



COURT FILE NUMBER 2001-01210

COURT COURT OF QUEEN'S BENCH OF ALBERTA

COM
Nov. 12, 2020
Justice Eidsvik

JUDICIAL CENTRE CALGARY

PLAINTIFF GMT CAPITAL CORP.

DEFENDANTS STRATEGIC OIL AND GAS LTD. and STRATEGIC TRANSMISSION LTD.

IN THE MATTER OF THE RECEIVERSHIP OF STRATEGIC OIL & GAS LTD. and STRATEGIC TRANSMISSION LTD.

APPLICANT KPMG INC., IN ITS CAPACITY AS COURT APPOINTED RECEIVER AND MANAGER OF STRATEGIC OIL AND GAS LTD. and STRATEGIC TRANSMISSION LTD.

DOCUMENT **THIRD REPORT OF THE RECEIVER**

DATE NOVEMBER 2, 2020

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1. INTRODUCTION AND PURPOSE OF REPORT

Introduction

1. By order of the Court of Queen’s Bench of Alberta (the “**Court**”) dated January 28, 2020, KPMG Inc. was appointed receiver and manager (the “**Receiver**”) of Strategic Oil & Gas Ltd. and Strategic Transmission Ltd. (together, the “**Company**”) pursuant to an application brought by GMT Capital Corp. under section 243(1) of the *Bankruptcy and Insolvency Act*, RSC 1985, c B-3, section 13(2) of the *Judicature Act*, RSA 2000, c J-2, section 99(a) of the *Business Corporations Act*, RSA 2000, c B-9 and section 65(7) of the *Personal Property Security Act*, RSA 2000 c P-7, without security, of all of the current and future assets, undertakings, and properties of every nature and kind whatsoever, and wherever situate, including all proceeds thereof with the exception of the Northwest Territories property (collectively, the “**Property**”) of the Company.
2. Concurrently, the government of the Northwest Territories (“**GNWT**”) requested that a separate receiver (the “**NWT Receiver**”) be appointed solely over the Company’s assets located in the Northwest Territories. Consequently, a separate receivership order was granted for the Northwest Territories assets.
3. On February 14, 2020, the Receiver filed its first report which described, among other things, the Company’s primary assets and liabilities, the Receiver’s activities to date, and the Receiver’s proposed sale and investment solicitation process (“**SISP**”).
4. On July 6, 2020, the Receiver filed its second report (the “**Second Report**”) and the supplemental confidential first report to the Court which contained details of the results of the SISP, the purchase and sale agreement with Tallahassee Exploration Inc. (“**Tallahassee**”, the “**Tallahassee PSA**”), and the Receiver’s statement of receipts and disbursements for the period of January 28, 2020 to June 17, 2020.

Purpose of the Report

5. This is the Receiver’s third report to the Court (the “**Third Report**” or this “**Report**”) which has been prepared to provide the Court with:
 - a) An update on the actions of the Receiver since the Second Report;

- b) The Receiver's interim and estimated final statement of receipts and disbursements;
- c) The Receiver's and Receiver's counsel's fees and disbursements for the period from June 1, 2020 to the proposed Receiver's discharge;
- d) The Receiver's request for advice and directions regarding the competing priority to receivership funds, as between the AER and GNWT;
- e) The Receiver's request for its discharge; and
- f) The Receiver's recommendations.

Terms of Reference

- 6. All materials filed with the Court and all orders granted by the Court in connection with the receivership proceedings will be made available to creditors and other interested parties in electronic format on the Receiver's website <https://www.kpmg.com/ca/strategic>.
- 7. In preparing this Report, the Receiver has been provided with, and has relied upon, unaudited and other financial information, books and records (collectively, the "**Information**") prepared by the Company and/or its representatives, and discussions with the Company's management and/or representatives.
- 8. The Receiver has reviewed the Information for reasonableness, internal consistency and use in the context in which it was provided. The Receiver has not audited, reviewed or otherwise attempted to verify the accuracy or completeness of the Information in a manner that would wholly or partially comply with Canadian Auditing Standards pursuant to the Chartered Professional Accountants Handbook and accordingly, the Receiver expresses no opinion or other form of assurance in respect of the Information.
- 9. The information contained in this Report is not intended to be relied upon by any prospective purchaser or investor in any transaction with the Receiver.
- 10. Unless otherwise stated, all monetary amounts noted herein are expressed in Canadian dollars.

