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| PLAINTIFF | CANADIAN WESTERN BANK | |
| DEFENDANTS | COUGAR OIL AND GAS CANADA INC. | |

DOCUMENT

**THIRD REPORT OF ERNST & YOUNG INC., IN ITS CAPACITY AS COURT-APPOINTED RECEIVER OF COUGAR OIL AND GAS CANDA INC.**

**January 15th, 2013**

ADDRESS FOR SERVICE AND CONTACT INFORMATION OF PARTY FILING THIS DOCUMENT


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**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 third report (the "Third Report") of the Receiver is to advise this Honourable Court with respect to:

    a) the activities of the Receiver for the period of October 19, 2012 to January 10, 2013 (the "Reporting Period");

    b) the results of sales process ("Sales Process") approved pursuant to an order of this Honourable Court dated October 29, 2012 (the "Sales Process Order"); and

c) an overview of the asset purchase agreement to be entered into between the Receiver and Verity Energy Ltd. ("Verity") for the sale of the majority of Cougar Oil and Gas's Property;

d) an overview of the asset purchase agreement to be entered into between the Receiver and Ember Resources Inc. ("Ember") for the sale of the Cougar Oil and Gas's Property (the "Buffalo Lake Property") located in the Buffalo Lake area of Alberta;

e) the proposed distribution of funds recovered by the Receiver to secured creditors;

f) the request for the discharge of the Receiver; and

g) the Receiver's recommendations.

6. Capitalized terms not defined in this Third 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 second report of the Receiver dated October 26, 2012 (the "Second Report"), 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.

11. Further to the relief provided in the Appointment Order, the Energy Resources Conservation Board ("ERCB") has agreed to extend the time for payment of the Liability Management Rating security deposit (the "LMR Security Deposit") until January 31, 2013. The ERCB has advised that it will not extend the relief past January 31, 2013.

12. The following table sets out the receipts and disbursements of the Receiver for the period of the Appointment Date to January 10, 2013.

**Statement of Receipts & Disbursement**
**For the period of May 11, 2012 to January 10, 2013**

| | Notes | |
|---|---|---|
| **Receipts** | | |
| Oil and Gas Revenue | *a* | **$ 558,288** |
| Receiver's Borrowings | *b* | **200,000** |
| Recovery of Joint Venture Expenses | *c* | **-** |
| GST Collected | | **27,575** |
| **Total Receipts** | | **785,862** |
| **Disbursements** | | |
| Operating Expenses | | |
| Field Operator Fees | *d* | **327,730** |
| Electricity for Facilities | | **59,739** |
| Misc. Operating and Camp Expenses | | **55,549** |
| Repair of well access roads | | **19,973** |
| Deposits to Field Suppliers | | **5,000** |
| Oil Transportation | | **2,358** |
| Administrative and Other Costs | | |
| Office Lease | *f* | **61,333** |
| Production Accounting Service and Contract Accountant | | **50,530** |
| Salaries and Wages | *e* | **46,660** |
| Insurance | *g* | **36,594** |
| Mineral Lease Costs and ERCB Fees | | **30,627** |
| GST Paid | | **27,751** |
| Interest on Receiver's Borrowings | | **14,816** |
| IT Consultant and Software Licences | | **9,310** |
| Utilities | | **5,091** |
| Daily Oil Bulletin Advertising | | **3,000** |
| Office Equipment Lease | | **2,658** |
| Moving and Storage | | **2,323** |
| Bank charges | | **606** |
| Filing fees paid to OSB | | **70** |
| **Total Disbursements** | | **761,717** |
| Net Change in Cash | | **24,146** |
| Opening Cash Balance | | **-** |
| **Ending Cash Balance** | | **$ 24,146** |

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

a) Production was consistent from 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, which causes increased production in August to December 2012 however this increase was off-set by a rod failure at another well which caused production to cease at the well. Estimated repairs to bring this well back into production is approximately $100,000 and the Receiver did not have funding to complete this repair;

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 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 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.

## SALES PROCESS

14. As described in the Second Report, the Receiver had undertaken a sales process (the "Initial Sales Process") to sell the Property shortly after the granting of the Appointment Order however the Receiver was unable to close a transaction based upon the offers received in the Initial Sales Process. The Receiver subsequently undertook another sales Process in accordance with the Sales Process Order granted October 29, 2012.

15. Pursuant to the Sales Process Order, the Receiver retained NRG Divestitures Inc. ("NRG") to act as selling agent with respect to the sale of the Property. The Sales Process, under the direction of NRG, involved the following:

    a) placed advertisements in the Daily Oil Bulletin on November 20, 2012, November 22, 2012, November 27, 2012, November 29, 2012 and December 3 2012. The Advertisement described the Property and solicited interested parties to contact NRG for further information with respect to the Sales Process;

    b) NRG prepared a marketing brochure describing the Property and the Sales Process. NRG sent the marketing brochure via e-mail to over 1,600 parties per their marketing database;

    c) NRG advertised the Property and Sales Process on their website; and

    d) NRG identified companies who may be particularly interested in acquiring the assets (primarily companies operating in the same geographic location or those that had expressed an interest in acquiring similar properties) and contacted these parties directly via phone calls with the companies' management.

