

**TRUSTEE'S PRELIMINARY REPORT**  
**IN THE MATTER OF THE BANKRUPTCY OF**  
**ESTATE NO.: 25-2351565 - SEQUOIA RESOURCES CORP.**  
**hereinafter referred to as "SRC" or the "Company"**  
**of the City of Calgary, in the Province of Alberta**

**I. Background**

SRC (formerly Perpetual Energy Operation Corp.) was acquired by 1986114 Alberta Inc., a Canadian corporation, on October 1, 2016. SRC grew through a series of transactions in which SRC purchased primarily dry gas assets. Between September 2016 and August 2017, the Company grew to approximately 3,200 gas wells ("Wells") and their associated facilities and pipelines. The key transactions were as follows:

<u>Source</u>	<u>Transaction</u>	<u>Approximate % of Wells acquired</u>
Perpetual Energy Operating Corp.	Corporate sale	~75%
Husky Oil Operations Ltd.	Asset purchase	~11%
Waldron Energy (in bankruptcy)	Asset purchase	~6%
Other	Asset purchase	~8%

Former management of SRC has advised the Trustee that SRC's business strategy was to:

- acquire gas assets, some at close to the end of their life cycle, from gas producers;
- implement cost reduction programs throughout its operations to reduce overall costs to the Company both in the field and at head office; and
- reduce the operating costs of the assets, in part, by cleaning up older wells, and where appropriate, abandoning and reclaiming well sites, reducing long term surface, mineral and other carrying costs.

Former management of SRC advises the Trustee that the acquisitions were completed at a time when gas prices were at historic lows and thought to be at the bottom of the commodity cycle. Former management of SRC also advises that by cleaning up the old wells and implementing the abandonment and reclamation program, through the creation of an in-house team, SRC believed that it could reduce costs sufficiently to turn a profit and responsibly produce the remaining assets.

Based on materials reviewed by the Trustee, for the period October 1, 2016 to December 31, 2017, SRC abandoned approximately 150 wells and received reclamation certificates for approximately 90 wells. This ranked SRC fifth in the province for number of properties abandoned and reclaimed, behind CNRL, Cenovus, Husky and Paramount Energy.

SRC did not drill any new wells since inception. Based on discussions with former management of SRC, it appears that the Company's cash flow was primarily used on operations, a rehabilitation program, and on the abandonment and reclamation program.

Former management of SRC has advised the Trustee that SRC's strategies appeared to be successful until around August, 2017, when gas prices in Alberta began to decline significantly. Gas price depression has continued through the spring of 2018 and forecasted prices for summer 2018 remain low.

Former management of SRC advised the Trustee that it investigated various options to diversify its gas exposure, to sell certain assets and find other ways to reduce costs. Former management of SRC noted that none of the projects identified had the economics or scale to make a big enough difference in the face of the low price environment. Former management of SRC asserts that because of this low price environment, SRC could not complete its abandonment program or continue to operate without sustaining significant cash losses.

Former management of SRC advised the Trustee that SRC recently attempted, unsuccessfully, to negotiate with several municipalities to reduce the Company's municipal tax obligations as in some cases SRC's municipal tax burden exceeded the price of gas being sold in the area. The Trustee understands that SRC also attempted to obtain the refinancing required to continue operations during the depressed price environment, but was unable to obtain further funds.

Based on the Trustee's review of SRC's records, it does not appear that any of SRC's directors were paid salary, fees or other remuneration, nor were the shareholders paid any dividends or returns of capital throughout SRC's existence.

Former management of SRC states that because of its financial difficulties and inability to complete its abandonment and reclamation program, on February 22, 2018, SRC contacted the Alberta Energy Regulator ("AER") to discuss the possibility of shutting down operations in manner satisfactory to the AER. Shortly after this meeting, SRC pursued a plan for the shut-in of its assets. All of this was completed on notice to the AER. Further discussions with the AER were held on February 28, 2018 to provide an update to AER on the status of the shut-in program.

## **II. NOI and Bankruptcy Proceedings**

On March 1, 2018, SRC received a closure order from the AER. On March 2, 2018, to ensure the fair and equitable treatment of its creditors and stakeholders while responsibly working with the AER to safely deal with its assets, SRC filed a Notice of Intention to Make a Proposal.

SRC continued to use its cash on hand to fund the safe and orderly shutdown of its assets and entertained offers for its non-producing assets to generate further cash. On March 22, 2018, SRC closed a sale for a package of gross overriding royalties to provide liquidity and continue the orderly shutdown. SRC continued to meet with the AER regularly throughout the NOI proceedings to provide updates regarding its operations and the status of the shutdown process.

On March 23, 2018, when SRC no longer had certainty it would have sufficient cash to continue its operations, SRC terminated all of its employees and contractors and filed a voluntary assignment into bankruptcy.

### **III. Interim Actions of the Trustee**

#### Securing well sites:

As at the date of bankruptcy, SRC, its staff and various contractors had worked diligently, using the time and financial resources available, to shut in production on all of the approximately 836 wells that were producing on February 22, 2018. The majority of these well locations were concurrently locked and chained to prevent access by unauthorised parties as part of the shut in process. However, as of the date of bankruptcy, approximately 20-25 well sites had not been locked and chained. Given the public safety concerns associated with unlocked well sites, the Trustee engaged four former SRC employees and contractors to complete this work on a contract basis. As of April 5, 2018, the work was completed and all of SRC's well sites (with the exception of one, as described below) had been locked and chained.