2. ACTIVITIES OF THE RECEIVER SINCE THE SECOND REPORT

Operations

11. As detailed in the Second Report, the Receiver completed the shut-in of the Company's operating assets in the Marlowe area. There are no remaining active assets held by the Company.
12. Upon the Court's approval of the Tallahassee PSA, the Receiver coordinated activities with Tallahassee to close the sale. This has included the transfer of numerous leases and AER licenses attached to the sold assets. The sale is now complete, and Tallahassee now holds the required leases and licenses to commence operations.
13. Upon shut-in of the Marlowe assets, the Receiver terminated the employees and contractors that were no longer required for operating activities in this area. Three employees have been retained to assist the Receiver with its requirements as license holder of the unsold assets, and the completion of the transaction under the Tallahassee PSA.
14. As the license holder of oil and gas assets in Alberta, the Receiver has been required to conform with various ongoing environmental and regulatory requirements issued by the Alberta Energy Regulator (the "AER"). The Receiver has been required to perform various activities to conform to these regulations, including, but not limited to, the following:
 - a) Negotiation for the retention of specialized equipment and contractors;
 - b) Arrangements for the prepayment of contractor invoices;
 - c) Arrangements for contractor travel and use of third-party facilities;
 - d) Correspondence and negotiations with partners and stakeholders of leased properties;
 - e) Regular maintenance and repair of oil and gas assets;
 - f) Quarterly and annual inspections of various properties;
 - g) Issuance of various environmental and health and safety compliance reports; and
 - h) Assessment and remediation of minor leaks and spills.

15. Due to the activities as described above, the Receiver is of the opinion that the Company's Alberta-based assets are in as safe a state as possible, with risk of environmental or health and safety issues minimized. The Receiver will be required to continue the ongoing maintenance activities until the Receiver is discharged, at which point the AER will resume its process to identify responsible parties to conduct abandonment and reclamation, such as remaining working interest participants, or the Orphan Well Association (the "OWA").
16. The Receiver has carried out the following routine administrative tasks:
 - a) Prepared and filed various statutory returns, which included, without limitation, GST returns;
 - b) Reported to and liaised with the AER and the NWT Receiver on various statutory, administrative, and environmental matters; and
 - c) Attended to processing of weekly disbursements.
17. The Receivership is effectively concluded and accordingly the Receiver is seeking its discharge. Currently, abandonment and reclamation obligations for the remaining facilities are estimated at approximately \$20.4 million and the estate has insufficient funds available to undertake this work.
18. Accordingly, the Receiver understands that upon its discharge, remaining wells, facilities and pipelines will be directed to be abandoned and reclaimed, according to the appropriate legislation and regulation.

3. STATEMENT OF RECEIPTS AND DISBURSEMENTS

19. The estate's operating costs have been financed by remaining Company funds on hand as at the date of receivership, and ongoing production revenues up to the shut-in of the assets. The Receiver's disbursements primarily relate to operations of producing oil and gas assets, shut-in of the operations, and ongoing inspection, maintenance, and repair of the assets.
20. Below is the Receiver's interim receipts and disbursements for the period from January 28, 2020 to October 26, 2020:

