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COURT FILE NUMBER BK NO: 25-1543324

COURT COURT OF QUEEN'S BENCH OF ALBERTA
IN BANKRUPTCY AND INSOLVENCY

JUDICIAL CENTRE CALGARY

PROCEEDING IN THE MATTER OF THE BANKRUPTCY OF DESMARAIS ENERGY
CORPORATION

DOCUMENT **FIRST REPORT OF THE TRUSTEE OF THE PROPOSAL OF
DESMARAIS ENERGY CORPORATION**

DATED OCTOBER 21, 2011

PREPARED BY HARDIE & KELLY INC.

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DOCUMENT

Gowling Lafleur Henderson LLP
1400, 700 2nd Street SW
Calgary, AB T2P 4V5

Telephone (403) 298-1000
Facsimile (403) 263-9193
Email: jeffrey.oliver@gowlings.com

File No. A124378

Attention: Jeffrey L. Oliver

**FIRST REPORT OF THE TRUSTEE
HARDIE & KELLY INC.
OCTOBER 21, 2011**

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INTRODUCTION

1. On September 26, 2011, Desmarais Energy Corporation (“Desmarais or the “Company”) filed a Notice of Intention to Make a Proposal (the “NOI”) pursuant to the Bankruptcy & Insolvency Act (the “Act”). Hardie & Kelly Inc. consented to act as trustee (the “Trustee”).

2. On October 5, 2011, the Trustee filed the following documents with the Office of the Superintendent of Bankruptcy (the “OSB”):
 - a. the Cash Flow Statement prescribed by S.50.4(2)(a) of the Act covering the period beginning September 26, 2011 through to the week beginning November 28, 2011 (the “Initial Cash Flow Statement”), a copy of which is attached as Exhibit “A”;
 - b. the *Trustee’s Report on Cash Flow Statement* as prescribed by S.50.4(2)(b) of the Act, a copy of which is attached as Exhibit “B”; and
 - c. the *Report on Cash Flow Statement by the Person Making the Proposal* as prescribed by S.50.4(2)(c) of the Act, a copy of which is attached as Exhibit “C”.

3. The purpose of this first report (the “First Report”) is to provide an update to the Court with respect to the following:
 - a. Background information with respect to Company;
 - b. The Company’s operations since the commencement of the proceedings;
 - c. The notices issued by the Trustee to the Company’s creditors;
 - d. The Company’s financial performance since the commencement of the proceedings;
 - e. The Company’s revised cash flow forecast for the period October 17, 2011 – December 9, 2011;
 - f. The Company’s restructuring activities;
 - g. The Company’s request for authority to borrow funds and the Trustee’s recommendation thereto;

- h. The Company's request for the establishment of an Administration Charge and the Trustee's recommendation with respect thereto; and
- i. The Company's request for a 45-day extension of the stay of proceedings (the "Stay") through to December 9, 2011 and the Trustee's recommendation with respect thereto.

TERMS OF REFERENCE

4. In preparing this First Report, the Trustee has relied upon unaudited financial information, records of the Company and discussions with the Company's management ("Management"). The Trustee has not performed an audit, review or other verification of such information. An examination of the cash flow information as outlined in the Canadian Institute of Chartered Accountants Handbook has not been performed. Future-oriented financial information relied upon in this report is based on Management's assumptions regarding future events and actual results achieved may vary from this information and the variations may be significant.

COMPANY BACKGROUND

5. Desmarais is a junior oil and gas exploration and production company primarily focused in west central and south east Alberta. The Company is publicly traded on the TSX Venture Exchange (the "TSX").
6. The Company has varying working interests in 27 wells with an average working interest of 34%. Desmarais operates 71% of its producing properties. Current production is approximately 50 boe/d.
7. Desmarais currently has only two full-time employees but engages a number of parties in consulting capacities.

ONGOING OPERATIONS

8. The Company has stabilized and continued its operations since the filing of the NOI. To date, Management, with the assistance of the Trustee, has been able to communicate with suppliers and make mutually satisfactory payment arrangements to ensure the uninterrupted supply of goods and services.

NOTICE TO CREDITORS

9. Pursuant to S. 50.4(1) of the Act, the Trustee mailed copies of the NOI, the Trustee's executed consent and the listing of creditors (the "Initial Filing Documents") to all known creditors as represented by the Company. Copies of the Initial Filing Documents have also been posted on the Trustee's website at www.insolvency.net.

