

**Court File No. CV-19-00614629-00CL**

**PAYLESS SHOESOURCE CANADA INC. and  
PAYLESS SHOESOURCE CANADA GP INC.**

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

**October 16, 2019**

**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  
PAYLESS SHOESOURCE CANADA INC. AND PAYLESS SHOESOURCE CANADA  
GP INC.**

(the "**Applicants**")

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

**A. INTRODUCTION**

1. On February 18, 2019, Payless Holdings LLC and certain of its subsidiaries and affiliates (collectively, the "**Debtors**") commenced cases (collectively, the "**U.S. Proceedings**") under Chapter 11 of Title 11 of the United States Bankruptcy Code in the United States Bankruptcy Court for the Eastern District of Missouri (the "**U.S. Court**").
2. On February 19, 2019, Payless ShoeSource Canada Inc. ("**PSSC**") and Payless ShoeSource Canada GP Inc. (collectively, the "**Applicants**"), which are debtors in the U.S. Proceedings, sought and obtained an initial order (the "**Initial Order**") under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended (the "**CCAA**"). The benefits, protections, authorizations and restrictions of the Initial Order were also extended to Payless ShoeSource Canada LP ("**Payless Canada LP**", and together with the Applicants, the "**Payless Canada Entities**", and together with the Debtors, the "**Payless Group**"). The proceedings commenced under the CCAA by the Payless Canada Entities are referred to herein as the "**CCAA Proceedings**".
3. The Initial Order, among other things:

- (a) appointed FTI Consulting Canada Inc. ("**FTI**") as monitor of the Payless Canada Entities (in such capacity, the "**Monitor**") in the CCAA Proceedings;
  - (b) granted a stay of proceedings (the "**Stay of Proceedings**") against the Payless Canada Entities until and including March 21, 2019;
  - (c) approved the engagement of Ankura Consulting Group, LLC ("**Ankura**") as Chief Restructuring Organization of the Payless Canada Entities; and
  - (d) approved a cross-border protocol.
4. On February 21, 2019, this Court granted an order approving a liquidation consulting agreement dated February 12, 2019 (the "**Liquidation Consulting Agreement**") between the Debtors (including the Payless Canada Entities) and a contractual joint venture comprised of Great American Group, LLC and Tiger Capital Group, LLC (together, the "**Consultant**"). Pursuant to the Liquidation Consulting Agreement, the Debtors engaged the Consultant to advise the Debtors with respect to the liquidation of inventory and certain fixtures at the stores identified in the Liquidation Consulting Agreement.
5. On March 20, 2019, this Court granted an Order granting the Payless Canada Entities an extension of the Stay of Proceedings until and including June 7, 2019 and approving the Pre-Filing Report, the First Report, the Second Report and the activities of the Proposed Monitor and the Monitor, as applicable.
6. On April 24, 2019, this Court granted an Order (the "**Claims Procedure Order**") approving a claims procedure to solicit and identify (but not resolve) certain claims against the Payless Canada Entities (the "**Claims**").
7. Also on April 24, 2019, this Court granted an Order (the "**Amended Cash Flow Order**") that, *inter alia*, approved the Third Report and authorized the Payless Canada Entities to transfer funds to the U.S. Debtors, subject to the existing security interest of the Term Loan Lenders, (a) materially consistent with the Cash Flow Statement (as defined in the Amended Cash Flow Order), (b) in such amounts as may be determined by the Payless Canada Entities with the prior written consent of the Monitor, or (c) as otherwise ordered by the Court.