Interim Statement of Receipts and Disbursements	
January 28, 2020 to October 26, 2020	
	Amount (CAD \$)
Cash Receipts	
Opening cash balance	5,507,410
Production revenues	3,338,031
Sale to TEI	200,000
GST collections	167,471
GST refunds	76,542
Refund of deposits	64,349
TEI tax preparation	20,000
Interest	1,325
Total cash receipts	9,375,127
Cash disbursements	
Contractor and operational disbursements	(4,306,735)
Payroll	(1,082,855)
Insurance	(625,574)
Receiver fees	(280,024)
GST paid	(226,993)
Legal fees	(134,026)
Rent	(119,741)
Utilities	(76,028)
Telephone, cable and internet	(61,816)
Office expenses	(47,694)
GST remitted	(17,611)
Bank fees	(1,594)
Total cash disbursements	(6,980,691)
Excess receipts over disbursements	2,394,436

21. As the Receiver continues to act as the license holder of the Company's shut-in oil and gas assets, the Receiver must continue to conform with the requirements of the AER to ensure that the assets are maintained in a safe state. The inspection and maintenance activities are anticipated to cost approximately \$348,500 to discharge.

22. The Receiver continues to retain three specialized employees to assist with ongoing inspection and maintenance requirements, and final sale and receivership matters. Future payroll costs are anticipated to amount to approximately \$100,000 to discharge.
23. Additionally, the Receiver is attempting to monetize approximately \$150,000 of Gas Cost Allowance (“GCA”) – Strategic usually receives certain credits from the Alberta Government for their share of capital and operating costs related to its operated gas processing facilities. The GCA is currently held by the Alberta Government who are holding these funds as “[t]he Department’s standard practice in creditor protection or insolvency proceedings is to refuse a refund of credit balances in royalty client accounts, to ensure that royalty obligations arising from ongoing gas production, as well as adjustments to claimed costs, are satisfied.” The Receiver is currently of the view that no royalty obligations or adjustments are outstanding, and that the Alberta Government’s position is without merit and the funds should be paid to Strategic, and the Receiver will demand payment of same.
24. The Receiver is maintaining cash holdbacks to address the following future disbursements:
 - a) \$405,000 for Scientific Research and Experimental Development (“SRED”) credits. The sum of approximately \$405,000 of SRED credits was received and included in cash on hand on the date of receivership. SRED credits are contingent upon CRA review and issuance of clearance certificate, with a potential requirement to repay a portion or all credits received. Due to COVID-19, this clearance certificate has been delayed, and currently there is no estimated time for completion. Upon issuance of clearance certificate in full, payment to the service provider for the preparation of the SRED credit return in the amount of \$126,000 will be required from the holdback amount; and
 - b) Approximately \$205,800 to address property taxes payable on unsold assets. Property taxes attached to assets sold have been assumed by Tallahassee.
25. Below is the Receiver’s estimated final statement of receipts and disbursements from January 28, 2020 to discharge (the “**Final SRD**”):

Estimated Final Statement of Receipts and Disbursements	
January 28, 2020 to Discharge	
	Amount (CAD \$)
Cash Receipts	
Opening cash balance	5,507,410
Production revenues	3,338,031
Sale to TEI	200,000
GST collections	167,471
GST refunds	76,542
Refund of deposits	64,349
TEI tax preparation	20,000
Interest	1,325
Total cash receipts	9,375,127
Cash disbursements	
Contractor and operational disbursements	(4,634,374)
Payroll	(1,182,855)
Final distribution of funds	(881,944)
Insurance	(625,574)
Receiver fees	(547,892)
CRA SRED holdback	(405,000)
Legal fees	(298,586)
GST paid	(248,612)
Property taxes payable	(205,806)
Rent	(119,741)
Utilities	(76,028)
Telephone, cable and internet	(61,816)
Office expenses	(47,694)
Income tax preparation	(20,000)
GST remitted	(17,611)
Bank fees	(1,594)
Total cash disbursements	(9,375,127)
Excess receipts over disbursements	-

