July 2012 with 4 wells producing at approximately $75,000 per month. Revenue collected in August was only approximately $30,000 due to the inability of being able to transport all crude oil inventory in June due to poor road conditions, resulting in increased revenue in September 2012. Field operators have been able to increase the production from one of the wells through hot water injections increasing production August to December 2012 however this increase will be off-set by a rod failure at another well which has ceased production at the well. Estimated repairs to bring this well back into production is approximately $100,000;

b) The Receiver was authorized to borrow a maximum of $200,000 under the Appointment Order and $200,000 has been borrowed to date;

c) Cougar Oil and Gas is presently in a net receivable position with its joint venture partners of approximately $65,000 (net of joint venture payables). The Receiver will be issuing demand letters to collect the outstanding joint venture receivables however the cash flow above does not include the receipt of these receivables as timing of collection is unknown;

d) The Receiver has retained two field operators who are on-site at the Trout Lake properties; the Receiver is required to provide 30 days notice prior to terminating the contracts with the field operators;

e) The Receiver had retained Cougar Oil and Gas's controller and a junior land man since the date of the receivership. Salaries and wages unless include payment of wages owing to Cougar's geologist and Chief Financial Officer as at the Receivership date which would have been a secured priority in the receivership;

f) The Receiver occupied Cougar Oil and Gas's corporate office until September 30, 2012.; and

g) The Receiver has been required to renew several insurance policies for Cougar Oil and Gas which had or were about to lapse as a result of non-payment by Cougar Oil and Gas prior to the date of the Appointment Order.

INITIAL SALES PROCESS

17. Pursuant to the Initial Sales Process Order, the Receiver undertook the Initial Sales Process as described in the First Report. The Initial Sales Process involved the following:

a) placed advertisements in the Daily Oil Bulletin on May 17, 2012, May 23, 2012 and May 24, 2012. The Advertisement described the Property and solicited interested parties to contact the Receiver for further information with respect to the Sales Process; and

b) the Receiver prepared a marketing teaser describing the Property and the Initial Sales Process. On May 18, 2012 the Receiver mailed the marketing teaser to over 80 parties which it had determined to be potentially interested in the Property.

18. During the Initial Sales Process, the Receiver was contacted by four parties requesting that the Receiver provide a confidentiality agreement ("CA") for their execution so that the parties could gain access to due diligence information.

19. Prior to the bid deadline on June 15, 2012, the Receiver received one non-binding letter of intent (the "All Property LOI") from a party (the "Prospective Purchaser") interested in purchasing all of the assets of Cougar Oil and Gas and two non-binding letters of intent from parties interested in acquiring certain of Cougar Oil and Gas's properties.

20. The All Property LOI form the Prospective Purchaser provided for the highest recovery from the sale of the Property and the Receiver assisted the Prospective Purchaser with further due diligence with the goal of entering into a definitive agreement for the sale of the Property however in the middle of July 2012, the Prospective Purchase withdrew the All Property LOI.

21. Subsequent to the Prospective Purchaser withdrawing the All Property LOI, the Receiver negotiated with one of the parties that had a submitted a letter of intent on certain of the Cougar Oil and Gas properties. This party elected not to submit a binding offer in respect of the Company's assets.

PROPOSED SALES PROCESS

22. As the Initial Sales Process did not conclude with a sale of Cougar Oil and Gas's Property, the Receiver is now proposing to proceed with the Proposed Sales Process.

23. The Receiver requested proposals from two financial advisors that specialize in the marketing of oil and gas properties in similar size to the Property. The Receiver, in consultation with Canadian Western Bank ("CWB"), selected NRG Divestitures Inc. ("NRG") to act as the proposed selling agent with respect to the Property. CWB is the first secured creditor on the Property.

24. A copy of an engagement letter for the Receiver to retain NRG to market the Property is attached as appendix A to the Second Report (the "NRG Engagement Letter"). The retention of NRG as selling agent is subject to the approval of this Honourable Court.