FINANCIAL PERFORMANCE

10. As noted above, the Initial Cash Flow Statement was filed with the OSB on October 5, 2011. A variance analysis of the Company's actual receipts and disbursements over the period September 26 – October 14, 2011 versus the corresponding period in the Initial Cash Flow Statement is set out in the following table:

	September 26 – October 14, 2011		
	Actual	Forecast	Variance
<u>RECEIPTS</u>			
Petroleum and natural gas revenues	94,176	94,176	-
Accounts receivable	<u>49,427</u>	<u>49,427</u>	-
	<u>143,603</u>	<u>143,603</u>	-
<u>DISBURSEMENTS</u>			
<u>Oil and Gas Operations</u>			
Operating costs	(7,875)	(17,875)	10,000
Payroll:			
Employees & benefits	(13,211)	(13,211)	-
Consultants	(12,395)	(13,445)	1,050
Lease Payments:			
Premises	(4,069)	(4,072)	3
Land and mineral lease rentals	-	(19,008)	19,008
General and administrative	(93)	(2,718)	2,625
Insurance	(6,602)	(6,462)	(140)
Restructuring costs	<u>(30,000)</u>	<u>(30,000)</u>	-
	<u>(74,245)</u>	<u>(106,791)</u>	<u>32,546</u>
NET CASH FLOW	69,358	36,812	32,546
OPENING – CASH	<u>2,059</u>	<u>2,059</u>	-
CLOSING – CASH	<u><u>71,417</u></u>	<u><u>38,871</u></u>	<u><u>32,546</u></u>

11. Desmarais experienced a positive cash flow of approximately \$69,000 over the period September 26 through to October 14, 2011 versus an anticipated surplus of approximately \$37,000 over the same period. However, the positive variance of approximately \$33,000 is attributed to timing differences with respect to the payment of forecasted operating costs and lease rental payments that have yet to be made. These expenses have been provided for in the Company's updated cash flow forecast discussed below.
12. The Company maintained a cash balance of approximately \$71,000 as at October 14, 2011.

CASH FLOW FORECAST

13. Management, with the assistance of the Trustee, has prepared a revised cash flow forecast for the period October 17 – December 9, 2011 (the "October 17 Forecast") which is attached as Appendix "D".
14. A summary of the October 17 Forecast is provided in the table below:

<u>October 17 – December 9, 2011</u>	
Forecast	
<u>RECEIPTS</u>	
P&NG revenues	165,000
Less: royalties	<u>(5,000)</u>
	160,000
Accounts receivable	<u>31,006</u>
Total Receipts	191,006
<u>DISBURSEMENTS</u>	
Joint venture partners	(25,000)
Operating costs	(80,500)
Payroll	
Employees & Benefits	(27,000)
Consultants	(16,050)
Lease Payments	
Premises	(8,138)
Land/mineral leases	(47,694)
General and administrative	(3,278)
Insurance	(6,938)
Restructuring costs	<u>(40,000)</u>
Total Disbursements	<u>(254,598)</u>
Net Cash Flow	<u>(63,592)</u>
Opening Cash	<u>71,417</u>
Closing Cash	<u>7,825</u>

15. The October 17 Forecast reflects negative cash flow of approximately \$64,000 over the forecast period leaving an anticipated cash balance of only \$7,825 by December 9, 2011.
16. The Trustee is satisfied that the October Forecast is reasonable in the circumstances; however; as there is very little room for error, both the Trustee and Management are concerned with the Company's ability to cope with any unforeseen expenditures that may arise over the period. Consequently, the Company intends on seeking the Court's approval for authority to grant interim financing of up to \$100,000 on a debtor-in-possession basis ("DIP Financing") pursuant to S.50.6 of the BIA to be secured by a charge ranking ahead of all other creditors, but subject to the Administration Charge discussed below. A copy of the letter outlining the terms of the interim financing is attached as Exhibit "A" to the October 20, 2011 Affidavit of James Long filed in these proceedings.
17. The Trustee understands that funds from the DIP Financing would only be drawn upon if necessary. Consequently, The Trustee is satisfied that the proposed DIP Financing is reasonable in the circumstances so as to improve the Company's ability to continue operations through its restructuring process.
18. 323 Holdings Ltd. ("323"), the principal secured creditor owed approximately \$2.6 Million, has advised the Trustee that it is supportive of the restructuring proceedings and does not oppose the granting of a priority charge in respect of DIP Financing. The Trustee understands that the principal of 323 is a part of the proposed lending syndicate likely to provide the interim financing.