8. On June 4, 2019, this Court granted an Order (the "**Second Stay Extension Order**") granting the Payless Canada Entities an extension of the Stay of Proceedings until and including September 20, 2019 and approving the Fourth Report and the activities of the Monitor. The Second Stay Extension Order also approved the fees and disbursements of the Monitor for the period from February 19, 2019 to May 19, 2019, and of counsel to the Monitor for the period from February 19, 2019 to May 17, 2019.
9. On September 17, 2019, this Court granted an Order (the "**Third Stay Extension Order**"), *inter alia*:
  - (a) granting the Payless Canada Entities an extension of the Stay of Proceedings until and including December 20, 2019;
  - (b) lifting the Stay of Proceedings, to the extent necessary, for the limited purpose of allowing the Payless Canada Entities to apply to the U.S. Court to dismiss the Payless Canada Entities' U.S. Proceedings;
  - (c) ordering that all references to Cash Flow Statement in the Initial order shall mean the cash flow statement attached to the Fifth Report;
  - (d) approving the fees and disbursements of the Monitor for the period from May 20, 2019 to August 31, 2019, and of counsel to the Monitor for the period from May 18, 2019 to August 31, 2019; and
  - (e) approving the Fifth Report and the activities of the Monitor.
10. On September 17, 2019, the Monitor filed a Supplement to the Fifth Report (the "**Supplemental Report**") which provided a summary of the CCAA Plan (as defined below). A copy of the Supplemental Report is attached hereto as Appendix "A".
11. On September 19, 2019, this Court granted an Order (the "**Meetings Order**"), *inter alia*, accepting the filing of the Payless Canada Entities' proposed plan of compromise and arrangement dated September 17, 2019 (as may be amended in accordance with the terms thereof, the "**CCAA Plan**") and authorizing the convening of the meetings of creditors to consider and vote on the CCAA Plan (the "**Creditors' Meetings**").

**B. PURPOSE**

12. The purpose of this Sixth Report of the Monitor (the "**Sixth Report**") is to provide the Court with the Monitor's comments and recommendation regarding the CCAA Plan, the First Amended CCAA Plan (as defined below) and the Plan Supplement (as defined below).

**C. TERMS OF REFERENCE**

13. In preparing the Sixth Report, the Monitor has relied upon audited and unaudited financial information provided by the Debtors, including their books and records, financial information, forecasts and analysis, in addition to discussions with various parties, including senior management ("**Management**") of, and advisors to, the Payless Canada Entities, the other Debtors, and Ankura (collectively, the "**Information**").
14. Except as otherwise described in the 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 the Sixth Report in a manner that would comply with the procedures described in the Chartered Professional Accountants of Canada Handbook.
15. Future-oriented financial information reported in or relied on in preparing the Sixth Report is based on Management's and Ankura's assumptions regarding future events. Actual results will vary from these forecasts and such variations may be material.
16. The Monitor has prepared the Sixth Report in connection with the Creditors' Meetings. The Sixth Report should not be relied on for any other purpose.
17. Unless otherwise stated, all monetary amounts contained herein are expressed in Canadian Dollars.

18. Capitalized terms not otherwise defined herein have the meanings ascribed to them in the First Amended CCAA Plan or the Plan Supplement, as applicable.

**D. NOTICE OF CREDITORS' MEETINGS AND SANCTION MOTION**

19. The Information Package and the Notice of the Creditors' Meetings and Sanction Motion were provided in accordance with the provisions of the Meetings Order as follows:
- (a) On September 24, 2019, the Monitor sent copies of the Information Package in English to all Eligible Voting Creditors;
  - (b) On September 30, 2019, the Monitor sent copies of the Notice of Creditors' Meetings and Sanction Motion in French to all Quebec employees;
  - (c) *The Globe and Mail* (National Edition) ran the Notice of Creditors' Meetings and Sanction Motion on September 26, 2019 and September 27, 2019;
  - (d) *La Presse* ran the Notice of Creditors' Meetings and Sanction Motion in French on September 28, 2019 and September 30, 2019;
  - (e) On September 19, 2019, the Monitor posted an electronic copy of the Information Package, inclusive of the Notice of Creditors' Meetings and Sanction Motion, on the Monitor's Website; and
  - (f) On September 20, 2019, Monitor's counsel sent a copy of the Information Package to the Service List.

