

**Court File No. CV-17-11846-00CL**

**SEARS CANADA INC.,  
AND RELATED APPLICANTS**

**SIXTH REPORT OF FTI CONSULTING CANADA INC., AS MONITOR**

**October 25, 2017**

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**ONTARIO  
SUPERIOR COURT OF JUSTICE  
(COMMERCIAL LIST)**

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

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF  
SEARS CANADA INC., CORBEIL ÉLECTRIQUE INC., S.L.H. TRANSPORT INC., THE  
CUT INC., SEARS CONTACT SERVICES INC., INITIUM LOGISTICS SERVICES INC.,  
INITIUM COMMERCE LABS INC., INITIUM TRADING AND SOURCING CORP., SEARS  
FLOOR COVERING CENTRES INC., 173470 CANADA INC., 2497089 ONTARIO INC.,  
6988741 CANADA INC., 10011711 CANADA INC., 1592580 ONTARIO LIMITED, 955041  
ALBERTA LTD., 4201531 CANADA INC., 168886 CANADA INC. AND  
3339611 CANADA INC.

APPLICANTS

**SIXTH REPORT TO THE COURT  
SUBMITTED BY FTI CONSULTING CANADA INC.,  
IN ITS CAPACITY AS MONITOR**

**A. INTRODUCTION**

1. On June 22, 2017, Sears Canada Inc. ("**Sears Canada**") and a number of its operating subsidiaries (collectively with Sears Canada, the "**Sears Canada Group**" or the "**Applicants**") sought and obtained an initial order (as amended and restated on July 13, 2017, the "**Initial Order**"), under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended (the "**CCAA**"). The relief granted pursuant to the Initial Order was also extended to Sears Connect LP, a partnership forming part of the operations of the Sears Canada Group. The proceedings commenced under the CCAA by the Sears Canada Group are referred to herein as the "**CCAA Proceedings**".

2. The Initial Order, among other things:
  - (a) appointed FTI Consulting Canada Inc. as monitor of the Sears Canada Group (the “**Monitor**”) in the CCAA Proceedings;
  - (b) granted an initial stay of proceedings against the Sears Canada Group until July 22, 2017;
  - (c) authorized the Sears Canada Group to enter into the DIP Credit Agreements and access funds available under the facilities provided under these agreements; and
  - (d) scheduled a comeback motion for July 13, 2017 (the “**Comeback Motion**”).
  
3. Following the Comeback Motion, the Court extended the stay of proceedings to October 4, 2017. In addition, the following orders were issued:
  - (a) the amended and restated Initial Order;
  - (b) an order setting out the terms of the appointment of Ursel Phillips Fellows Hopkinson LLP as representative counsel for the non-unionized active and former employees of the Sears Canada Group (“**Employee Representative Counsel**”);
  - (c) an order setting out the terms of the appointment of Koskie Minsky LLP as representative counsel to the non-unionized retirees and non-unionized active and former employees of the Sears Canada Group with respect to pension and post-employment benefit matters (“**Pension and Retiree Representative Counsel**”);
  - (d) an order authorizing the eventual suspension of special payments under the Sears Canada Pension Plan, certain payments in connection with supplemental pension plans and certain payments under post-retirement benefit plans pursuant to a term sheet agreed to by the Superintendent of Financial Services, as Administrator of the Pension Benefits Guarantee Fund, Employee

Representative Counsel, Pension and Retiree Representative Counsel, each of their respective representatives, and the Sears Canada Group; and

- (e) an order approving a sale and investor solicitation process (the “**SISP**”) to solicit interest in potential transactions, including investment and liquidation proposals, involving the business, property, assets and/or leases of the Applicants.
4. On October 4, 2017, the Court issued, among other orders, an order extending the stay of proceedings to November 7, 2017 and Orders approving certain sales of businesses and assets of the Applicants, including:
- (a) the businesses of Corbeil Électrique Inc. and S.L.H. Transport Inc.;
  - (b) sales of owned real estate (“**Property Sale Transactions**”);
  - (c) transfers of leases to new tenants (“**Lease Transfer Transactions**”); and
  - (d) surrenders of leases to landlords (“**Lease Surrender Transactions**”).
5. On October 13, 2017, the Court issued, among other orders, an order approving an agreement (the “**Second Liquidation Agreement**”) and a process (the “**Second Liquidation Process**”) for the liquidation of the inventory and FF&E at all remaining Sears Canada locations.
6. The purpose of this sixth report of the Monitor (the “**Sixth Report**”) is to provide the Court with the Monitor’s comments and recommendations, regarding the Sears Canada Group’s motion returnable October 27, 2017 (the “**October 27 Motion**”) seeking approval of an additional Property Sale Transaction, as well as distributions of the proceeds of such transaction to the DIP Term Lenders and payment of a Termination Fee as described below.