25. A summary of the Proposed Sales Process is as follows:

   a) NRG will act as the selling agent and receive the following fees:

      i. a success fee of 3% on a transaction with a value of up to $3.2 million;

      ii. a success fee of 6% on the proceeds of any transaction with a value in excess of $3.2 million; and

      iii. a one-time work fee of $3,000 to cover advertising expenses associated with marketing the Property.

b) Marketing will include the following:

i. preparation of a marketing brochure;

ii. e-mail marketing brochure to approximately 2,000 parties in NRG's database;

iii. contact key players who are indentified as potentially being interested in the Property; and

iv. Advertise in the Daily Oil Bulletin.

c) interested parties must submit non-binding letters of intent ("LOI") to acquire all or part of the Property to NRG by 4:00 PM (Mountain Daylight Time) on November 21, 2012;

d) the Receiver and NRG will evaluate the LOI's with the intent to select the most favourable LOI and enter into a binding agreement (the "Binding Agreement") for the sale of the Property by December 7, 2012; and

e) the Receiver shall immediately apply to this Honourable Court for an order approving the Binding Agreement and vesting all or part of the Property with the Purchaser in accordance with the Binding Agreement with a closing of the sale expected to occur on or before December 31, 2012.

26. The Receiver believes the fees payable to NRG upon the successful closing of a sale of the Property is reasonable based upon fees for similar transactions.

Cash Flow Forecast during Proposed Sales Process

27. The following is a cash flow forecast (the "Cash Flow Forecast") prepared by the Receiver with receipts and disbursements forecast during the period of October 1, 2012 to December 31, 2012 (the "Forecast Period"):

Cash Flow Forecast
For the period of October 1, 2012 to December 31, 2012

	October 2012	November 2012	December 2012	Total
Receipts				
Oil and Gas Revenue	$ 124,166	$ 59,751	$ 59,751	**$ 243,668**
GST Collected	6,208	2,988	2,988	**12,183**
Total Receipts	**130,374**	**62,738**	**62,738**	**255,851**
Disbursements				
Operating Expenses				
Field Operator Fees	34,250	34,250	34,250	**102,750**
Electricity for Facilities	35,000	17,500	17,500	**70,000**
Misc. Camp Expenses	5,315	5,000	5,000	**15,315**
Well Repairs and Maintenance	10,000	10,000	10,000	**30,000**
Oil Transportation	2,000	2,000	2,000	**6,000**
Repair of well access roads	3,000	3,000	3,000	**9,000**
				-
Administrative and Other Costs				**-**
Office Lease	15,500			**15,500**
Office Closure Costs	1,000			**1,000**
Utilities	1,000	500	5,000	**6,500**
IT Consultant and Software Licences	2,000	500	500	**3,000**
Insurance	4,500			**4,500**
Well and Mineral Surface Leases	25,000	3,000	3,000	**31,000**
GST Paid	8,695	4,171	4,396	**17,262**
Interest on Receiver's Borrowings	5,333	2,667	2,667	**10,667**
Production Accountant Contractor	30,000	5,000	5,000	**40,000**
Bank charges	400	200	200	**800**
Total Disbursements	**182,993**	**87,788**	**84,417**	**355,197**
Net Change in Cash	(52,619)	(25,049)	(21,678)	**(99,346)**
Opening Cash Balance	138,953	86,334	61,285	**138,953**
Ending Cash Balance	**$ 86,334**	**$ 61,285**	**$ 39,607**	**$ 39,607**

Receipts

28. Receipts of approximately $255,000 are forecast to be received through oil and gas revenue.

Disbursements

29. Disbursements relate to operating costs to maintain oil production and general and administrative costs.

30. The Receiver and its legal counsel's professional fees are covered under the Receiver's charge in the Appointment Order and will be paid out from the proceeds from the sale of the Property and therefore are not included in the forecast above.

31. The Cash Flow Forecast demonstrates that the Receiver will have sufficient funds throughout the Forecast Period to complete the Proposed Sales Process.

RECOMMENDATIONS

32. The Receiver recommends that this Honourable Court approve:

    a) the Proposed Sales Process; and

    b) the Receiver's retention of NRG.

Dated at Calgary, this 26th day of October, 2012.

ERNST & YOUNG INC.
in its capacity as the Receiver
of Cougar Oil and Gas

Neil Narfason, CA•CIRP, CBV
Senior Vice-President

APPENDIX A

26 October 2012

Ernst & Young Inc.
1000, 440 – 2nd Ave. S.W.
Calgary, Alta
T2P 5E9

NRG DIVESTITURES INC.

Attention: Peter Chisholm

Strictly Confidential

Dear Sir:

Re: **Engagement to assist with potential sale of the properties of Cougar Oil & Gas Inc. (the "Company") as outlined in Schedule A**

Further to our recent discussions, NRG Divestitures Inc.(**"NRG Divestitures"**) understands that pursuant to the order (the "**Order**") of the Court of Queen's Bench Alberta in Action Number 1201 06039 dated May 11, 2012, Ernst & Young Inc. (the "**Receiver**") was appointed receiver and manager of the Company. The Receiver wishes to engage an advisor to assist in finding companies interested in purchasing the Company's assets as described in Schedule B (the "**Assets**"), . NRG Divestitures would be pleased to act as strategic advisor and agent to the Receiver with respect to the sale of the Company or the Assets (each a "Transaction").