26. Upon discharge, it is estimated that the Receiver will have approximately \$881,900 of remaining funds for distribution.
27. Based on the Receiver's understanding of abandonment and reclamation obligations, all remaining funds will be distributed in accordance with the case of *Orphan Well Association v Grant Thornton Ltd.*, 2019 SCC 5 ("**Redwater**"), as outlined further in this Report.
28. The Receiver and the Receiver's counsel have incurred unpaid fees inclusive of GST in the amount of \$202,511 and \$130,786 respectively, for the period of June 1, 2020 to October 26, 2020 (the "**Unpaid Professional Fees**"). In addition, the Receiver and the Receiver's counsel estimate professional fees and disbursements to conclude the estate to be approximately \$75,000 and \$40,000 respectively (the "**Completion Professional Fees**"). A summary of all receivership professional fees is set out below:

Summary of Receivership Professional Fees			
Service Period	Fees and Disbursements		GST (5%) Total Amount
KPMG Inc.			
January 28 - May 31, 2020	280,024	14,001	294,026
Prior approved fees	280,024	14,001	294,026
June 1 - October 26, 2020	192,868	9,643	202,511
Unpaid Professional Fees	192,868	9,643	202,511
Estimated Professional Fees to Completion	75,000	3,750	78,750
Total KPMG Inc.	547,892	27,395	575,287
Torys LLP			
January 28 - January 31, 2020	1,988	99	2,087
February 1 - February 28, 2020	40,269	2,008	42,277
March 1 - March 31, 2020	5,695	285	5,980
April 1 - April 30, 2020	41,462	2,070	43,532
May 1 - May 31, 2020	43,899	2,195	46,093
Prior approved fees	133,312	6,657	139,969
June 1 - June 30, 2020	45,027	2,249	47,276
July 1 - July 31, 2020	49,418	2,471	51,889
August 1 - August 31, 2020	15,605	780	16,385
September 1 - September 31, 2020	14,511	726	15,236
Unpaid Professional Fees	124,560	6,226	130,786
Estimated Professional Fees to Completion	40,000	2,000	42,000
Total Torys LLP	297,872	14,883	312,755
Total Professional Fees	845,764	42,277	888,042

29. The Receiver is seeking approval of the Unpaid Professional Fees. Copies of the invoices described therein, including detailed time analysis, will be made available to the Court, if requested.
30. The Receiver is of the view that, in light of the nature, extent and value of the assets, and the Receiver's activities including: (a) the Receiver's assessment, inspection, and maintenance activities since June 1, 2020; (b) the completion of the Tallahassee PSA; (c) the shut-in of the producing assets; and (d) the liaising with the AER, the Unpaid Professional Fees and the Completion Professional Fees are fair and reasonable.

4. DISTRIBUTION OF REMAINING FUNDS

31. Upon discharge, the Receiver intends to make certain payments to creditors, from the remaining funds realized in the course of the administration of the Debtors' receivership estate, for certainty, wholly in relation to the Alberta Property, and distribute the remaining funds in accordance with the principles and priority structure set out in Redwater. Accordingly, the Receiver intends to make a distribution to the AER of the estimated \$881,900 remaining in the receivership estate (the "Remaining Funds"), on account of outstanding environmental and regulatory obligations of the Debtors in the Province of Alberta. For certainty, any further funds received by the Receiver (including, but not limited to, any receipts in respect of the outstanding GCA amounts the Receiver may potentially receive and the release of the above described holdbacks) will form part of the Remaining Funds and treated as such.
32. For certainty, included within the Remaining Funds is the sum of up to \$100,000 for the payment of such further Receiver's fees and costs (including, without limitation, the Receiver's legal counsel's fees and disbursements) not included in the final statement of receipts and disbursements that may be incurred in the event that, as a result of the position of OROGO and/or as a result of the AER's discretion, the Receiver is required to take part in future discussions and/or court proceedings related to the competing claims over the Remaining Funds.
33. However, the Receiver is aware that there may be competing claims to the Remaining Funds as between the AER and GNWT's Office of the Regulator of Oil and Gas Operations ("**OROGO**").
34. Accordingly, the Remaining Funds, in the Receiver's view, should be held in trust by the AER, pending resolution of the competing claims to the Remaining Funds between the AER and the government of the Northwest Territories Office of the Regulator of Oil and Gas Operations. With the exception of the \$100,000 retained for future Receiver's fees and costs as described in paragraph 32 above, which should be permitted to be utilized for the payment of such fees and costs, the Remaining Funds are not to be utilized prior to such a resolution.
35. Pursuant to the above, the Receiver's counsel has conducted a high-level review of certain relevant jurisprudence and the current situation relating to OROGO and AER and has attempted to analyze the situation.

