

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

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

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

**October 17, 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

**FIFTH 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**” or the “**Company**”) and a number of its operating subsidiaries (collectively with Sears Canada, the “**Sears Canada Group**”) 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 ABL and the DIP Term Credit Agreements and access funds available under the facilities provided by the lenders under these agreements (collectively, the “**DIP Lenders**”); 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 (the “**Employee Representative Counsel**”) for the non-unionized active and former employees of the Sears Canada Group (“**Employee Group**”);
  - (c) an order setting out the terms of the appointment of Koskie Minsky LLP as representative counsel (the “**Pension and Retiree 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 Group**”);
  - (d) an order authorizing the eventual suspension of special payments under the Sears Canada Inc. Registered Retirement 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 (the “**Superintendent**”), 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 Sears Canada Group.
4. On July 18, 2017, the Court issued a Liquidation Sale Approval Order, which approved (i) a process for the liquidation of inventory, furniture, fixtures and equipment (“**FF&E**”) at locations scheduled for closure (the “**First Liquidation Process**”); and (ii) in connection with the First Liquidation Process, an Amended and Restated Agency Agreement and a Consulting Agreement between Sears Canada and the agent and consultant described therein.
5. 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 Sears Canada Group, including:
- (a) the businesses carried on by two subsidiaries of Sears Canada namely Corbeil Électrique Inc. and SLH Transport Inc.;
  - (b) sales of owned real estate;
  - (c) transfers of leases to new tenants; and
  - (d) surrenders of leases to landlords.
6. On October 13, 2017, the Court issued, amongst other orders, an Order extending the stay of proceedings to January 22, 2018 and an Order (i) approving the liquidation of inventory and FF&E at all remaining Sears Canada stores (the “**Second Liquidation Process**”); and (ii) in connection with the Second Liquidation Process, an Amended and Restated Agency Agreement (the “**Second Agency Agreement**”) between Sears Canada and the agent described therein (the “**Agent**”).

7. The purpose of this fifth report of the Monitor (the “**Fifth Report**”) is to provide the Court with (i) information with respect to the Superintendent’s decision to appoint Morneau Shepell as replacement administrator in respect of Sears Canada’s pension plan, and (ii) the Monitor’s comments and recommendations regarding the Sears Canada Group’s motion returnable October 17, 2017 (the “**October 17 Motion**”) seeking to approve an amended key employee retention plan (the “**Amended KERP**”) in respect of management and staff employees of Sears Canada whose services will be required by Sears Canada during, and in certain cases, following, the Second Liquidation Process.

**B. TERMS OF REFERENCE**

8. In preparing this Fifth 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**”).
9. Except as otherwise described in this Fifth 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 Fifth Report in a manner that would comply with the procedures described in the *Chartered Professional Accountants of Canada Handbook*.
10. Future-oriented financial information reported in or relied on in preparing this Fifth Report is based on Management’s assumptions regarding future events. Actual results will vary from these forecasts and such variations may be material.
11. The Monitor has prepared this Fifth Report in connection with the October 17 Motion. The Fifth Report should not be relied on for any other purpose.

12. Unless otherwise stated, all monetary amounts contained herein are expressed in Canadian Dollars.
13. Defined terms used herein that are not defined have the meanings ascribed to such terms in the Initial Order.

**C. APPOINTMENT OF REPLACEMENT ADMINISTRATOR FOR THE PENSION PLAN**

14. In light of the Second Liquidation Process, the Superintendent notified the Company and the Monitor of its intention to appoint Morneau Shepell as the replacement administrator for the Sears Canada Inc. Registered Retirement Plan, in accordance with its powers to do so under the *Pension Benefits Act*. FSCO advised the Company and the Monitor of its intention to issue, on October 17, 2017, an announcement regarding the appointment, which is intended to take effect immediately. The Monitor understands that the date and details of the eventual wind-up of the plan are still to be determined.
15. Counsel to the Term DIP Lenders has advised the Monitor that, in its view, the appointment of a replacement administrator is a default under the DIP Term Credit Agreement. The Monitor will report to this Court at a later date on this matter and the impact, if any, on the Company's borrowing arrangements.

**D. REQUEST FOR APPROVAL OF THE AMENDED KERP**

16. At the outset of the CCAA Proceedings, this Court issued the Initial Order approving, amongst other things, a key employee retention plan in connection with certain store and head office management and executive employees (the "**Initial KERP**"). The salient features of the Initial KERP were described in the Company's application record in respect of the Initial Order as well as in the Monitor's pre-filing report dated June 22, 2017 (the "**Pre-Filing Report**"). The relevant extract of the Pre-Filing Report is attached as **Appendix "A"** hereto.
17. As indicated in the Pre-Filing Report, the Monitor was consulted in connection with the Initial KERP. The Initial KERP was intended to create incentives for certain key employees to remain with the Sears Canada Group through the CCAA Proceedings, to

perform effectively as measured by specific key performance indicators, and to attempt to achieve a going concern outcome for the business. In addition, the Initial KERP incentivized key employees to help facilitate a successful liquidation of the then closing stores and an orderly exit from these premises.

