

AGREED STATEMENT OF FACTS AND UNDERTAKING

BETWEEN

**MICHAEL J. SMITH
LEXIN RESOURCES LTD.**

AND

ALBERTA ENERGY REGULATOR

(collectively “the Parties”)

Agreed Facts

Whereas the Alberta Energy Regulator (“AER”) began an investigation into the regulatory and environmental noncompliances of Lexin Resources Ltd. (“Lexin”) in August 2016;

Whereas the investigation confirmed, and Michael J. Smith (“Mr. Smith”), a director of Lexin, does not contest, that Lexin was in contravention of sections of the *Environmental Protection and Enhancement Act*, RSA 2000, c E-12 (“EPEA”), and *Oil and Gas Conservation Act*, RSA 2000, c O-6 (“OGCA”), as amended, referred to in this Agreed Statement of Facts and Undertaking (“Agreement”) and as set out in detail in the orders issued by the AER; and

Whereas Mr. Smith accepts responsibility for and on behalf Lexin and its directors and officers for Lexin's noncompliances and does not contest the following facts and provides the following undertakings in resolution of these noncompliances.

Background

1. Mr. Smith was a director of Lexin at the time of the noncompliances and is the sole director of Lexin as of the date of this Agreement.
2. Lexin, an oil- and gas-producing company incorporated in British Columbia.
3. As a result of the global downturn in the oil and gas industry and other factors, Lexin was unable to obtain sufficient capital to operate its business in the ordinary course.

4. Mr. Smith is a non-resident of Canada and relied upon in-country managers and other personnel for the operations of Lexin.
5. Lexin is an AER licensee that currently holds 1662 operational licences (1380 wells, 81 facilities, and 201 pipelines) and licences for 134 abandoned wells, 5 abandoned facilities, and 6 abandoned pipelines.
6. Lexin, Smith and the AER have agreed to work together cooperatively to resolve all outstanding matters.
7. On March 20, 2017, the Court appointed Grant Thornton Limited the receiver pursuant to section 234(1) of the *Bankruptcy and Insolvency Act* and Section 13(2) of the *Judicature Act* of all of Lexin's current and future assets, undertakings, and properties, excluding any oil or gas wells, pipelines, or facilities located outside the province of Alberta or regulated by an entity other than the AER.
8. Solely for oil and gas regulatory purposes in Alberta, and as the basis for the resolution and undertakings referred to in paragraph 36, Mr. Smith does not contest the facts and consequences set out in this Agreement.

Circumstances

9. In April 2016, Lexin was directed by the AER in an environmental protection order issued under section 113 of *EPEA* to address, with the other working interest participants (WIPs) in the site in question, a serious surface casing vent flow issue. On June 1, 2016, one of the WIPs contacted the AER to advise that Lexin had not paid its share of the costs and was not returning calls.
10. Around April 2016, Lexin ceased to report its production volumes and other similar data to Petrinex, the data collection and management organization to which licensees are required to report. Because Lexin has not been reporting to Petrinex, the revenues it has been generating from its AER-licensed sites since that time are unknown to the AER, the Government of Alberta, or the public.
11. On February 5, 2016, the AER issued to Lexin a notice of noncompliance for failure to install a dilution gas meter at a sour gas facility and failure to remove numerous bags of spent catalyst from the grounds of the facility. On June 15, 2016, the AER issued an order to Lexin for failure to comply with the February 2016 noncompliance notice ("Metering and Removal Order").
12. Lexin has not complied with the metering and removal order.
13. On June 13, 2016, the AER issued a notice of garnishment as a result of Lexin failing to pay AER-issued administrative levies. The levies owed amount to more than \$1 million.
14. Lexin has also failed to provide more than \$70 million of security required to offset its liabilities.
15. The AER received information from Lexin and other sources that Lexin had laid off most of its staff and would not be able to respond should an incident or emergency occur involving a Lexin-licensed sour gas facility. As a result, on August 9, 2016, the AER issued to Lexin an order ("Mazeppa Order")

directing, among other things, that Lexin and LR Processing Ltd., a related party that has an ownership interest in the Mazeppa sour gas facility and infrastructure, immediately suspend and discontinue the facility's operations.