ADMINISTRATION CHARGE

19. Desmarais requires the assistance of its legal counsel and the Trustee to prepare and implement the Proposal without which Desmarais will unlikely be able to successfully restructure its affairs. In light of there being little margin for error available in respect of the Company's cash flow forecast, the Company will be making application to Court seeking a priority charge to a maximum of \$100,000 (the "Administration Charge") pursuant to S.64.2 of the Act in respect of the fees and disbursements of the Company's legal counsel, the Trustee and the Trustee's counsel, ranking ahead of all other creditors.

20. Given the October 17 Forecast estimates the Company will only have approximately \$7,000 on hand by December 9, 2011, the Trustee is satisfied that the granting of an Administration Charge is appropriate in the circumstances. The Trustee has confirmed directly with 323 that 323 does not object to the granting of an Administration Charge in priority to its security interest.

RESTRUCTURING EFFORTS

21. The Trustee is satisfied that Management has been acting with due diligence and in good faith and has been working towards ultimately presenting a proposal to its creditors. Since the filing of the NOI, Management has:
- a. responded to inquiries from various creditors regarding the status of the proceedings;
 - b. held discussions with 323, who is expected to continue to support the restructuring, in regard to potential alternatives;
 - c. arranged DIP Financing to secure sufficient funds to enable the Company to work through the restructuring period;
 - d. held discussions with legal counsel and the Trustee in regard to alternatives with respect to the structure of a Proposal; and
 - e. commenced an analysis of its creditors for purposes of the potential classification and treatment of creditors in a Proposal.

RECOMMENDATIONS

22. The Trustee is of the view that a further extension of the Stay for 45 days is warranted to allow the Company the opportunity to continue to formulate the terms of its proposal as the Trustee is satisfied that:
- a. Management continues to act in good faith and with due diligence with a view towards preparing a proposal for presentation to its creditors;
 - b. the Company will likely be able to formulate a viable proposal; and
 - c. no creditor would be materially prejudiced if a further extension is granted.

23. As set out above, the Trustee is also supportive of the following:

- a. Authorization of the proposed DIP Financing; and
- b. Authorization of the Administration Charge.

All of which is respectfully submitted this 21st day of October 2011.

Hardie & Kelly Inc., in its capacity as
Trustee of the Proposal of Desmarais Energy Corporation
and not in its personal capacity

Per:



Marc Kelly, CA•CIRP
Senior Vice President

EXHIBIT “A”

Dominion Energy Corporation
Forecasted Cash Flow
(unaudited)

Notes	WEEK BEGINNING							PERIOD TOTAL
	26-Sep-11	03-Oct-11	10-Oct-11	17-Oct-11	24-Oct-11	31-Oct-11	07-Nov-11	
1	94,176	-	-	-	70,000	-	-	94,000
2	94,176	-	-	-	70,000	(2,000)	-	(3,000)
3	6,189	43,233	-	-	70,000	(2,000)	-	93,000
	100,165	43,233	-	-	70,000	12,931	-	16,075
							95,000	13,075
								334,609
4	-	(7,875)	(10,000)	-	-	(33,000)	-	(25,000)
5	(13,211)	-	-	-	(13,500)	-	-	(40,000)
6	-	(13,443)	-	-	-	(8,025)	-	(40,211)
7	-	(4,072)	-	-	(4,072)	-	-	(8,025)
8	(15)	(99,008)	-	-	(13,086)	-	-	(12,216)
9	-	(2,625)	(78)	(50)	-	(78)	(50)	(15,000)
10	-	(6,462)	-	(1,761)	-	(708)	(2,000)	(47,694)
	-	(30,000)	-	-	(20,000)	-	-	(78)
	(13,226)	(83,487)	(10,078)	(1,811)	(13,500)	(81,591)	(2,078)	(128,405)
	87,159	(40,249)	(10,078)	(1,811)	56,500	(68,660)	(2,074)	(1,811)
	2,059	89,198	48,949	38,371	37,060	93,560	24,900	23,827
	89,198	48,949	38,371	37,060	93,560	24,900	22,822	21,011
							21,011	116,011
								681
11								681

The purpose of this cash flow forecast is to demonstrate the company's ability to fund its operations over the forecasted period.

1. Revenues (net of transportation charges and Crown royalties) have been estimated based on recent historical results and estimated pricing.
2. Freehold & Crown Overriding Royalties are estimated based on anticipated post-filing revenue receipts.
3. Amounts received in account include miscellaneous receipts.
4. Payments to joint venture partners based on anticipated post-filing activities.
5. Field operating costs have been estimated based on recent historical operations.
6. It is assumed that wages, benefits and consulting fees will continue to be paid in the ordinary course.
7. It is assumed lease obligations will be paid in the ordinary course.
8. Estimated general and administrative costs based on recent historical operations.
9. Insurance includes renewal, lump sum payments and ongoing monthly payments.
10. Costs associated with restructuring including those of the company's legal counsel, the Trustee and counsel for the Trustee.

