| | |
|---|---|
| COURT FILE NUMBER | 1601-06131 |
| 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<br><br>AND IN THE MATTER OF CONNACHER OIL AND GAS LIMITED |
| DOCUMENT | **SEVENTH REPORT OF THE MONITOR**<br><br>**January 31, 2017** |
| ADDRESS FOR SERVICE AND CONTACT INFORMATION OF PARTY FILING THIS DOCUMENT | <u>MONITOR</u> |

Clerk's Stamp

CLERK OF THE COURT FILED

JAN 31 2017

JUDICIAL CENTRE OF CALGARY

**MONITOR**

ERNST & YOUNG INC.
Calgary City Centre
2200, 215 - 2nd Street SW
Calgary, Alberta T2P 1M4
Attention: Neil Narfason
Telephone: 403-206-5067
Fax: 403-206-5075
Email: neil.narfason@ca.ey.com

**COUNSEL**

McCarthy Tétrault LLP
Suite 4000, 421 7th Avenue SW
Calgary, Alberta T2P 4K9
Attn: Sean Collins
Walker MacLeod
Telephone: 403-260-3531
403-460-3710
Email: scollins@mccarthy.ca
wmacleod@mccarthy.ca

TABLE OF CONTENTS OF THE SEVENTH REPORT

## INTRODUCTION

1. On May 17, 2016 (the "**Filing Date**"), Connacher Oil and Gas Limited (the "**Company**" or "**Connacher**"), sought and obtained protection pursuant to 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. Ernst & Young Inc. was appointed as Monitor (the "**Monitor**") of the Company pursuant to the terms of the Initial Order.

3. The purpose of this seventh report of the Monitor (the "**Seventh Report**") is to provide this Honourable Court with the Monitor's comments with respect to the following:

    a) an employee severance program (the "**Employee Severance Program**") proposed by Connacher;

    b) the settlement agreement (the "**Settlement Agreement**") entered into between Connacher and Arundel Capital Corporation ("**Arundel**"), subject to approval of this Honourable Court; and

    c) the Monitor's recommendations.

4. All references to dollars are in Canadian currency unless otherwise noted.

5. Capitalized terms not defined herein are as defined in the Initial Order.

## BACKGROUND

6. Additional background information on Connacher and these CCAA proceedings is available on the Monitor's website at www.ey.com/ca/connacheroilandgas.

## TERMS OF REFERENCE AND DISCLAIMER

7. In preparing this Seventh Report, the Monitor has relied upon unaudited financial information, company records and discussions with management of the Company. The Monitor has not performed an audit, review or other verification of such information. An examination of the financial forecast as outlined in the Canadian Institute of Chartered Accountants Handbook has not been performed. Future orientated financial information relied upon in this report is based on management's assumptions regarding future events and actual results achieved will vary from this information and the variations may be material.

## PROPOSED EMPLOYEE SEVERANCE PROGRAM

8. Pursuant to an Order of this Honourable Court dated January 12, 2017, Connacher's stay period (the "**Stay Period**") was extended to June 30, 2017. The Stay Period was extended to permit Connacher to assess and implement appropriate strategic options (including potential sale transactions, hedging, and other long-term contracts), while also exploring a creditor-sponsored alternative to a sale with the Interim Lenders, with a view of securing and implementing a viable exit from these CCAA proceedings.

9. Connacher is continuing to operate in the ordinary course of business during the Stay Period and is assessing a number of cost saving initiatives including potential staff reductions. Connacher believes that the ability to pay severance in connection with any necessary staff reductions would enhance employee morale and positively influence Connacher's ability to maintain the highly qualified workforce required to operate its business.

10. Furthermore, Connacher has a higher proportion of contractors in its workforce than it would like. Permanent employees have lower rates of turn-over and higher productivity and, as such, Connacher is considering offering employment to certain of its highly skilled contractors and these individuals likely have access to alternative employment that would include payment of severance upon their dismissal.

11. The proposed Employee Severance Program would pay any employee whose employment is terminated by Connacher an amount equal to two weeks' salary per year of service plus 6%.

