

Action No: 0901-02873

IN THE COURT OF QUEEN'S BENCH OF ALBERTA
JUDICIAL DISTRICT OF CALGARY

IN THE MATTER OF THE *COMPANIES' CREDITORS*
ARRANGEMENT ACT, R.S.C. 1985, c. C-36, AS AMENDED

AND IN THE MATTER OF **CANADIAN SUPERIOR ENERGY INC.**

AND IN THE MATTER OF **SEEKER PETROLEUM LTD.**

AND IN THE MATTER OF **CANADIAN SUPERIOR TRINIDAD AND TOBAGO
LIMITED**

**THIRD REPORT OF THE MONITOR
HARDIE & KELLY INC.
APRIL 28, 2009**

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INDEX

INTRODUCTION	1
INDEPENDENT COMMITTEE	1
ADVISORS TO THE INDEPENDENT COMMITTEE	2
JENNINGS CAPITAL INC.....	3
COOPERATION WITH MONITOR	5
MANAGEMENT CHANGES.....	6
RECOGNITION OF INDEPENDENT COMMITTEE.....	6
RECOMMENDATION	8

INTRODUCTION

1. On March 5, 2009, Canadian Superior Energy Inc. (“CSEI”), Seeker Petroleum Ltd. (“Seeker”) and Canadian Superior Trinidad and Tobago Limited (“CSTT”) made application for 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 (the “Initial Order”) of the Court of Queen’s Bench of Alberta (the “Court”).
2. Pursuant to the Initial Order, Hardie & Kelly Inc. was appointed as monitor (the “Monitor”) of CSEI, Seeker and CSTT (collectively referred to as the “Companies”).
3. On March 25, 2009, this Honourable Court granted a further extension of the Stay of Proceedings through to May 4, 2009. We understand the Companies will be making an application to Court on May 4, 2009 requesting a further extension of the stay period. The Monitor will be filing a full report in terms of the Companies’ operations and restructuring activities in advance of that application.
4. The purpose of this interim report (the “Third Report”) is to provide the Court with the Monitor’s comments and recommendation in respect of the relief sought by the Independent Committee established by the Board of Directors of CSEI (the “Board”) as set out in the Notice of Motion filed by the Independent Committee on April 24, 2009.

INDEPENDENT COMMITTEE

5. The Board is comprised of seven members; five of whom are not members of CSEI’s management team (the “Independent Directors”) and each of whom (as per the Mandate of the Independent Committee described below) have been determined by the Board “to be independent pursuant to standards of applicable securities laws and applicable stock exchange or regulatory requirements”. The Independent Directors are Mr. Jake Harp, Mr. Charles Dallas, Mr. Karre Idland, Mr. Alexander Squires and Mr. Richard Watkins.
6. The remaining two members of the Board are Mr. Greg Noval and Mr. Michael Coolen both of whom until April 24, 2009 were also members of CSEI’s management team. Mr. Noval served as the Executive Chairman of CSEI and Mr. Coolen served as the President and Chief Executive Officer of CSEI.

7. On March 30, 2009, the Board passed a resolution establishing a committee of three Independent Directors (the "Independent Committee") with the principal mandate of assisting the Board in fulfilling its responsibilities in regard to the Companies' proceedings under the CCAA.
8. On April 1, 2009, the Board passed a further resolution adding the additional two Independent Directors to the Independent Committee.
9. The Independent Committee's charter and mandate ("Charter and Mandate") which were formally adopted by the Board on April 15, 2009 are attached as Exhibit "B" to the April 24, 2009 Affidavit of Richard M. Watkins (the "Watkins Affidavit"). A summary of the key components of the Charter and Mandate is as follows:
 - a. Assist the Board in fulfilling its obligations in respect of the CCAA proceedings including the consideration, evaluation and recommendation of alternatives leading towards the formulation of a plan of compromise or arrangement.
 - b. Addressing potential matters of conflict in regard to Challenger Energy Corp. ("Challenger") as a result of the complexity of the relationship between CSEI and Challenger.
 - c. Retain, at the expense of CSEI, legal counsel and any additional advisors as deemed appropriate without seeking Board approval.

ADVISORS TO THE INDEPENDENT COMMITTEE

10. On April 3, 2009, the Independent Committee formally engaged Jennings Capital Inc. ("Jennings") as its financial advisor pursuant to an engagement letter dated April 2, 2009 (the "Advisory Agreement") which is attached as Exhibit "A" to the Watkins Affidavit.
11. On April 6, 2009 the Independent Committee formally appointed Carscallen Leitch LLP ("Carscallen Leitch") as its legal counsel effective April 3, 2009.
12. The Independent Committee formally retained Felesky Flynn LLP as its special tax counsel on April 21, 2009.

JENNINGS CAPITAL INC.**Mandate**

13. The Advisory Agreement charges Jennings with assisting the Independent Committee in exploring and reviewing alternatives potentially available to CSEI including but not limited to a sale of CSEI, a recapitalization, an equity injection or a sale of certain assets with a view to the Companies successfully emerging from the CCAA proceedings.