Balance forward as at September 26, 2011.

Dominion Energy Corporation

 Per James G. Long
 President

October 5, 2011
 Calgary, Alberta

This Statement of Forecasted Cash Flow of Dominion Energy Corporation prepared pursuant to S.S. 50-2(2)(c) of the Bankruptcy and Insolvency Act should be read in conjunction with the Trustee's Report on Cash Flow Statement dated the 31st day of October, 2011.


 Per Mark Kelly
 Senior Vice-President

EXHIBIT “B”

District of: Alberta
Division No. 02 - Calgary
Court No. 25-1543324
Estate No. 25-1543324

FORM 29
Trustee's Report on Cash-Flow Statement
(Paragraphs 50(6)(b) and 50.4(2)(b) of the Act)

The attached statement of projected cash flow of Desmarais Energy Corporation, as of the 26th day of September 2011, consisting of the projected cash flow through to the week beginning November 28, 2011, has been prepared by the management of the insolvent person for the purpose described in the notes attached, using the probable and hypothetical assumptions set out in the notes attached.

Our review consisted of inquiries, analytical procedures and discussion related to information supplied to us by: the management and employees of the insolvent person or the insolvent person. Since hypothetical assumptions need not be supported, our procedures with respect to them were limited to evaluating whether they were consistent with the purpose of the projection. We have also reviewed the support provided by: management or the insolvent person for the probable assumptions and preparation and presentation of the projection.

Based on our review, nothing has come to our attention that causes us to believe that, in all material respects,

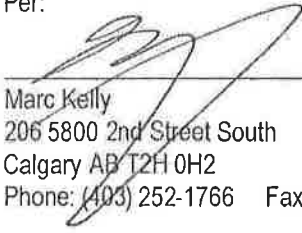
- (a) the hypothetical assumptions are not consistent with the purpose of the projection;
- (b) as at the date of this report, the probable assumptions developed are not suitably supported and consistent with the plans of the insolvent person or do not provide a reasonable basis for the projection, given the hypothetical assumptions; or
- (c) the projection does not reflect the probable and hypothetical assumptions.

Since the projection is based on assumptions regarding future events, actual results will vary from the information presented even if the hypothetical assumptions occur, and the variations may be material. Accordingly, we express no assurance as to whether the projection will be achieved.

The projection has been prepared solely for the purpose described in the notes attached, and readers are cautioned that it may not be appropriate for other purposes.

Dated at the City of Calgary in the Province of Alberta, this 5th day of October 2011.

Hardie & Kelly Inc - Trustee
Per:



Marc Kelly
206 5800 2nd Street South
Calgary AB T2H 0H2
Phone: (403) 252-1766 Fax: (403) 640-0591

District of: Alberta
Division No. 02 - Calgary
Court No. 25-1543324
Estate No. 25-1543324

FORM 29 - Attachment
Trustee's Report on Cash-flow Statement
(Paragraphs 50(6)(b) and 50.4(2)(b) of the Act)

Purpose:

The purpose of this cash flow forecast is to demonstrate the company's ability to fund its operations over the forecasted period.

Projection Notes:

As disclosed on the cash-flow forecast document.

Assumptions:

As disclosed on the cash-flow forecast document.

Dated at the City of Calgary in the Province of Alberta, this 5th day of October 2011.

Hardie & Kelly Inc - Trustee
Per:



Marc Kelly
206 5800 2nd Street South
Calgary AB T2H 0H2
Phone: (403) 252-1766 Fax: (403) 640-0591

EXHIBIT “C”

District of: Alberta
Division No. 02 - Calgary
Court No. 25-1543324
Estate No. 25-1543324

FORM 30

Report on Cash-Flow Statement by the Person Making the Proposal
(Paragraphs 50(6)(c) and 50.4(2)(c) of the Act)

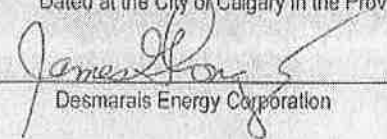
The Management of Desmarais Energy Corporation, has/have developed the assumptions and prepared the attached statement of projected cash flow of the insolvent person, as of the 26th day of September 2011, consisting of the projected cash flow through to the week beginning November 28, 2011.