16. Lexin has only partially complied with the Mazeppa Order.
17. In August 2016, numerous closure and abandonment orders were issued against Lexin, including for expired surface rights (3 wells) and mineral rights (26 wells).
18. Lexin has not complied with the closure and abandonment orders.
19. On October 25, 2016, the AER issued an order to Lexin to take immediate steps to clean up a hydrocarbon spill at another sour gas facility ("Cleanup Order"). The AER first informed Lexin of this spill on July 28, 2016. By the date of the Cleanup Order, Lexin had not cleaned up the spill despite statutory obligations to do so and despite having received from the AER a notice of noncompliance in August 2016 for this spill.
20. Lexin has not complied with the cleanup order.
21. The AER received reports of equipment being sold in 2016 and 2017, leading to the AER issuing a cease and desist letter on October 27, 2016, directing Lexin to cease the removal and sale of assets and infrastructure from Lexin-licensed sites.
22. The AER obtained evidence in February 2017 that Lexin sold infrastructure from the Cowley gas plant, located at Legal Subdivision 13, Section 34, Township 8, Range 2, West of the Fifth Meridian, through a company called International Oilfield Equipment Brokers in contravention of the AER's October 2016 cease and desist letter and the *OGCA*.
23. In a November 24, 2016, letter to Lexin, the AER advised that it had imposed Global Refer status on Lexin because of its inability or unwillingness to comply with regulatory requirements.
24. On January 19, 2017, the AER issued a declaration under section 106(1) of the *OGCA* naming Mr. Smith, Jasmina Cezek, and Rob Jennings as persons in direct or indirect control of Lexin, and declaring that Lexin has, among other things, contravened AER requirements, failed to comply with orders of the AER, or is indebted to the AER. Section 106 of the *OGCA* applies when the AER considers it in the public interest to make a declaration naming one or more directors, officers, agents, or other persons who, in the AER's opinion, were directly or indirectly in control of a licensee, approval holder, or working interest participant that has (i) contravened or failed to comply with an order of the AER or (ii) has an outstanding debt to the AER or the orphan fund for suspension, abandonment, or reclamation costs.
25. On February 15, 2017, the AER issued an environmental protection order regarding the Mazeppa sour gas facility under sections 113 and 241 of *EPEA* to Lexin, LR Processing Ltd., Jasmina Cezek, Mr. Smith, and Rob Jennings ("Mazeppa EPO"). The Mazeppa EPO ordered the parties to clean up and remove any released substances; immediately remove and properly dispose of the substances in

accordance with regulatory requirements; immediately test and dispose of the liquid collected in the surface water retention ponds; purge and clean all underground piping, tanks, and drain systems; and ensure that all tanks on site are taken out of service in compliance with all regulatory requirements. The substances identified in the Mazeppa EPO are known to have an adverse effect on the environment and include sulfolane/sulfanol, hydrocarbon liquids, sulphur, and sulphur recovery catalyst, as well as other oilfield wastes.

26. Lexin, Mr. Smith, and all other parties named in the Mazeppa EPO have not complied with the order.
27. On January 23, 2017, an AER inspection verified that no steps had been taken to clean up the hydrocarbon spill as required by the cleanup order. As a result, on February 15, 2017, the AER amended the cleanup order to add Jasmina Cezek, Mr. Smith, and Rob Jennings to the list of named parties and persons responsible, varied paragraph 2, and repealed paragraph 3 of the cleanup order.
28. Lexin, Mr. Smith, and all other parties named in the Clean-Up Order have not complied with the order.
29. On March 6, 2017, the AER received a letter from Groia & Company of Toronto (Groia), counsel for Lexin, stating that it had significant concerns about health, safety, and environmental issues at the sites and facilities licensed by Lexin and stating that Lexin was unable to address these issues.
30. The letter from Groia also stated that Lexin did not know if its 1-800 emergency line for reporting health, safety, and environmental emergencies was currently operational, as Telus had advised that it would be disconnecting the line shortly. The letter also stated that Lexin did not have the resources to handle any calls to that line as it now only had two employees. The letter further stated that the pond levels at the Mazeppa sour gas facility were dangerously high and that there was a “real danger of an overflow and environmental damage as a result thereof.”
31. The AER responded to Groia’s letter by letter dated March 7, 2017. In that letter, the AER asked Lexin to confirm that the 1-800 emergency number was operational and that Lexin would take steps to provide a response in the event of an emergency.
32. Lexin replied to the AER in a letter dated March 8, 2017, stating again that the company had no funds to address its obligations and asking the AER to take steps to mitigate safety risks. Lexin did not confirm whether its 1-800 number for emergency response was still working or whether steps would be taken by Lexin in the event of an emergency. Failure to maintain an emergency response number is a contravention of sections 6.020(3) and 6.020(5) of the *Oil and Gas Conservation Rules* and sections 2.1(2) and 2.1(3) of *Directive 071: Emergency Preparedness and Response Requirements for the Petroleum Industry*.
33. As a result of the health and safety concerns and statement by Lexin that it was unable to address its obligations, the AER applied to the Alberta Court of Queen’s Bench, pursuant to section 234(1) of the *Bankruptcy and Insolvency Act* and/or section 13(2) of the *Judicature Act*, to appoint a receiver over Lexin’s assets. On March 20, 2017, the Court appointed Grant Thornton Limited the receiver of

all of Lexin's current and future assets, undertakings, and properties, excluding any oil or gas wells, pipelines, or facilities located outside the province of Alberta or regulated by an entity other than the AER.