Block 5(c)

14. The Monitor's First Report, dated March 12, 2009, and the Monitor's Second Report, dated March 24, 2009, both discussed CSEI's engagement of Scotia Waterous (USA) Inc. ("Scotia Waterous") to sell CSEI's participating interest in Block 5(c) in Trinidad and Tobago ("Block 5(c)").
15. Despite the involvement of Jennings, CSEI and the Independent Committee have instructed Scotia Waterous to continue with its sales process. Although Jennings has established a virtual data room in respect of Block 5(c), they have advised the Monitor that it exists only to provide information to parties that may express an interest in recapitalizing CSEI.
16. Jennings has confirmed to the Monitor on several occasions that they are not running any form of parallel sales process in respect of Block 5(c) and that they do not intend to compromise the Scotia Waterous sales process.
17. The Monitor has maintained regular contact with Scotia Waterous who on several occasions has advised the Monitor that, to date, the engagement of Jennings has not negatively impacted their ongoing sales process of Block 5(c).

Western Canadian Assets

18. In the Monitor's Second Report, the Monitor advised this Honourable Court that CSEI had received an unsolicited offer from an arms-length party to purchase all of the Western Canadian oil and gas assets of CSEI and Seeker ("Western Assets"). CSEI continued to have additional discussions and negotiations with the party leading to an amended offer which CSEI ultimately allowed to lapse as it deemed the amended offer unacceptable.

19. As part of its mandate to explore alternatives, Jennings initiated a limited sales process of the Western Assets. Preliminary expressions of interest are due on April 28, 2009.

Challenger Energy Corp.

20. On April 27, 2009, the Monitor and Deloitte & Touche Inc., the Court appointed Interim Receiver of CSEI's participating interest in Block 5(c) (the "Receiver"), met with representatives of Carscallen Leitch and Jennings who advised that, to date, preliminary discussions have been held with Challenger and/or its representatives in regard to resolving the business issues between CSEI and Challenger.
21. They advised the Monitor and the Receiver that formal discussions between CSEI and Challenger would be accelerated this week.

Remuneration

22. The key terms of Jennings' compensation under the Advisory Agreement are as follows:
- a. A work fee of \$125,000;
 - b. Success fee(s) based on one or more of the following events:
 - i. 0.25% of the sales value with respect to CSEI's interest in Block 5(c);
 - ii. 1.25% of any asset sale, excluding Block 5(c) (excepting one purchaser previously identified by CSEI marked at 0.25%);
 - iii. 2.00% in the event of a recapitalization, equity injection or other investment in CSEI;
 - iv. 0.50% of the enterprise value in the event CSEI emerges from CCAA;
 - v. 1.50% of the enterprise value in the event of a corporate transaction calculated based upon the weighted average share price of the day following public announcement.
 - c. Any success fees earned are payable on the closing of the respective transaction;
 - d. If CSEI enters into a transaction contemplated above within 12 months of the Advisory Agreement being terminated the respective fees set out above shall be payable; and
 - e. All fees are payable by CSEI.

23. The Advisory Agreement also provides for success fees ranging from 4.0% - 6.0% in the event Jennings completes a brokered capital transaction; however, Jennings is not currently and does not contemplate undertaking this initiative.
24. The Monitor has the following comments with respect to the financial terms of the Advisory Agreement:
- a. Based on the Monitor's experience, except as set out in b) below, the fee structure is not unreasonable for an engagement of this nature.
 - b. The 0.25% fee that may become payable in the event of the sale of Block 5(c) is in addition to the 5% fee that CSEI will pay to Scotia Waterous in the event of such a sale. The Independent Committee has explained that Jennings, while not being the party actively marketing the asset, is heavily involved in the process, not only as the Independent Committee's advisor, but also working closely with Scotia Waterous strategically. The Independent Committee has informed the Monitor that the 0.25% fee was carefully negotiated and designed to ensure that Jennings had no financial disincentive to recommend a sale of Block 5(c) if that was a proper course of action.
25. The Monitor notes that pursuant to S.155(3)(f) of the Business Corporations Act (Alberta) no committee of directors (as opposed to the Board of Directors) has authority to pay a commission on the sale of the corporation's shares (or a commission for procuring or agreeing to procure purchasers for the shares of the corporation). Thus while the Advisory Agreement appears to have been approved by the Independent Committee it may also have to be approved by the Board.

COOPERATION WITH MONITOR

26. To date, the Independent Committee and its respective advisors have accommodated various information requests of the Monitor including attendance at status update meetings requested by the Monitor and held on April 6, 24 and 27, 2009.
27. The Independent Committee has provided the Monitor with copies of its resolutions from time to time.

MANAGEMENT CHANGES

28. On April 24, 2009, Mr. Noval and Mr. Coolen were terminated as employees and officers of the Companies and Mr. Jake Harp was named as Interim Chairman of the Board. A replacement for Mr. Coolen has not yet been named.