## **B. TERMS OF REFERENCE**

7. In preparing this Sixth Report, the Monitor has relied upon audited and unaudited financial information of the Sears Canada Group, the Sears Canada Group’s books and

records, certain financial information and forecasts prepared by the Sears Canada Group, and discussions with various parties, including senior management (“**Management**”) of, and advisors to, Sears Canada (collectively, the “**Information**”).

8. Except as otherwise described in this Sixth Report:
  - (a) the Monitor has not audited, reviewed or otherwise attempted to verify the accuracy or completeness of the Information in a manner that would comply with Generally Accepted Assurance Standards pursuant to the *Chartered Professional Accountants of Canada Handbook*; and
  - (b) the Monitor has not examined or reviewed the financial forecasts or projections referred to in this Sixth Report in a manner that would comply with the procedures described in the *Chartered Professional Accountants of Canada Handbook*.
9. Future-oriented financial information reported in or relied on in preparing this Sixth Report is based on Management’s assumptions regarding future events. Actual results will vary from these forecasts and such variations may be material.
10. The Monitor has prepared this Sixth Report in connection with the October 27 Motions. The Sixth Report should not be relied on for any other purpose.
11. Unless otherwise stated, all monetary amounts contained herein are expressed in Canadian Dollars.
12. Capitalized terms not otherwise defined herein have the meanings ascribed to them in the affidavit of Mr. Billy Wong, the Chief Financial Officer of Sears Canada, sworn on June 22, 2017 (the “**First Wong Affidavit**”), the affidavit of Mr. Mark Caiger, Managing Director, BMO Nesbitt Burns Inc., sworn on September 28, 2017 (the “**Caiger Affidavit**”), and the Affidavit of Mr. Wong sworn October 23, 2017 (the “**Newmarket Wong Affidavit**”), the SISP and the prior reports of the Monitor in these proceedings.

13. This Report should be read together with the Third Report of the Monitor, dated October 2, 2017 (the “**Third Report**”), which provided a detailed description of the steps taken in connection with the SISP. These descriptions are not repeated in this Sixth Report.

#### **C. FUTURE LEASE SURRENDER TRANSACTIONS AND LEASE TRANSFER TRANSACTIONS**

14. Following the motion heard on October 13, 2017, counsel for certain landlords raised concerns that Sears Canada’s store leases remained subject to continued marketing following the SISP bid deadline of August 31<sup>st</sup>. Counsel to these landlords requested clarification on the timing of termination of the marketing of these store leases.
15. The Applicants are in discussions with counsel to the landlords and an update will be provided on this matter at the hearing scheduled for October 27, 2017.

#### **D. ADDITIONAL PROPERTY SALE TRANSACTION**

16. On October 4, 2017, Sears Canada entered into an Agreement of Purchase and Sale with Serruya Private Equity Inc. (“**Serruya**”), for the sale of the property (the “**Newmarket Home Property**”) currently used as a Sears Canada Home Store adjacent to Upper Canada Mall in Newmarket, Ontario (the “**Original Newmarket Agreement**”).
17. The terms of the Original Newmarket Agreement are substantially similar to the template Property Sale Transaction terms described in the Monitor’s Third Report. Modifications to the template transaction terms included:<sup>1</sup>
  - (a) If the transaction is not completed for any reason, other than a default by the Purchaser, the full amount of the deposit delivered on signing of the Original Newmarket Agreement would be returned to the Purchaser;

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<sup>1</sup> Capitalized terms not defined in this section of the Sixth Report have the meaning ascribed to them in the Original Newmarket Agreement. This summary is for general information purposes only. In the case of any conflict between this summary and the terms of the Original Newmarket Agreement or the Second Newmarket Agreement, the terms of those agreements will govern.