34. Since the appointment of the receiver, the AER has learned that Lexin failed to maintain its insurance, which is also a contravention of AER requirements.

Uncontested Breaches of Alberta Environmental and Oil and Gas Laws

35. Based on these agreed facts, as director and person responsible under *EPEA*, Mr. Smith does not contest that Lexin breached section 108(2) and 108(1)(a) of the *OGCA* and section 227(h) of *EPEA* by failing to comply with the terms and conditions of the Metering and Removal Order, the Mazeppa Order, the Closure and Abandonment Orders, the Clean-Up Order, the Mazeppa EPO; by the unauthorized sale and removal of the Lexin-licensed assets of the Callum gas plant; by failing to record and report hydrocarbon production according to AER *Directive 007: Volumetric and Infrastructure Requirements*; by failing to pay the issued levies and security owing, by failing to maintain insurance in accordance with AER *Directive 067: Applying for Approval to Hold EUB Licences* ("Uncontested breaches").

Terms and Undertakings

36. Mr. Smith and the AER agree to resolve the current and outstanding matters between the two Parties and Lexin as set out in this agreed statement of facts, and, in the case of Mr. Smith, including any current or outstanding noncompliances or other matters not currently subject to the orders or directions set forth above, as follows:
- 36.1. In recognition of his role and responsibility for the Uncontested breaches by Lexin during the time that he was a director of Lexin, Mr. Smith agrees and commits to the AER's executive vice president of Operations to pay to the AER \$175,000 on or before June 19, 2017.
- 36.2. Mr. Smith and Lexin agree to cooperate with the receiver's sales process and to facilitate obtaining consent from the entities to be added into the receivership as set forth in the application of the receiver to the Court of Queen's Bench of Alberta filed on June 9, 2017.
- 36.3. Mr. Smith undertakes not to directly or indirectly control any licensee or holder of an approval in relation to upstream hydrocarbon production, exploration, or transportation in the province of Alberta.
- 36.4. The section 106 declaration as it applies to Mr. Smith will remain in effect.
- 36.5. Mr. Smith waives any right existing under AER administered legislation or otherwise, to a hearing, review, judicial review, or appeal of this matter.

- 36.6. The AER agrees that executing and fulfilling the terms of this Agreement by Mr. Smith resolves all issues involving Mr. Smith related to the conduct described above, will enable the parties to move forward towards an efficient resolution of the matters between the AER and Lexin, and the AER will take no further steps against Mr. Smith arising from these facts.
- 36.7. This Agreement concludes all investigations of the AER in relation to Lexin, Mr. Smith and any other current or former directors and/or officers of Lexin, in relation to the Uncontested breaches.
- 36.8. Notwithstanding the foregoing terms of this Paragraph 36, solely as to Lexin, nothing herein shall effect the requirement of Lexin to remedy the Uncontested breaches, or any future licensee of the sites subject to the orders referenced herein from compliance with the outstanding provisions applicable to Lexin set forth in the Metering and Removal Order, the Mazeppa Order, the Closure and Abandonment Orders, the Clean-Up Order and the Mazeppa EPO, provided, however, that this Agreement is intended to resolve such matters as to Mr. Smith.
37. It is acknowledged that Mr. Smith is entering into this Agreed Statement of Facts and Undertaking for and on behalf of Lexin because Lexin is currently subject to a receivership as set forth above.

General

38. Mr. Smith and the AER agree to execute the documents necessary to accomplish the objectives of this Agreement.
39. Mr. Smith acknowledges that he received independent legal advice and has voluntarily made the admissions and undertakings in this Agreement.
40. Mr. Smith acknowledges and agrees that the AER may enforce this Agreement in the Court of Queen's Bench or in any other court of competent jurisdiction.
41. This Agreement is governed by the laws of the province of Alberta.
42. Terms used in this Agreement have the same meaning as defined in the Alberta oil and gas and environmental laws.