1. ENGAGEMENT

The Receiver hereby engages NRG Divestiture on behalf of the Company and in accordance with the provisions of the Order and NRG Divestitures agrees to act as the Receiver's strategic advisor and agent with respect to the sale of the Company or the Assets. The Receiver grants NRG Divestitures the right to conduct a process in furtherance of a Transaction for a period of 3 months from the date first written above (the "**Term**"), commencing upon an order being granted by the Court of Queen's Bench of Alberta approving this engagement, on the terms and conditions set out in this letter agreement (the "**Engagement**")..

NRG Divestitures' engagement hereunder may be terminated at any time, with or without cause, by either NRG Divestitures or the Receiver upon 30 days prior written notice to the other party, subject to the Company's ongoing obligations for fees and expenses as contemplated herein.

2. SERVICES TO BE PROVIDED BY NRG Divestitures Inc.

(a) **Marketing Services:** NRG Divestitures will during the Term, to the extent requested by the Receiver, conduct a marketing process to generate awareness of the Company's Assets.

(b) **Transaction Support Services:** NRG Divestitures will, during the Term, to the extent requested by the Receiver, be available to provide some or all of the following Transaction support services:

(i) maintain contact with potential Transaction candidates and assist in providing follow-up information as requested;

(ii) prepare and deliver to the Receiver a weekly report detailing potential Transaction counterparties contacted;

(iii) organize Transaction offers, if any, and present them to the Receiver; and

(iv) organize engineering, geologic, summary land, summary financial, marketing and other data for inclusion in technical review data perform computing, geotechnical and clerical functions (*i.e.*, format transformation, typing, digitizing, scanning, image capturing, and graphical annotation) as necessary or desirable in NRG Divestitures' discretion, to convert paper records such as text documents, spreadsheets, maps, well logs, graphs, cross-sections, etc., into a digital or other electronic format acceptable for use in emails. This will lead to the creation of an information summary to assist in preparing marketing materials to describe the assets for potential clients to review.

NRG Divestitures has the right to use the Company's name and logo in any marketing or promotional materials. If NRG Divestitures is requested to provide services not outlined in this engagement letter, the terms and conditions (including compensation therefore) for those services are to be outlined in a separate letter agreement and the applicable fees are to be in addition to compensation for the services provided pursuant to this Engagement.

3. COMPENSATION, EXPENSES & INDEMNITY

As compensation for NRG Divestitures' services pursuant to this Engagement, the Receiver will cause the Company to:

(a) pay NRG Divestitures Inc:

(i) a fee (the "**Success Fee**") equal to the amount calculated in the Success Fee Scale below, which calculation is to be based upon a percentage(%) of the Transaction Value, as defined below. Each level is calculated and the sum total will be the fee:

<u>Success Fee Scale</u>

1 3% on the Transaction Value up to $3,200,000.00; and
2 6.0% on the portion of the Transaction Value that is in excess of $3,200,000.00;

The Receiver's obligations hereunder survive any provision of services hereunder, the expiry of the Term or other completion, modification or termination of NRG Divestitures' engagement, or the completion of any Transaction. In connection with the foregoing, the parties acknowledge and agree that:

(b) all amounts payable to NRG Divestitures pursuant to this letter agreement are subject to Goods and Services Tax ("**GST**"). Where GST is applicable, an additional amount equal to the amount of GST owing will be charged to and paid by the Company;

(c) "**Transaction Value**" means the aggregate of any cash consideration and the market value of all non-cash consideration (such as shares, other assets or financial instruments) received pursuant to the Transaction or otherwise paid by one or more Transaction counterparties in connection with such Transaction. The Transaction Value excludes the security deposit held by the Energy Resources Conservation Board in relation to the Company's Liability Management Rating and a purchaser compromising debt owed by the Company as consideration;

(d) NRG Divestitures and the Receiver will jointly determine the value of any non-cash consideration using industry standard practices effective as of the closing date of a Transaction. If the value of any non-cash consideration cannot be agreed upon, a third party firm acceptable and agreed to by the Receiver and NRG Divestures (failing agreement, to be appointed by the court) is to be engaged by the Company at the Company's expense to prepare an independent valuation, such independent valuation to be final and binding on the parties absent manifest and material error; and