**E. U.S. PROCEEDINGS DISMISSAL MOTION**

20. As noted above, pursuant to the Third Stay Extension Order, the Court lifted the Stay of Proceedings, to the extent necessary, for the limited purpose of allowing the Payless Canada Entities to apply to the U.S. Court to dismiss the Payless Canada Entities' U.S. Proceedings.
21. On or about October 2, 2019, the Payless Canada Entities filed a motion in the U.S. Proceedings seeking entry of an order pursuant to 11 U.S.C § 1112(b) dismissing the U.S. Proceedings as against the Payless Canada Entities upon the implementation of the U.S. Plan. The motion is currently scheduled to be heard on October 23, 2019 at 10:00 am

(Central Time), which is the same time that confirmation is scheduled to be sought in respect of the U.S. Plan.

## F. THE CCAA PLAN AND THE PLAN SUPPLEMENT

### (i) *The CCAA Plan and the First Amended CCAA Plan*

22. As discussed in the Supplemental Report, the Monitor had input into the development of the CCAA Plan, reviewed it, and was of the view that it was appropriate and reasonable in the circumstances. Additional details in respect of the CCAA Plan are contained in the Supplemental Report.
23. On October 16, 2019, the Payless Canada Entities served on the Service List the First Amended and Restated CCAA Plan (the "**First Amended CCAA Plan**").
24. The First Amended CCAA Plan contemplates the appointment of FTI as receiver (in such capacity, the "**Receiver**") pursuant to a Receivership Order in respect of Payless Canada LP over a certain limited pool of funds. If the Receivership Order is granted, \$100 and all Employee Distributions (as defined in the First Amended CCAA Plan) will be directed to the Receiver instead of being distributed to the former employees. As Payless Canada LP was the employer of all employees for the benefit of the Payless Canada Entities, the receivership will have the effect of triggering the Wage Earner Protection Program (the "**WEPP**") pursuant to the *Wage Earner Protection Program Act*, S.C. 2005, c.47, s.1 ("**WEPPA**"), which will result in a better recovery for all former employees of Payless Canada LP who are Affected Creditors.
25. Former employees who would not be eligible for payments under the WEPP will not be included in the receivership process and will receive their distributions as General Unsecured Creditors.<sup>1</sup> The fees of the Receiver and its counsel in connection with administering the WEPP will be paid from the receivership property.

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<sup>1</sup> Pursuant to section 6 of WEPPA, an individual is not eligible to receive a payment in respect of any wages earned during, or that otherwise relate to, a period in which the individual (a) was an officer or director of the former employer; (b) had a controlling interest within the meaning of the regulations in the business of the former employer; (c) occupied a managerial position within the meaning of the regulations with the former employer; or (d) was not dealing at arm's length with (i) an officer or director of the former employer, (ii) a person who had a controlling interest within the meaning of the regulations in the business of the former employer, or (iii) an individual who occupied a managerial position within the meaning of the regulations with the former employer.

26. If the Receivership Order is not granted, the Employee Distributions will be made directly to employees in the same manner as distributions to other General Unsecured Creditors. The granting of the Receivership Order is not a condition to implementation of the First Amended CCAA Plan.
27. The Monitor is of the view that the appointment of a Receiver is just in the circumstances. Should the Receivership Order be granted, the employees will be able to access the WEPP benefits, resulting in a greater recovery for the applicable former employees of the Payless Canada Entities. The Monitor has started to engage in discussions with Service Canada and the WEPP, Policy and Oversight office, in respect of the proposed administration of the WEPP.
28. The Monitor is not aware of any creditor that will be prejudiced by the receivership or the amendments contained in the First Amended CCAA Plan. The Monitor also notes that the amendments contained in the First Amended CCAA Plan were made in accordance with the provisions of the Meetings Order and the CCAA Plan.