The hypothetical assumptions are reasonable and consistent with the purpose of the projection described in the notes attached, and the probable assumptions are suitably supported and consistent with the plans of the insolvent person and provide a reasonable basis for the projection. All such assumptions are disclosed in the notes attached.

Since the projection is based on assumptions regarding future events, actual results will vary from the information presented, and the variations may be material.

The projection has been prepared solely for the purpose described in the notes attached, using a set of hypothetical and probable assumptions set out in the notes attached. Consequently, readers are cautioned that it may not be appropriate for other purposes.

Dated at the City of Calgary in the Province of Alberta, this 5th day of October 2011.


Desmarais Energy Corporation

James G. Long
President

Name and title of signing officer

District of: Alberta
Division No. 02 - Calgary
Court No. 25-1543324
Estate No. 25-1543324

FORM 30 - Attachment
Report on Cash-Flow Statement by the Person Making the Proposal
(Paragraphs 50(6)(c) and 50.4(2)(c) of the Act)

Purpose:

The purpose of this cash flow forecast is to demonstrate the company's ability to fund its operations over the forecasted period.

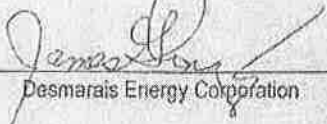
Projection Notes:

As disclosed on the cash-flow forecast document.

Assumptions:

As disclosed on the cash-flow forecast document.

Dated at the City of Calgary in the Province of Alberta, this 5th day of October 2011.



Desmarais Energy Corporation

EXHIBIT “D”

Desmarais Energy Corporation
Forecast Cash Flow
(unaudited)

	Notes	WEEK BEGINNING							PERIOD TOTAL
		17-Oct-11	24-Oct-11	31-Oct-11	7-Nov-11	14-Nov-11	21-Nov-11	28-Nov-11	
RECEIPTS									
Petroleum and natural gas revenues	1	-	70,000	-	-	-	95,000	-	165,000
Less: Freehold & GOR Royalties	2	-	-	(2,000)	-	-	-	(3,000)	(5,000)
		-	70,000	(2,000)	-	-	95,000	(3,000)	160,000
Accounts receivable	3	-	-	14,931	-	-	-	16,075	31,006
Subtotal		-	70,000	12,931	-	-	95,000	13,075	191,006
DISBURSEMENTS									
Oil and Gas Operations									
Joint Venture Partners	4	-	-	-	-	-	-	(25,000)	(25,000)
Operating costs	5	(10,000)	-	(33,000)	-	-	-	(37,500)	(80,500)
Payroll	6	-	(13,500)	-	-	-	-	(13,500)	(27,000)
Lease payments	6	-	-	(8,025)	-	-	-	(8,025)	(16,050)
Consultants	7	-	-	(4,069)	-	-	-	(4,069)	(8,138)
Premises	7	(19,008)	-	-	-	(13,686)	-	-	(47,694)
Land lease rentals	7	(1,050)	-	(1,050)	(78)	(50)	-	(1,050)	(3,278)
General & administrative	8	(1,761)	-	(708)	(2,000)	(1,761)	-	(708)	(6,938)
Insurance	9	-	-	(20,000)	-	-	-	(20,000)	(40,000)
Restructuring costs	10	-	-	-	-	-	-	-	-
Subtotal		(31,819)	(13,500)	(66,852)	(2,078)	(15,497)	-	(109,852)	(254,598)
NET CASH FLOW (DEFICIT)		(31,819)	56,500	(53,921)	(2,078)	(15,497)	95,000	(96,777)	(63,592)
OPENING CASH	11	71,417	39,598	96,098	42,177	40,099	24,602	119,602	71,417
CLOSING CASH		39,598	96,098	42,177	40,099	24,602	119,602	22,825	7,825

Notes:

- 1 Revenues (net of transportation charges and Crown royalties) have been estimated based on recent historical results and estimated pricing.
- 2 Freehold & Gross Overriding Royalties are estimated based on anticipated post filing revenue receipts.
- 3 Amounts received on account includes miscellaneous receipts.
- 4 Payments to joint venture partners on anticipated post filing activities.
- 5 Field operating costs have been estimated based on recent historical operations.
- 6 It is assumed that wages, benefits and consulting fees will continue to be paid in the ordinary course.
- 7 It is assumed lease obligations will be paid in the ordinary course.
- 8 Estimated general and administrative costs based on recent historical operations.
- 9 Insurance includes renewal lump sum payments and ongoing monthly installments
- 10 Costs associated with restructuring including those of the company's legal counsel, the Trustee and counsel for the Trustee.
- 11 Balance forward as at October 14, 2011.