#### Continue removal of contaminants:

As at the date of bankruptcy, former management of SRC informed the Trustee that during the well shut in process, the Company did not have sufficient time and resources to arrange for the draining and removal of contaminated contents in a salt-water bath at one of its well sites. In order to mitigate the risk of an environmental incident and the associated public safety risks, the Trustee contracted with a former SRC employee to monitor the site and assist the Trustee in safely removing the contaminated contents. Subsequent to removal of the contaminated contents by a third party environmental service provider, the site will be locked and chained.

#### Taking possession and recording inventory:

The majority of SRC's movable assets include trucks, trailers, off highway vehicles and various agriculture equipment used to perform abandonment and reclamation work. The Company was not able to provide a detailed ledger of assets with unique unit identification numbers, however various spreadsheets exist that summarised the assets purchased in the key transactions over the past two years. Using these summaries, the Trustee worked with former management to coordinate a group of seven previous SRC employees hired on a contract basis to assist in gathering assets, securing them in central locations and taking an inventory. The movable assets were spread out across Alberta and the Trustee directed the former employees to relocate assets to central locations over a period of eight days, advising which locations were not accessible and the condition of assets found.

#### Head Office:

The Trustee has contracted with one member of former management and seven former employees to provide expertise and assistance with coordinating the completion of field safety work, advising on the Emergency Response Plan, shut-in well status submissions to the regulator, review and execute crossing requests, completion of revenue accounting and various other matters. The Trustee has also entered into a short-term tenancy agreement for office space and access to software at SRC's former shared office.

The Trustee is receiving cooperation from former management in the provision of information as and when requested by the Trustee.

#### IV. Overview of Assets and Secured Claims

##### Estate Funds:

Summary of cash held by the estate and funds spent to date:

<b>Sequoia Resources Corp.- in Bankruptcy</b>	
Effective April 9, 2018	
Cash available at date of Bankruptcy:	2,393,921
Less: Funds segregated pending security review	(450,000)
	<b>1,943,921</b>
Collection of accounts receivable	26,101
Disbursements to date:	
Asset collection consultants and storage	(19,580)
Office consultants	(22,940)
Rent and storage	(104)
Securing well sites	(15,994)
	<b>(58,618)</b>
Estimated funds committed to date:	
Asset collection consultants and storage	(42,295)
Office consultants	(10,000)
Rent and storage	(15,000)
Salt tank consultant and disposal	(50,000)
Securing well sites	(18,000)
	<b>(135,295)</b>
<b>Estimated funds available for the estate</b>	<b>1,776,109</b>

##### Inventory and Movable Assets:

The Trustee has worked with former employees and contractors to gather and secure SRC's trucks, site equipment, trailers, off highway vehicles and tools into two secure locations. The estimated value of the assets collected to date is unknown at this time.

##### Secured Creditors

SRC's largest known secured creditor is Mercuria Commodities Canada Corporation ("Mercuria") which has an outstanding claim in the amount of \$447,846.21. Subject to an arrangement entered into by SRC and Mercuria shortly prior to the date of bankruptcy, the Trustee is holding \$450,000.00 in trust pending completion of the Trustee's independent security review.

As at April 9, 2018, 40 liens in the aggregate amount of \$331,104 have been received by the Trustee.

##### Books and Records

The Trustee took possession of the Company's books and records following the assignment in bankruptcy, ensuring a complete electronic backup was created. As part of the short-term tenancy agreement for office space at SRC's former shared office, the Trustee has access to the various programs and databases used by SRC in the ordinary course of operations.

## **Projected Distribution and Anticipated Realization**

Until the magnitude of claims has been resolved and the required field safety work is completed, the Trustee is not in a position to determine the likelihood of any distributions.

## **Third-Party Deposits and Indemnity**

Prior to the Company filing a NOI on March 2, 2018, SRC provided the Trustee with a \$250,000 retainer and an indemnity for fees and expenses in respect of acting as a Trustee. In accordance with OSB Directive 16, these funds do not form part of the estate and are held in a clearly identified trust account separated from estate funds.

## **V. Legal Matters**

The Trustee has engaged independent legal counsel, Torys LLP. The Trustee's legal counsel will be providing an opinion regarding the validity and enforceability of Mercuria's security and will be providing assistance with the evaluation of liens.

## **VI. Fraudulent Preferences and Reviewable Transactions**

The Trustee, as part of its due diligence, will be reviewing the books and records for any fraudulent preferences and reviewable transactions.

## **VII. Creditors**

The claims of creditors filed prior to the meeting are as follows:

Secured	\$7,054,630
Preferred	\$53,745
Unsecured	<u>\$237,393,343</u>
Total	<b>\$244,501,718</b>

## **VIII. Fees**

Fees and disbursements of the Trustee incurred during the Administration of the bankruptcy will be paid from the funds it has swept from the account held by SRC prior to the bankruptcy.

Dated this 11<sup>th</sup> day of April, 2018

**PricewaterhouseCoopers Inc.**  
**Trustee in the Estate Sequoia Resources Corp.**



Per: Paul Darby LIT  
Trustee