(ii) *Preferences and Transfers at Undervalue*

29. Section 36.1 of the CCAA provides that Sections 95 to 101 of the *Bankruptcy and Insolvency Act* (the "**BIA**") apply to proceedings under the CCAA. Pursuant to these sections, a Court may, on application by the Monitor under the CCAA, declare preference transactions and transfers at undervalue (collectively, a "**Preference Transaction**") to be void as against the Monitor or, in the case of transfers at undervalue, order any party to (or privy to) the transfer to pay the difference in value between the consideration received by the debtor and the value given by the debtor.
30. The Monitor notes that pursuant to the Fifth Amended Joint Plan of Reorganization of Payless Holdings LLC and its Debtor Affiliates pursuant to Chapter 11 of the Bankruptcy Code dated July 21, 2017 (the "**2017 U.S. Plan**"), which was confirmed by the U.S. Court and recognized by this Court as part of the Payless Group's prior restructuring, all of the then-debtors (which included the Payless Canada Entities) waived all rights to commence



or otherwise pursue any and all Avoidance Actions<sup>2</sup>, and such Avoidance Actions were released on plan implementation.

31. Taking into consideration the foregoing, during the course of the CCAA Proceedings, the Monitor has analyzed and considered the Payless Canada Entities' financial statements for the periods following the implementation of the 2017 U.S. Plan and has not identified any variances that indicate a material Preference Transaction occurred. Based on the foregoing, the Monitor is of the view that it is reasonable to include that sections 36.1 and 95 to 101 of the BIA do not apply in respect of the First Amended CCAA Plan.

(iii) *The Plan Supplement*

32. As contemplated by the Meetings Order, on October 16, 2019, the Payless Canada Entities served the Plan Supplement (the "**Plan Supplement**") on the Service List. The Monitor understands that the Plan Supplement is acceptable to the Supporting Term Loan Lenders.
33. The Plan Supplement, as contemplated by the Meetings Order, the CCAA Plan and the First Amended CCAA Plan, contains the following schedules:
  - (a) Schedule A – Transaction Steps (including treatment of Intercompany Claims) ("**Schedule A**"); and
  - (b) Schedule B – Reserves ("**Schedule B**").
34. The implementation of the First Amended CCAA Plan is conditional on the U.S. Plan becoming effective. The U.S. Plan contemplates that (i) for no consideration, Payless Finance Inc. ("**Finance**") will cancel the intercompany note in the amount of approximately US\$114 million (including principal and interest) owed by Finance to PSSC, and (ii) PSS Canada, Inc. ("**PCI**"), an entity incorporated in the United States and a Debtor in the U.S. Proceedings, will repay Payless Canada LP the Post-Filing Intercompany Loans (including accumulated interest thereon) in full in the amount of approximately US\$15.6 million. Following the effective date of the U.S. Plan, certain holders of the Tranche A-2 Term

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<sup>2</sup> Pursuant to the 2017 U.S. Plan, Avoidance Actions means "any and all claims and causes of action which any of the Debtors, the debtors in possession, the Estates, or other appropriate party in interest has asserted or may assert under sections 502, 510, 542, 545, or 547 through 553 of the Bankruptcy Code or under similar or related state or federal statutes and common law, including fraudulent transfer laws."

Loan Secured Claims (as defined in the U.S. Plan) will own 100% of the equity in reorganized Payless Holdings LLC.

35. Schedule A of the Plan Supplement contemplates that, at the Effective Time, the following events or transactions will occur, or be deemed to have occurred and be taken and effected in five minute increments (unless otherwise indicated), in the order provided below (or in such other manner or order, or at such other time or times, as the Payless Canada Entities may determine in consultation with the Monitor):
- (a) The Payless Canada Entities shall fund the Reserves and the Affected Creditor Distribution Account in accordance with the First Amended CCAA Plan;
  - (b) The Monitor, on behalf of the Payless Canada Entities, shall pay any Priority Claims from the Priority Claim Reserve Account as required by the CCAA and in accordance with the First Amended CCAA Plan;
  - (c) The Administration Charge and Directors' Charge shall continue and shall attach solely to the Administration Reserve and the Directors' Claim Reserve, respectively, from and after the Implementation Date pursuant to and in accordance with the proposed Sanction Order;
  - (d) Landlords shall be entitled to the treatment as set out in section 4.2 of the First Amended CCAA Plan;
  - (e) General Unsecured Creditors shall be entitled to the treatment as set out in sections 4.1, 4.7 and 6.2(b) of the First Amended CCAA Plan;
  - (f) The compromises with the General Unsecured Creditors and the Landlords and the release of the Released Parties shall become effective in accordance with section 4.7 and Article 8 of the First Amended CCAA Plan and as otherwise set forth in the proposed Sanction Order;
  - (g) The Intercompany Claims will be dealt with as follows:
    - i. Payless Canada LP will pay proceeds of the Post-Filing Intercompany Loans (including accumulated interest) received from PCI to Payless