Background

36. On October 4, 2019, OROGO issued an order to Strategic regarding the “Abandonment of Wells and Decommissioning of Oil and Gas Infrastructure at the Cameron Hills Field” (the “**OROGO Order**”).
37. In the affidavit filed with this court dated January 22, 2020 by Amanda Reitenbach (at the time, the Chief Operating Officer of Strategic), Ms. Reitenbach stated that “*Strategic was disappointed when OROGO issued [the OROGO Order]*”.
38. The AER issued an order (the “**AER Order**”) on January 20, 2020. The AER Order required Strategic to post a security deposit in the amount of \$48,702,033 to be applied against the estimated cost to abandon and reclaim the environmental liabilities of Strategic. The AER Order was issued due to concerns about the ability of Strategic to meet its end of life obligations on the licenses it held.
39. The Receiver takes the position that it is not responsible for disproving the assertions presented by OROGO. When a receiver takes a position and then applies to the court “for advice and directions with respect to its findings on the validity of a claim...” (*Alberta Energy Regulator v Lexin Resources Ltd*, 2018 ABQB 590 at para 31), the onus is on the party arguing otherwise to prove the position taken is incorrect (*Lexin*, para 31).
40. Notwithstanding the foregoing, the Receiver has, pursuant to a request by counsel to OROGO to provide the Court with the background and certain relevant facts, undertaken to review, evaluate and understand the nature of the competing claims by reviewing the law as it applies to a claim pursuant to *Redwater* made by an out-of-province regulator.

Analysis

41. The Receiver’s high-level analysis of this matter focused on three key questions:
 - a) What does the *Redwater* case stand for? Does *Redwater* stand for the proposition that the first available funds be used for attending to environmental regulatory obligations?
 - b) Are their material differences between the orders of the GNWT and the AER such that one would create a greater entitlement to the remaining funds than the other?
 - c) Can an out-of-province regulator have priority over remaining funds when the in-province regulator has not first had all their claims covered in whole?

Does Redwater stand for the proposition that the first available funds must be used for attending to environmental regulatory obligations?

42. There are three tests outlined in *Redwater*; although previously articulated in the Supreme Court of Canada's decision in *Abitibi*, *Redwater* heavily modified and further explained the meaning behind the various steps in the test.
 - a) "First, there must be a debt, a liability or an obligation to a *creditor*."
 - b) "Second, the debt, liability or obligation must be incurred *before the debtor becomes bankrupt*."
 - c) "Third, it must be possible to attach a *monetary value* to the debt, liability or obligation."
43. Pursuant to the Receiver and its counsel's preliminary analysis, OROGO's claim meets the first and second part of the test. It is not clear, however, whether the third step in the test is met without a better understanding of the remediation policies in the Northwest Territories. If it is found that OROGO itself will ultimately perform the remediation work, then arguably, this step in the test would likely be met. A key indicator would be whether OROGO is under a statutory obligation to perform such work.
44. The AER claim meets the first and second part of the test. The AER Order fails to satisfy the sufficient certainty test. The AER, as it was in *Redwater*, is not in the business of performing abandonments. The AER is unlikely to perform the remediation work itself.

Are there differences between the orders of the GNWT and the AER to create priority for either one?