12. The Employee Severance Program is not applicable in the following situations:

   a) if the employee has resigned, been terminated with cause or has failed to perform his/her duties;

   b) if the termination is a result of a:

      i. court-approved sale of all or substantially all of Connacher's business or assets;

      ii. court-approved restructuring transaction implemented by Connacher;

      iii. termination of this CCAA proceeding; or

iv. cessation of Connacher's operations; and

c) if the employee is otherwise a beneficiary under the key-employee retention plan approved by Order of this Court dated November 14, 2016.

13. Payments under the Employee Severance Plan are subject to the approval of the Interim Lenders.

14. The Employee Severance Plan will enhance the prospects of Connacher continuing to operate as a viable going concern while pursuing its restructuring initiatives and is supported by the Interim Lenders.

15. The Monitor also supports the Employee Severance Plan and believes that it is fair and reasonable in the circumstances.

## ARUNDEL SETTLEMENT AGREEMENT

16. As at the Filing Date, Connacher was leasing five used tandem trailers (the "**Trailers**") from Arundel to transport its dilbit product to market. The Trailers were leased pursuant to three lease agreements dated February 8, 2016 (the "**Arundel Leases**"), copies of the Lease Agreements are attached to the January 30$^{th}$ Beeston Affidavit (the "**January 30$^{th}$ Beeston Affidavit**").

17. Connacher continued to use the trailers during these CCAA proceedings. However, Connacher has not paid post-CCAA amounts due under the Arundel Leases as Connacher and the Monitor believe that the Arundel Leases are 'financing leases' and post-CCAA filing payment is not required under the CCAA or currently permitted under the Initial Order.

18. Arundel recently communicated to Connacher that it disputes the treatment of the leases as 'financing leases' and identified additional concerns it had with the leases.

19. During late November 2016, one of the Trailers (the "**Written-Off Trailer**") was in an accident resulting in the Trailer being written-off. Connacher has been advised by its insurance company that proceeds of $296,640 will be payable in connection with the Written-Off Trailer (the "**Insurance Proceeds**").

### Arundel Settlement Agreement

20. Connacher and Arundel have entered into the Settlement Agreement, attached to the

January 30th Beeston Affidavit, to settle the dispute in respect of the Arundel Leases and application of the Insurance Proceeds.

21. The following is an overview of the key terms of the Settlement Agreement, which is intended as a summary only and does not supersede or vary the binding terms of the actual Settlement Agreement.

22. Pursuant to the Settlement Agreement and subject to the conditions described below and contained therein, Connacher and Arundel have agreed as follows:

a) Following receipt of the Insurance Proceeds, Connacher will pay Arundel the amount of $170,307 from the Insurance Proceeds in full and final satisfaction of all of Connacher's past, current or future obligations and liabilities in connection with the Written-Off Trailer, and Connacher will retain the balance of the Insurance Proceeds;

b) Connacher will release the four remaining Trailers to Arundel and Arundel will take possession of same at its sole cost, expense and risk, in accordance with the terms of the Settlement Agreement;

c) The Lease Agreements and all of Connacher's continuing obligations thereunder will be terminated upon the release of the remaining Trailers to Arundel; and

d) Arundel will provide a broad full and final release of all claims, including in connection with Arundel's claims for unpaid rent under the Lease Agreements.

23. The Settlement Agreement is conditional upon:

a) Arundel directing that the Insurance Proceeds be paid directly to Connacher;

b) receipt by Connacher of the Insurance Proceeds in the amount of not less than $296,640 in immediately available funds (or such other amount as agreed by Connacher with the consent of the Interim Lenders); and

c) approval of the Settlement Agreement by this Honourable Court.

24. The Monitor believes that the Settlement Agreement reflects a fair compromise of the dispute as:

a) Connacher will retain $126,333, representing the Insurance proceeds in excess of the $170,307 payable to Arundel under the Settlement Agreement;

b) Connacher is implementing an alternative transportation and trucking arrangement and it will no longer require the Trailers to deliver its product to market; and

c) the Interim Lenders have consented to the Settlement Agreement.

## RECOMMENDATIONS

25. The Monitor respectfully recommends that this Honourable Court approve the:

a) Employee Severance Program; and

b) Settlement Agreement.

Dated at Calgary, this 31st day of January, 2017.

**ERNST & YOUNG INC.**
**in its capacity as the Monitor**
**of Connacher Oil and Gas Limited**

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

Peter Chisholm CA, CIRP
Vice-President