ShoeSource Distribution, Inc. ("PSSD") in partial satisfaction of the principal amounts owing from Payless Canada LP to PSSD;

- ii. Payless Canada LP will repay to PSSD in partial satisfaction of the principal amounts owing from Payless Canada LP to PSSD, the available cash remaining after provision for the Reserves (which remaining cash is estimated to be approximately \$2.1 million); and
- iii. PSSC will cancel the existing note (including accumulated interest thereon) payable to Collective Brands II Cooperatief UA.

36. Schedule B of the Plan Supplement contemplates that the Reserves provided for in the First Amended CCAA Plan be set out in the following amounts:

- (a) Administrative Reserve - \$1,065,150.00 (less amounts paid for October 2019);
- (b) Directors' Claim Reserve - \$2,000,000.00;
- (c) Post-Filing Claims Reserve - \$908,402.00; and
- (d) Priority Claim Reserve - \$0.00.

37. The Monitor is of the view that the Plan Supplement is appropriate and reasonable in the circumstances. Among other things, the Monitor is satisfied with the quantum of Reserves having considered many factors, including the Claims filed, the provisions of the CCAA and the Initial Order, and the work still to be done to implement the First Amended CCAA Plan and complete the CCAA Proceedings. The Plan Supplement is acceptable to the Monitor.

#### **G. THE MONITOR'S ASSESSMENT OF THE FIRST AMENDED CCAA PLAN**

38. The First Amended CCAA Plan is a plan of compromise and arrangement covering all of the Payless Canada Entities. The First Amended CCAA Plan is conditional upon and subject to all conditions being satisfied in the U.S. Plan. It is intended that the First Amended CCAA Plan will be implemented immediately after the U.S. Plan in the U.S. Proceedings. The First Amended CCAA Plan and the U.S. Plan are intended to affect a coordinated restructuring of all the Payless Group.

39. As described in the Supplemental Report, the Monitor is of the view that the unsecured creditors of the Payless Canada Entities are similarly situated to the Class 5B General Unsecured Creditors in the U.S. Proceedings, and as such should be treated equitably with the Class 5B General Unsecured Creditors. For the reasons set out in the Supplemental Report, the Monitor is satisfied that the unsecured creditors of the Payless Canada Entities are in fact being treated equitably with the similarly situated Class 5B General Unsecured Creditors under the U.S. Plan.

(i) *Classification of Creditors*

40. As described in the Supplemental Report, the CCAA Plan provides for two (2) classes of voting creditors, the General Unsecured Creditor class and the Landlord class, as follows:

- (a) each General Unsecured Creditor in the General Unsecured Creditor class with a Proven Claim will receive a distribution in an amount equal to its *pro rata* share of the General Unsecured Pool, which is estimated to be a recovery of approximately 3.2% of its Proven Claim, subject to further reconciliation and finalization of Claims;
- (b) each Landlord will receive the lesser of:
  - i. \$3,840.00 per Lease (provided that if there are multiple Landlords per Lease, only one payment of \$3,840.00 shall be made); and
  - ii. The amount asserted in the Landlord's Notice of Dispute of Claim Statement or Proof of Claim, or if no Notice of Dispute of Claim Statement or Proof of Claim was filed, the amount in the Landlord's Claim Statement.

The First Amended CCAA Plan contains no changes in this regard.

41. With respect to the classification of creditors, Section 22 of the CCAA provides as follows:

“22(1) A debtor company may divide its creditors into classes for the purpose of a meeting to be held under section 4 or 5 in respect of a compromise or arrangement relating to the company and, if it does so, it is to apply to the court for approval of the division before the meeting is held.