16. During the Sales Process, ten interested parties executed confidentiality agreements ("CA's") in order to gain access to the data room to obtain further information with respect to the Property in order for the interested parties to perform due diligence.

17. The Sales Process Order had a deadline of 4:00 p.m. (Mountain Daylight Time) on November 21, 2012 (the "Original Bid Deadline") for interested parties to submit offers on the property. Based upon the recommendation of NRG, the Receiver agreed to extend the Original Bid Deadline to 4:00 p.m. (Mountain Daylight Time) on December 5, 2012 (the "Bid Deadline") to allow parties additional time to perform due diligence on the Proeprty. All of the marketing materials issued by NRG referenced the Bid Deadline of December 5, 2012. Prior to the Bid Deadline, NRG received three offers on the Property as follows:

a) an offer on the Cougar Oil and Gas properties located in the Trout Lake Area of Alberta (the "Trout Offer");

b) an offer from Verity on all of the Property with the exception of the Buffalo Lake Property (the "Verity Offer"); and

c) an offer from Ember on the Buffalo Lake Property that Cougar Oil and Gas owns working interests (the "Buffalo Lake Offer"). Ember is the operator of the property being purchased pursuant to the Buffalo Lake Offer.

18. The Trout Offer provided the highest recovery on the Property however the company that submitted the Trout Offer withdrew their offer as they were unable to obtain financing to close the transaction.

19. The Receiver, in consultation with NRG and Canadian Western Bank ("CWB"), Cougar Oil and Gas's primary secured lender on the Property, agreed to pursue the Verity Offer and the Buffalo Lake Offer. The Receiver has is currently in the process of finalizing the asset purchase agreements for the sale of the Property in accordance with the Verity Offer and the Buffalo Lake Offer.

**Verity Offer**

20. Set out below is a summary of the terms of the draft asset purchase agreement to be entered into between the Receiver and Verity Energy Ltd. (the "Verity APA"), the Verity

APA is expected to be executed early in the week of January 14, 2013 in the substantially in the form as the draft Verity APA attached hereto as Appendix A:

a) all of the Property of Cougar Oil and Gas located in Alberta excluding the Buffalo Lake Property are to be acquired by Verity for cash consideration of $400,000 as described in Appendix A to the draft Verity APA attached hereto as Appendix;

b) the effective date of the transaction under the Verity APA is January 1, 2013;

c) Cougar Oil and Gas's LLR security deposit (the "LLR Security Deposit") with the ERCB of $810,488.62 will be transferred from Cougar Oil and Gas to Verity and continue to be held by the Energy Resource and Conservation Board ("ERCB"). 165023 Alberta Ltd. ("165") provided debtor-in-possession financing ("DIP") to Cougar Oil and Gas's during its proceedings under the CCAA. 165 has a first charge against the LLR Security Deposit and 165 has agreed to having the LLR Security Deposit transferred to Verity; and

d) closing will occur as soon as practicable in the event of Court approval.

21. The Verity APA contemplates that the assets being acquired are to be vested free and clear of any claims or unassumed contracts/agreements, save and except certain permitted encumbrances, as more fully set out in the Verity APA and proposed Sale Approval and Vesting Order.

**Buffalo Lake Offer**

22. Set out below is a summary of the terms of the draft asset purchase agreement to be entered into between the Receiver and Ember (the "Ember APA"), the Ember APA is expected to be executed early the week of January 14, 2013

a) all of Cougar Oil and Gas Inc.'s interest in the Buffalo Lake Property are to be acquired by Ember for cash consideration of $40,000; and

b) the effective date of the transaction under the Ember APA is January 1, 2013.

23. As the consideration being received under the Ember APA is less than the $100,000 threshold for the Receiver to dispose of Property under the Appointment Order, the Ember APA does not require Court approval. Furthermore, as Cougar Oil and Gas is not the licensee on these properties, the Receiver does not require approval from the ERCB to transfer the Buffalo Lake Property to Ember.

24. The Verity APA contemplates that the assets being acquired are to be vested free and clear of any claims or unassumed contracts/agreements, save and except certain permitted encumbrances, as more fully set out in the Verity APA and proposed Sale Approval and Vesting Order.