- (b) If, during the period between execution of the Original Newmarket Agreement and closing of the transaction, the Subject Assets are damaged by fire or other hazard, and such damage exceeds 10% of the Purchase Price, the Purchaser may elect to not close the transaction.
- (c) If the transaction is not completed as a result of a default by Sears Canada, the Purchaser shall be entitled to a reimbursement of its reasonable out of pocket expenses incurred following execution of the Original Newmarket Agreement, up to a maximum of \$25,000.
- (d) The agreement provides for a post-closing access period of up to 15 weeks to allow Sears Canada, or its agents, to access the property for the purpose of liquidating and removing remaining inventory and FF&E, consistent with the template transaction terms. However, Sears Canada will be required to pay an occupancy fee of \$15,000 monthly, commencing on the fifth week of the post-closing access period, and will pay all utilities. Sears Canada will also be required to maintain, at its sole cost and expense, a policy of commercial general liability insurance covering any and all liability of Sears Canada or the Purchaser with liability limits of not less than \$10,000,000.
- (e) Sears Canada will ensure that certain restoration steps are taken at the property, at Sears Canada's cost, to repair any material damage to the property arising from the removal of inventory, FF&E and other excluded assets from the property during the post-closing access period.
- (f) Sears Canada agrees that certain Remaining Fixtures, being fixtures that could not be removed without material damage or destruction to the Property will remain on the Property and will not be sold as part of the liquidation sale.
- (g) A right to a Termination Fee is provided to Serruya in certain circumstances described in greater detail below.
- (h) Sears Canada would have the right, no later than the 10<sup>th</sup> day prior to the Closing Date to elect to enter into a leaseback transaction for the property. This



was seen as a beneficial feature when a going concern transaction was still a possible outcome of the SISP. However, it is not expected that there would be any reason at this time for Sears Canada to make the election to enter into such a leaseback transaction.

- (i) The Purchaser may, prior to closing, elect to acquire title insurance with respect to the Subject Assets at its sole cost and expense.
18. As described in greater detail in the Newmarket Wong Affidavit, the Newmarket Home Property is the subject of an Operating Agreement between, among others Sears Canada and CPPIB Upper Canada Mall Inc. and Oxford Properties Retail Holdings II Inc. (the “**Mall Owners**”), being the owners of the Upper Canada Mall adjacent to the Newmarket Home Property. That operating agreement includes a right of first refusal in favour of the Mall Owners on any transaction for the sale of the Newmarket Home Property (the “**Newmarket Home ROFR**”).
19. As a result of the Newmarket Home ROFR, the Original Newmarket Agreement contained certain provisions requiring that:
  - (a) Sears Canada provide notice to the Mall Owners of the proposed sale of the Newmarket Home Property to determine if the Mall Owners wished to exercise the Newmarket Home ROFR and purchase the Newmarket Home Property on the same terms and conditions contained in the Original Newmarket Agreement; and
  - (b) if the Mall Owners did exercise the Newmarket Home ROFR, Serruya would be entitled to a Termination Fee equal to approximately 8% of the purchase price under the Original Newmarket Agreement.
20. Following entry of Sears Canada into the Original Newmarket Agreement, Sears Canada provided notice to the Mall Owners as described above. The Mall Owners had 15 days to provide notice to Sears Canada if they elected to exercise the Newmarket Home ROFR.

21. On October 19, 2017, and within the time periods required under the Newmarket Home ROFR, the Mall Owners exercised the Newmarket Home ROFR and an agreement of purchase and sale between Sears Canada and the Mall Owners (the “**Second Newmarket Agreement**”) was entered into on terms substantially the same as the terms of the Original Newmarket Agreement with Serruya. Under the Second Newmarket Agreement, the Mall Owners effectively stepped into the position of Serruya as purchaser of the Newmarket Home Property.
22. Under the terms of the Original Newmarket Agreement, Serruya is entitled to the Termination Fee described above.
23. Sears Canada now seeks approval for:
  - (a) its entry into and completion of the transactions under the Second Newmarket Agreement;
  - (b) payment of the Termination Fee in accordance with the Original Newmarket Agreement; and
  - (c) distribution of the net proceeds of the Second Newmarket Agreement to the DIP Term Lenders.
24. Information on the financial terms of the Second Newmarket Agreement and information on bids for the Newmarket Home Property are set out in Confidential Appendix “A” to this Sixth Report.

*Monitor’s Recommendation*

25. Based upon the considerations set out in the Third Report, as well as the fact that the Second Newmarket Agreement provides the highest or otherwise best available recovery from this asset, the Monitor supports the Applicants’ request for approval of the transaction contemplated by the Second Newmarket Agreement.
26. While appraisals are not necessarily determinative of market value and contain certain assumptions not consistent with the current circumstances, the Monitor notes that the

proposed purchase price under the Original Newmarket Agreement and the Second Newmarket Agreement is very near the appraised value as shown in the property appraisal attached hereto as Confidential Appendix “B”.