(2) For the purpose of subsection (1), creditors may be included in the same class if their interests or rights are sufficiently similar to give them a commonality of interest, taking into account:

(a) the nature of the debts, liabilities or obligations giving rise to their claims;

(b) the nature and rank of any security in respect of their claims;

(c) the remedies available to the creditors in the absence of the compromise or arrangement being sanctioned, and the extent to which the creditors would recover their claims by exercising those remedies; and

(d) any further criteria, consistent with those set out in paragraphs (a) to (c), that are prescribed.”

42. The Monitor has considered the factors set out in section 22(2) of the CCAA and is of the view that the classification of creditors under the First Amended CCAA Plan is fair and appropriate in the circumstances. The Monitor also notes that the classification of creditors was previously approved without any opposition pursuant to the Meetings Order.

*(ii) Compliance with Statutory Requirements*

43. A plan of compromise or arrangement can only be sanctioned by the Court if, among other things, it complies with all statutory requirements.

44. Section 5.1(1) of the CCAA permits the compromise of claims against directors of a debtor company; however, section 5.1(2) of the CCAA contains certain exceptions. Section 8.1(d) of the First Amended CCAA Plan contains the statutory exceptions required by the CCAA in respect of the releases in favour of the directors of the Payless Canada Entities.

45. Section 6(3) of the CCAA requires that a plan provide for the payment in full of certain Crown claims within six (6) months of the plan being sanctioned. The First Amended CCAA Plan provides that the Crown Priority Claims will be paid in full within six (6) months after the Sanction Order, as required by section 6(3) of the CCAA.

46. Section 6(5) of the CCAA requires that a plan provide for payment immediately after sanction of certain amounts owing to employees and former employees. The First

Amended CCAA Plan provides that all Employee Priority Claims, to the extent unpaid, shall be paid.

47. The First Amended CCAA Plan provides for the creation of the Priority Claim Reserve, to be funded in cash by the Payless Canada Entities on the Implementation Date, from which Crown Priority Claims or Employee Priority Claims will be paid. It is noteworthy, however, that the Priority Claim Reserve is contemplated to be nil as the Payless Canada Entities and the Monitor are not aware of any Crown Priority Claims or Employee Priority Claims.
48. Section 6(6) of the CCAA requires that a plan provide for payment of certain unpaid amounts relating to pension plans. The Payless Canada Entities have advised the Monitor that they do not participate in a prescribed pension plan, and accordingly it is not necessary for the First Amended CCAA Plan to provide for the payment of amounts of the type required to be paid pursuant to section 6(6) of the CCAA.
49. Pursuant to section 6(8) of the CCAA, a plan that provides for payment of an equity claim (as that term is defined in the CCAA) may not be sanctioned by the Court unless all non-equity claims are paid in full. The First Amended CCAA Plan does not contemplate the payment of any such claims.
50. Pursuant to section 19(2) of the CCAA, a plan may not purport to compromise any claim that relates to the debts or liabilities described in section 19(2) unless the plan explicitly provides for the compromise of such claim and the creditor holding the claim votes in favour of the plan. No claims of the type described in section 19(2) were asserted against the Payless Canada Entities pursuant to the Claims Procedure Order.
51. Based on the foregoing, the Monitor is not aware of any aspect of the First Amended CCAA Plan that is not in compliance with statutory requirements.

(iii) *Alternatives to the First Amended CCAA Plan*

52. In arriving at its recommendation, the Monitor has considered possible alternatives to the First Amended CCAA Plan.

53. As the Monitor has previously reported on, the Term Loan Lenders have valid security over substantially all of the Payless Canada Entities, and as a result, there is a lack of available alternatives.
54. If the First Amended CCAA Plan were not to be implemented, the Term Loan Lenders would be entitled to all of the funds currently held by the Payless Canada Entities, and no distributions would be made in respect of any other Claims, except that former employees could recover under WEPPA if there were to be a bankruptcy.
55. However, a bankruptcy for one or more of the Payless Canada Entities would require, among other things, the approval of the Court and sufficient financing for the proceeding to satisfy a trustee in bankruptcy. Accordingly, it is not certain that bankruptcy is even a viable alternative in the circumstances.
56. The Monitor is of the view that the stakeholders of the Payless Canada Entities, taken as whole, will derive a greater benefit under the First Amended CCAA Plan when compared to any potential alternative, including a bankruptcy.