**PROPOSED DISTRIBUTION**

25. The Receiver estimates recovering the following funds net of administrative costs (excluding the Receiver's professional fees and Receiver's counsel's professional fees):

| Forecast Proceeds to be Recovered from Receivership | |
|---|---|
| Return of ERCB LLR Security Deposit | $ 810,603 |
| Verity APA - Cash Consideration | 400,000 |
| Ember APA - Cash Consideration | 40,000 |
| Fee to NRG as Selling Agent (3% of Proceeds) | (13,200) |
| Estimated collection of Joint Venture Receivables (Net of Joint Venture Payables) | 65,000 |
| Net proceeds from operating oil wells | - |
| **Total Forecast Proceeds to be Recovered** | **$ 1,302,403** |

26. Paragraph 32 of the Appointment Order listed the following priority of charges and the Receiver has identified the amounts owed to the specific creditors as follows:

| Creditor | Description of Debt/Security | Amount Owed |
|---|---|---|
| 165023 Alberta Ltd. ("165") | Debtor in Possession Financing ("DIP") providing during Cougar Oil and Gas's proceedings under the CCAA. 165 has a first charge against the LLR security deposit held by the ERCB and funded by Cougar Oil and Gas using DIP during its CCAA proceedings. | $810,488.62 |
| Receiver (Ernst & Young Inc.), McCarthy Tétrault (Receiver's Counsel) and Borden Ladner Gervais LLP (Cougar Oil and Gas's Counsel) | Administration Charge to a maximum of $250,000 pursuant to the Initial Order and the Receiver's Charge under the Appointment Order, on a pari passu bais. The Receiver understands that professional fees owing under the Administration Charge are in excess of $250,000 and estimated professional fees under the Receiver's Charge to complete the administration of the receivership are forecast at $250,000. | 500,000 |
| Canadian Western Bank | Receiver's Borrowings pursuant to the Appointment Order | 200,000 |
| Canadian Western Bank | Estimated balance owed by Cougar Oil and Gas to CWB as at the date of Initial Filing Date | 2,500,000 |
| 165023 Alberta Ltd. ("165") | Estimated interest and legal fees owing under DIP facility | 200,000 |
| **Total Priority Charges per Appoinbtment Order** | | **$4,210,488.62** |

27. The Receiver further understands that there are outstanding municipal property taxes owing on the Property being transferred above. The majority of the outstanding property taxes owing on the Property by Cougar Oil and Gas arose prior to the Appointment Date and is as follows:

   a) the Municipal District of Opportunity No. 17 is owed approximately $475,761.65; and

   b) the County of Barrhead No. 11 is owed approximately $4,378.27.

28. The Receiver is proposing to distribute the funds recovered from realizing upon the Property as follows:

   a) the LLR Security Deposit will be transferred from Cougar Oil and Gas to Verity and continue to be held by the ERCB. 165 will continue to have a first charge against the LLR Security Deposit;

b) proceeds recovered from the closing of the Verity APA and Ember APA and collection of joint venture receivables shall be distributed to settle the Administration Charge under the Initial Order and the Receiver's Charge under the Appointment Order on a parri pasu basis (collectively the ("Outstanding Professional Fees"); and

c) recoveries in excess of the Outstanding Professional Fees, excluding the return of the LLR Security Deposit, shall be distributed in accordance with the priority of charges as described in paragraph 32 of the Appointment Order.

(collectively the "Proposed Distribution")

## APPROVAL OF PROFESSIONAL FEES

29. The Receiver's total fees are $114,903.60 (including applicable taxes). The Receiver's counsel fees are $37,270.73 (including applicable taxes). The Receiver has examined the bills of costs referred to above, and is of the opinion that the services referred to therein have been duly authorized and duly rendered and the charges therein are reasonable.

30. Copies of the invoices for these Receiver's and the Receiver's counsel's fees are available to this Honourable Court if requested.

31. The Receiver's and the Receiver's counsel estimate fees to completion of this engagement will not exceed $25,000.

32. The Receiver respectfully requests that this Honourable Court approve the Receiver's and the Receiver's counsel fees and disbursements along with the estimate of fees to completion.

## DISCHARGE OF THE RECEIVER

33. The Receiver's administration of the estates is essentially complete and the Receiver's discharge will be granted upon the Receiver issuing the Proposed Distribution. The Receiver may have some miscellaneous administrative items to attend to post-discharge

including the collection of joint venture accounts receivable owed to Cougar Oil and Gas, but these items are immaterial and in the Receiver's opinion should not prevent this Honourable Court from granting an unconditional discharge.

34. The Receiver respectfully requests that this Honourable Court approve an Order discharging absolutely, forever and unconditionally discharging the Receiver from any and all obligations as Receiver of Cougar Oil and Gas.

## RECOMMENDATIONS

35. The Receiver recommends that this Honourable Court approve:

a) the sale of the Property as set out in the Verity APA;

b) the Proposed Distribution; and

c) the discharge of the Receiver.

Dated at Calgary, this 15th day of January, 2013.

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

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

Peter Chisholm, CA
Manager