18. The maximum cost of the Initial KERP was estimated at \$9.2 million and, pursuant to the Initial Order, the entitlement of the beneficiaries of the Initial KERP to receive payments pursuant to the Initial KERP were secured by Court-ordered charges namely, the KERP Priority Charge and the KERP Subordinated Charge.
19. As at the date of this Fifth Report, Sears Canada has made payments totalling approximately \$3.5 million under the Initial KERP. Additional amounts to a maximum of approximately \$1.7 million have been, or will shortly be, earned and paid in the near term.
20. In a number of cases, additional payments under the Initial KERP will not be made either because the beneficiaries have left the Company's employment before such payments were earned, or because payments are based on individual key performance indicators that cannot be met in light of the Second Liquidation Process.
21. In the circumstances, Sears Canada, in consultation with the Monitor, has determined that it is appropriate to amend the Initial KERP and re-allocate approximately \$2.8 million of the unpaid amount thereunder to management and staff employees of Sears Canada whose services will be required during the Second Liquidation Process and wind-down of the estate of Sears Canada. The material terms of the Amended KERP are contained in **Confidential Appendix "B"** to this Fifth Report.
22. There are 36 proposed beneficiaries of the Amended KERP. The Monitor understands that Sears Canada has identified these proposed beneficiaries based on the functions they perform in various of the Company's departments that will continue to have a central role in connection with the Second Liquidation Process and the winding-down of the Sears Canada Group.



23. The maximum cost of the Amended KERP is estimated at \$2,760,560 and payments are contemplated to be made on the earlier of (i) March 31, 2018, or in the case of certain head office executives, April 30, 2018, or (ii) termination without cause.
24. The payments contemplated by the Amended KERP are proposed to be secured by the Subordinated KERP Charge.
25. 20 of the 36 proposed Amended KERP beneficiaries are beneficiaries under the Initial KERP. Out of these 20 employees, 18 are in a position to earn and receive additional payments under the Initial KERP. The Monitor understands that Sears Canada will ask these beneficiaries to waive any remaining entitlement under the Initial KERP in order to obtain the benefit of the Amended KERP. Should Initial KERP beneficiaries decide not to waive their entitlement under the Initial KERP, they will retain any entitlement they have under the Initial KERP but will not receive any benefit under the Amended KERP.
26. The Monitor is of the view that each of the Amended KERP participants performs a role critical to implementing the Second Liquidation Process, assisting with the maximization of the remaining assets of the Sears Canada Group, and/or eventually winding-up the estate of the Sears Canada Group.
27. The Monitor notes that the Second Agency Agreement provides for the possible payment of retention bonuses by the Agent to store employees. The Monitor understands that for this reason, the Amended KERP does not contemplate payments to store level employees.

Monitor's Recommendation

28. The Monitor supports the Sears Canada Group's request for approval of the Amended KERP including for the following reasons:
  - (a) the Second Liquidation Process is scheduled to begin on October 19, 2017 and contemplates the liquidation of all of Sears Canada's remaining inventory and FF&E and the closure of all of its remaining stores. In such circumstances, it is reasonable for Sears Canada to anticipate that, in the absence of appropriate

incentives, many of its remaining employees will be seeking alternative employment in the near term;

- (b) the SISP and several transactions in connection therewith are still being pursued, with a view to maximizing value for the benefit of the stakeholders as a whole and Sears Canada requires the support of certain key employees to complete the SISP and the related transactions. Sears Canada also requires certain key employees in connection with the Second Liquidation Process and the eventual wind-up of the estate;
- (c) the Amended KERP will be funded out of unpaid funds under the Court-approved Initial KERP and will result in aggregate KERP payments being less than originally approved by the Court; and
- (d) in reaching its decision, the Monitor has consulted extensively with and taken into account the views of financial advisors to each of the DIP Lenders, FSCO, the Employee Group and the Pension and Retiree Group. The Monitor was advised by counsel to these parties that they were not opposing the terms of the Amended KERP.

## **E. CONCLUSION**

- 29. For the reasons stated above, the Monitor supports the Sears Canada Group's request for an order approving the Amended KERP and granting the Amended KERP the benefit of the Subordinated KERP Charge.

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

Dated this 17th 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 and is centered on a light yellow rectangular background.

Paul Bishop  
Senior Managing Director

A handwritten signature in blue ink that reads "Greg Watson". The signature is written in a cursive style and is centered on a light yellow rectangular background.

Greg Watson  
Senior Managing Director

## APPENDIX “A”

### EXTRACT FROM THE PRE-FILING REPORT

(starting at page 28)

#### “M. KERP AND KERP CHARGE

90. The Proposed Monitor was also involved in the development of the KERP, which is intended to create incentives for certain key employees to remain with the Sears Canada Group through the CCAA Proceedings to perform effectively, as measured by specific key performance indicators, and to achieve a going concern outcome for the business. In addition, the KERP incentivizes key employees to help facilitate a successful liquidation of the Closing Stores (as defined below) and an orderly exit from the premises. A summary of the terms of the KERP is attached as Confidential Appendix “B” to this Pre-Filing Report.