(e) all Success Fees are due and payable from the Transaction proceeds immediately upon the completion of the Transaction

4. CONFIDENTIALITY & USE OF INFORMATION

NRG Divestitures will keep all non-public information provided to it by the Company or the Receiver and all notes, analyses, compilation studies or other documents containing such information or derived therefrom ("**Confidential Information**") strictly confidential and will not use any Confidential Information for any purpose other than in providing the services contemplated in this Engagement and will not, without prior written consent of the Company, disclose any Confidential Information except

(a) to its own directors, officers, employees or outside consultants or advisors who require access to the same for the purposes of this Engagement, or

(b) as may be required by law or in connection with any legal or regulatory proceeding, provided that NRG Divestitures will give prompt written notice of any such disclosure obligation to the Receiver so that the Receiver may instruct NRG Divestitures to seek a protective order or other appropriate remedy. NRG Divestitures will require its directors, officers, employees and outside consultants or advisors to adhere to the same confidentiality obligations imposed upon it hereunder. Upon a written request by the Receiver, NRG Divestitures will notify the Receiver of each outside advisor to whom any Confidential Information has been provided or disclosed.

The parties acknowledge and agree that the foregoing provisions do not apply to information that is or subsequently becomes public other than through breach by NRG Divestitures of its obligations hereunder or to information disclosed to NRG Divestitures by any third party who is not under an obligation of confidentiality in respect of such information.

Subject to the provisions hereof, none of the written or oral advice, valuation and opinions of NRG Divestitures, and any background or supporting materials or analyses, is to be publicly disclosed, in whole or in part, or summarized, excerpted from or otherwise referred to or provided to any third party by the Receiver without the prior written consent of NRG Divestitures except as required by the Receiver in fulfilling its duties as Court-appointed receiver and manager of the Company.

5. OTHER

a) The Receiver hereby acknowledges that in the course of providing services to other persons, NRG Divestitures may obtain or develop information regarding some or all of the Company's assets or any potential transaction respecting one or more of the Company's assets or an interest, direct or indirect, therein.

b) This letter expresses the entire agreement between the parties. The parties to this letter agreement may amend or modify this letter agreement only in writing. If any provision of this letter agreement is determined by any court of competent jurisdiction to be illegal, invalid or unenforceable, that provision is deemed severed from this letter agreement and does not affect the remaining provisions, which continue in full force and effect. Time is of the essence hereof. Nothing herein constitutes or is construed to constitute a partnership between the parties of any kind whatsoever or acting jointly or in concert in respect of any property or Transaction. The words "include", "includes" or "including", which following a general statement do not limit such general statement to the specific items or matters set forth but rather permits it to refer to all other items or matters that could reasonably fall within its broadest possible scope and is binding upon and endures to the benefit of the parties hereto and their respective successors and assigns. Neither party shall assign this agreement in whole or in part without the prior written consent of the other party. All dollar amounts stated or referred to in this letter agreement are in Canadian funds.

6. GOVERNING LAW

All aspects of the relationship created by this letter agreement are governed by and construed in accordance with the laws of the Province of Alberta. The parties hereby irrevocably and unconditionally consent to and submit to the exclusive jurisdiction of the Courts of the Province of Alberta, Canada.

Please confirm that the foregoing is accordance with your understanding by signing and returning to NRG Divestitures Inc. the enclosed duplicate of this letter agreement.

Yours truly,

Arno Keller
President

NRG Divestitures Inc.

By: ______________________
Steve Hrurich

AGREED AND ACCEPTED effective this 26TH day of OCTOBER, 2012.

Cougar Oil & Gas Ltd., by its court-appointed Receiver and Manager, Ernst & Young Inc. who is causing Cougar Oil & Gas Ltd. to enter into this agreement under and pursuant to the authority conferred upon Ernst & Young Inc. pursuant to the Order. The Receiver specifically advises it is entering into this Agreement solely in its representative and not in its personal or corporate capacity.

By: ______________________
Signature of Authorized Signatory

Neil Narfason S.V.P.
Name and Title of Authorized Signatory (Please Print)

Neil Narfason

Address

1000, 440 – 2nd Ave. S.W.

Calgary, Alta. T2P 5E9

SCHEDULE "A"
ASSETS FOR SALE

THE DETAILS OF LOCATION, RIGHTS AND INTERESTS ASSOCIATED WITH THESE PROPERTIES ARE CONTAINED IN AND ARE DEEMED TO BE A PART OF THIS SCHEDULE "B".