RECOGNITION OF INDEPENDENT COMMITTEE

29. On April 29, 2009, the Independent Committee will be making application to this Honourable Court seeking the following:
- a. Approval of the formation of the Independent Committee;
 - b. Approval of the engagement of Jennings;
 - c. Approval of the appointment of Carscallen Leitch LLP and Felesky Flynn LLP;
 - d. A declaration authorizing and approving the Advisory Agreement as a lawful and binding agreement between Jennings and CSEI; and
 - e. A declaration that the Independent Committee's advisors be deemed as "Assistants" to CSEI for the purpose of Paragraph 5 of the Initial Order thereby confirming payment of the advisors' fees and expenses are to be made by CSEI.
30. The Monitor has the following comments in respect of the Independent Committee's application:
- a. Based on the resolutions of the Board and the Monitor's review of the Charter and Mandate, it appears the constitution of the Independent Committee and the subsequent engagement of its respective advisors were authorized by the Board;
 - b. The Independent Committee is not seeking any form of priority or charge in respect of the fees and expenses of its respective advisors; and
 - c. The practical consequence of the Independent Committee's upcoming Court application is that the additional costs of advisory fees would be incurred by the Companies. As of the date of this Third Report, the amount of these costs are unknown, however we anticipate certain of the costs will be budgeted into the Companies' revised cash flow forecast that will be filed in conjunction with the Companies' upcoming application on May 4, 2009, should the Independent Committee's application be granted.

31. The impact of declaring the Independent Committee's advisors as "Assistants" under the Initial Order can be determined by reviewing Paragraphs 5, 7(b) and 31 of the Initial Order (the only paragraphs in which the term "Assistants" is used):

5. The Applicants shall remain in possession and control of their current and future assets, undertakings and properties of every nature and kind whatsoever, and wherever situate including all proceeds thereof other than as restricted by the Interim Receivership Order (the "Property"). For the purposes of this Order, the Property shall be comprised of CSEI's interest in the Block 5(c) Assets in Trinidad and Tobago, which are the subject of the Interim Receivership Order (the "Block 5(c) Assets"), and the balance of the Applicants' Property (the "Other Property"). Subject to further order of this Court, the Applicants shall continue to carry on business in a manner consistent with the preservation of their business (the "Business") and Property. The Applicants shall be authorized and empowered to continue to retain and employ the employees, consultants, agents, experts, accountants, counsel and such other persons (collectively "Assistants") currently retained or employed by them, with liberty to retain such further Assistants as they deem reasonably necessary or desirable in the ordinary course of business or for the carrying out of the terms of this order.

...

7(b) the fees and disbursements of any Assistants retained or employed by the Applicants in respect of these proceedings, at their standard rates and charges.

...

31. HARDIE & KELLY INC. is hereby appointed pursuant to the CCAA as the Monitor, and officer of this Court, to monitor the Property and the Applicants' conduct of the Business with the powers and obligations set out in the CCAA or set forth herein and that the Applicants and their shareholders, officers, directors, and Assistants shall advise the Monitor of all material steps taken by the Applicants pursuant to this Order, and shall co-operate fully with the Monitor in the exercise of its powers and discharge of its obligations.

32. Therefore, if the Independent Committee's advisors are deemed to be "Assistants":
- a. the Companies will have authority to hire them;
 - b. the Companies will be permitted but not required to pay their fees and disbursements; and
 - c. the advisors will be obligated to advise the Monitor of all material steps taken by the Companies pursuant to the Initial Order and shall cooperate fully with the Monitor in the exercising of its power and discharge of its obligations.

RECOMMENDATION

33. Except as noted in Paragraph 34 below, the Monitor is supportive of the relief sought by the Independent Committee for the following reasons:

- a. The Monitor is satisfied that, to date, the Independent Committee and its advisors have been working towards a successful restructuring of the Companies;
- b. Scotia Waterous have confirmed to the Monitor that the Independent Committee and its advisors have not hampered or otherwise affected their efforts to sell CSEI's interest in Block 5(c);
- c. As the Independent Committee is comprised of five of CSEI's seven Board members, the engagement of its advisors is appropriate and can be considered consistent with the Board's efforts to discharge its fiduciary duties to CSEI;
- d. Given the Independent Committee is comprised of a majority of the Board, it is not unreasonable they should seek to have their advisors' fees and expenses paid by the Companies; and
- e. The Independent Committee is not seeking any form of charge or priority with respect to their advisors' fees or expenses.

34. The Monitor notes that one of the terms of the Order sought by the Independent Committee is a declaration that the Advisory Agreement be authorized and approved as a lawful and binding agreement between Jennings and CSEI. However, CSEI is not a party to the Advisory Agreement as it was entered into between Jennings and the Independent Committee. Therefore, the Monitor is uncertain if it is appropriate to grant this term of the Order sought by the Independent Committee. However, the Monitor supports the application to have Jennings and the other advisors deemed to be "Assistants" and to have their fees and disbursements paid by the Companies.

All of which is respectfully submitted this 28th day of April 2009.

Hardie & Kelly Inc., in its capacity
as Monitor of the Companies
and not in its personal capacity

Per: 

Marc Kelly, CA • CIRP
Senior Vice President