27. The Monitor supports the Applicants’ request for approval to pay the Termination Fee to Serruya as:
- (a) Serruya was only willing to enter into the Original Newmarket Agreement if the Termination Fee was a feature of that agreement, as Serruya was aware that its bid would be delivered to the Mall Owners and there was a significant risk that its bid could be matched;
  - (b) the amount of the Termination Fee was arrived at through good faith negotiation between Serruya and the Sale Advisor;
  - (c) due to the existence of the Newmarket ROFR, it is unlikely that a party other than the Mall Owners would have engaged in significant due diligence and negotiation to arrive at an executable transaction respecting the ROFR rights that would maximize value to the Applicants without a Termination Fee, as all bidders would know that their bids would serve only to set the price that may ultimately be matched by the Mall Owners;
  - (d) the Original Newmarket Agreement served a useful purpose in the circumstances as it maximized the price that would be paid by the Mall Owners for the Newmarket Home Property;
  - (e) the Monitor notes that the Termination Fee in this case is, on a percentage basis, at the high end of the range of break fees observed in other CCAA transactions. However, the Monitor believes that there are important distinctions between the current case and a traditional break fee scenario. First, the beneficiary of the break fee will generally have an opportunity to submit a further bid for the subject asset, whereas in this case no such opportunity is provided. Second, the value of the asset sold in this case is significantly lower than the value in other precedent transactions that are often sales of entire going concern businesses.

On a dollar-value basis, the Termination Fee in this case is significantly lower than break fees observed on other transactions; and

- (f) even after accounting for the cost of the Termination Fee, the net proceeds of this transaction remain within reasonable proximity to the appraised value of the Newmarket Home Property and remain the highest recovery available for the Newmarket Home Property based upon the results of the SISP.

28. The Monitor also supports the Applicants' request to distribute the net proceeds of the transaction to the DIP Term Lenders. As of October 19, 2017, all obligations under the DIP ABL Credit Agreement were repaid or, in the case of outstanding letters of credit, cash collateralized through proceeds of the initial guarantee payment under the Second Liquidation Agreement. As of October 19, 2017, approximately CDN \$42.6 million remained unpaid under the DIP Term Credit Agreement. Pursuant to the Initial Order, the DIP Term Lenders were granted a court-ordered charge over all of the assets, undertakings and properties of the Applicants (the "**DIP Term Charge**"). The DIP Term Charge has priority over all other encumbrances on the Applicants' assets other than the Administration Charge, the KERP Priority Charge and the Directors' Priority Charge (in each case as defined in the Initial Order). The DIP Term Credit Agreement provides that the net proceeds of dispositions, such as the sale of the Newmarket Home Property, shall be applied promptly, and in any event no later than three business days after receipt thereof, to prepay obligations under the DIP Term Credit Agreement.

29. Confidential Appendix "A" and Confidential Appendix "B" to this Sixth Report contain commercially sensitive information, including information on the bids received for the Newmarket Home Property and the purchase price for the Newmarket Home Property. The public disclosure of this information would be harmful to the integrity of the SISP, including if the Newmarket Home Property needed to be subject to a further marketing process. The Monitor supports the Applicants' request for an order that Confidential Appendices "A" and "B" to this Sixth Report be kept confidential and not form part of the public record pending further order of the Court.

The Monitor respectfully submits to the Court this, its Sixth Report.

Dated this 25<sup>th</sup> day of October, 2017.

FTI Consulting Canada Inc.  
in its capacity as Monitor of  
Sears Canada Inc. and the other corporations in the Sears Canada Group

A handwritten signature in black ink that reads "Paul Bishop". The signature is written in a cursive style with a large initial "P".

Paul Bishop  
Senior Managing Director

A handwritten signature in blue ink that reads "Greg Watson". The signature is written in a cursive style with a large initial "G".

Greg Watson  
Senior Managing Director

**CONFIDENTIAL APPENDIX "A"**  
**BID SUMMARY**

**CONFIDENTIAL APPENDIX "B"**  
**APPRAISAL**

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

Court File No. CV-17-11846-00CL

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF SEARS CANADA  
INC., *et al.*

**ONTARIO  
SUPERIOR COURT OF JUSTICE  
COMMERCIAL LIST**

Proceeding commenced at TORONTO

**SIXTH REPORT TO THE COURT  
SUBMITTED BY FTI CONSULTING CANADA INC.,  
IN ITS CAPACITY AS MONITOR**

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