45. The orders issued by OROGO and the AER are different; however, in the Receiver's view, there is nothing on the face of either that would suggest one holds priority over the other.
46. The OROGO Order was issued earlier than the AER Order; however, unless both orders are found to be claims provable in bankruptcy, the date of issuance, in the Receiver's view, does not seem relevant and no jurisprudence was identified which discussed how to determine priority between competing *Redwater* claims and specifically by regulators in different provinces.
47. Before characterizing both the OROGO Order and the AER Order as *Redwater* claims, the test for claims provable in bankruptcy should be applied to both. If an order is found to constitute a claim

provable in bankruptcy, it will not be a *Redwater* claim and so will not have an entitlement to the first available funds from the bankruptcy process as an unsecured creditor of the bankrupt debtor.

Can an out-of-province regulator have priority over funds when the in-province regulator has not first had all its claims covered in whole?

48. No statute nor decision was identified which decided nor even discussed priority as between an in-province and an out-of-province regulator regarding outstanding environmental liabilities.
49. This is not surprising for two reasons. First, the novelty of the *Redwater* decision makes it unlikely that all the legal issues stemming from the decision have been properly explored, considered and adjudicated. Second, the novelty of a split receivership between a province and a territory also makes it unlikely such a fact-specific issue has previously been considered.
50. The *Redwater* decision does not contemplate or discuss the priority between an in-province regulator and an out of province regulator. As such, the Receiver is unable to determine priority to the remaining funds on hand between the AER and the GNWT.
51. Accordingly, in an attempt to resolve the competing claims, the Receiver and its counsel have encouraged the AER and the GNWT to engage in discussions to negotiate a settlement or allocation of funds. Notwithstanding many months of email correspondence and telephone conference calls, to date no resolution has been brought forward.
52. The ongoing receivership activities, while this matter is debated, continue to deplete the receivership estate's remaining funds. Furthermore, as the Receiver must uphold certain regulatory requirements as license holder, significant costs continue to be expended to conform with these requirements. In addition, the Receiver remains exposed to significant costs should a major unforeseen event occur in respect of the oil and gas assets. As no further receipts are anticipated, the Receiver estimates it will only have sufficient resources to continue with required maintenance and oversight of the assets for a maximum of three months and has insufficient funds to deal with any significant unexpected matters that may arise.
53. The Receiver believes the most appropriate step is for it to be discharged and for the remaining wells, facilities, and pipelines to be discharged, so that AER will resume its process to identify responsible parties to conduct abandonment and reclamation.

54. Additionally, the Receiver believes the most appropriate step, to avoid additional erosion of the Remaining Funds and to efficiently resolve the dispute as to priority between the AER and the OROGO over same, is for the Remaining Funds to be distributed to the AER to be held in trust pending a resolution of the noted claim over the Remaining Funds, and for the Remaining Funds to not be utilized for any further operating matters.

55. Given the unprecedented situation, however, the Receiver is seeking advice and directions from the Court regarding dealing with the Remaining Funds.

5. RECEIVER'S RECOMMENDATIONS

56. The Receiver submits this Third Report, respectfully requesting that the Court:
- a) Approve the Third Report, and the activities of the Receiver as set out therein;
 - b) Approve the Receiver's Final SRD;
 - c) Approve the Unpaid Professional Fees for the Receiver and the Receiver's counsel, Torys LLP, for the period of June 1, 2020 to the proposed Receiver's discharge;
 - d) Approve the distribution of all remaining funds to the AER, which are to be held in trust pending resolution of the AER and OROGO dispute over the Remaining Funds and/or otherwise provide advice and directions with respect to the priority over the Remaining Funds on hand in accordance with *Redwater*; and
 - e) Approve the Receiver's discharge.

This Report is respectfully submitted this 2nd day of November, 2020

KPMG Inc.

**In its capacity as Court-appointed Receiver of
Strategic Oil & Gas Ltd. and Strategic Transmission Ltd.
and not in its personal or corporate capacity**



Per: Neil Honess
Senior Vice President