91. The KERP covers 159 employees (the “KERP Participants”), 43 of whom are employed as executives and senior management at Sears Canada’s head office, and 116 of whom who are employed in various roles as store general managers, assistant store managers, operations managers, merchandising specialists, and loss prevention personnel at the Closing Stores. The Proposed Monitor understands that each of the KERP Participants performs a role critical to implementing the Sears Canada Group’s restructuring goals and is unlikely to be replaced on a timely basis or at a reasonable cost.

92. The estimated maximum cost of the KERP is approximately \$9.2 million, of which approximately \$7.6 million relates to head office participants and approximately \$1.6 million corresponds to Closing Store managers. The Proposed Initial Order therefore provides for a KERP Charge in the amount of \$9.2 million to secure the Sears Canada Group’s obligations to the KERP Participants. The priority of the KERP Charge is proposed to be bifurcated with \$4.6 million ranking only behind the Administration Charge and the FA Charge, and the balance of \$4.6 million ranking behind the DIP Lenders’ Charges.

#### Executives and Senior Management

93. The proposed payment structure of the KERP is intended to incentivize executives and members of senior management to achieve a going concern transaction and to remain in their employment until the earlier of:

- (a) the completion of a successful restructuring plan, whether through a recapitalization or a sale of all or part of the Sears Canada Group’s business (a “Successful Restructuring”);
- (b) the termination of the CCAA Proceedings; or
- (c) the termination of the individual’s employment without cause.

94. The aggregate KERP entitlement varies between 25% and 100% of each executive and senior management’s 2017 base salary, and is earned and payable in tranches:

- (a) First Tranche: a payment equal to 25% of the executive or senior manager’s aggregate entitlement is earned and payable on the earlier of (i) a Successful

Restructuring and (ii) 45 days after the commencement of the CCAA Proceedings, provided in each case that the employee remains employed at that time. To the extent that an employee, other than one of the eight senior executives mentioned below, is terminated without cause before one of the events described in (i) or (ii), that employee's First Tranche payment will be prorated for the number of days he or she was employed between the filing date and day 45 of the CCAA Proceedings.

In the case of nine senior executives of Sears Canada, payment of the First Tranche is earned and fully payable without pro-ration on the filing date and will be paid on the earlier of (i) a Successful Restructuring, (ii) 45 days after the commencement of the CCAA Proceedings, or (iii) the termination of their employment without cause.

- (b) Second Tranche: a second payment equal to 25% of the executive or senior manager's aggregate entitlement is earned upon the earlier of (i) a Successful Restructuring, and (ii) 90 days after the commencement of the CCAA Proceedings, provided in each case that the employee remains employed at that time. To the extent an employee is terminated without cause before one of the events described in (i) and (ii), the Second Tranche payment will be prorated for the number of days he or she was employed between day 45 and day 90 after the filing date.
- (c) Third Tranche
  - (i) Interim Payment (not applicable to eight senior executives (collectively, the "Senior Executives")): a payment equal to 25% of the executive or senior manager's aggregate entitlement is earned upon the earlier of (i) a Successful Restructuring, and (ii) 180 days after the commencement of the CCAA Proceedings, provided in each case that the employee remains employed at that time. To the extent an employee is terminated without cause before one of the events described in (i) and (ii), the Third Tranche payment will be prorated for the number of days he or she was employed between day 90 and day 180 after the filing date.
  - (ii) Final Payment: (A) the remaining 25% of the executive or senior manager's (excluding the Senior Executives) aggregate entitlement is only earned upon (x) the completion of a Successful Restructuring, and (y) the successful completion of key performance indicators described in the KERP, provided in each case that the employee remains employed at that time; and (B) in respect the remaining 50% for the Senior Executives' entitlement is only earned upon a Successful Restructuring, the achievement of which is to be determined by the Board of Directors, provided that the employee remains employed at that time.

### Closing Store Managers

95. In the case of Closing Store managers, the proposed KERP is intended to incentivize the KERP Participants to remain employed by Sears Canada until their stores are closed.

96. KERP Participants at the store level will be entitled to 25% of their 2017 base salary, which will be earned upon the closure of the Closing Store provided a certain realization rate (liquidation proceeds minus expenses) is achieved. Realization rates will vary depending on the Closing Store.

97. The terms of the proposed KERP and the quantum of the KERP Charge are reasonable both in the circumstances and when compared to other key employee retention plans approved by this Court in the past. The Proposed Monitor accordingly supports the granting of the KERP Charge.”

**CONFIDENTIAL APPENDIX "B"**

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., *et al.*

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

**ONTARIO  
SUPERIOR COURT OF JUSTICE  
COMMERCIAL LIST**

Proceeding commenced at TORONTO

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

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