*(iv) The Releases and Related Matters*

57. As described above, section 5.1(2) of the CCAA prohibits the release of certain claims against directors. While the contemplated releases do not release the Directors to the extent that any Claim cannot be released under the CCAA, the First Amended CCAA Plan and the proposed Sanction Order provide for a permanent injunction for actions in respect of Director/Officer Claims, other than Excluded Director/Officer Claims, against any party other than the provider of the Insurance Policies (as defined in the proposed Sanction Order) and limits recovery for valid Director/Officer Claims solely to the proceeds of the Insurance Policies..
58. As further detailed in the Supplemental Report, the CCAA Plan contemplates a number of broad releases of the Payless Canada Entities, the Term Loan Agent, the Term Loan Lenders and the Monitor and each of their respective directors, officers, agents, professionals and certain other parties. The First Amended CCAA Plan contains no changes in this regard. The Monitor has reviewed the releases and believes that they are

fair and reasonable in the circumstances. Specifically, the Monitor notes that the releases do not release:

- (a) the Payless Canada Entities and their respective assets, undertaking and properties from any Unaffected Claim that has not been paid in full under the First Amended CCAA Plan or the Plan Supplement to the extent of such non-payment;
- (b) a Released Party from its obligations under the First Amended CCAA Plan or the Plan Supplement;
- (c) subject to provisions in the First Amended CCAA Plan pertaining to insurance, a Released Party found by a court of competent jurisdiction by final determination on the merits to have committed fraud or willful misconduct in relation to a Released Claim for which it is responsible at law; or
- (d) subject to provisions in the First Amended CCAA Plan pertaining to insurance, the Directors from any Claims which have been preserved in accordance with the Claims Procedure Order that cannot be compromised due to the provisions of Section 5.1(2) of the CCAA. To the extent not released, the proposed Sanction Order will limit recovery for such claims against the Directors to available insurance.

## **H. CONCLUSION**

59. The only realistic alternative to the First Amended CCAA Plan is the possibility of a bankruptcy. For the reasons stated above, a bankruptcy is not a foregone conclusion in the event the First Amended CCAA Plan is not approved. If the First Amended CCAA Plan is not approved and there is no bankruptcy, the Term Loan Lenders would be entitled to all available funds in the estate, and unsecured creditors would not be entitled to a distribution resulting in no recovery in respect of their Claims. If the First Amended CCAA Plan is not approved and there is a bankruptcy, only the former employees who are now unsecured creditors would likely see a recovery on their claims through the implementation of WEPP, and the other unsecured creditors would not be entitled to a distribution. In the Monitor's view, the First Amended CCAA Plan provides the best alternative and recovery to the Payless Canada Entities' unsecured creditors.



60. Accordingly, the Monitor recommends that Creditors vote in favour of the First Amended CCAA Plan at the Creditors' Meetings.

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

Dated this 16<sup>th</sup> day of October, 2019.

FTI Consulting Canada Inc.,

solely in its capacity as Monitor of Payless ShoeSource Canada Inc.,  
Payless ShoeSource Canada GP Inc. and Payless ShoeSource Canada LP,  
and not in its personal capacity



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Greg Watson  
Senior Managing Director



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Paul Bishop  
Senior Managing Director

**APPENDIX "A"**

**[ATTACHED]**

**Court File No. CV-19-00614629-00CL**

**PAYLESS SHOESOURCE CANADA INC. and  
PAYLESS SHOESOURCE CANADA GP INC.**

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

**September 17, 2019**

**ONTARIO  
SUPERIOR COURT OF JUSTICE  
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**IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*,  
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**AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF  
PAYLESS SHOESOURCE CANADA INC. AND PAYLESS SHOESOURCE CANADA  
GP INC.**

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

**A. INTRODUCTION**

1. On September 12, 2019, the Monitor filed its Fifth Report to the Court (the "**Fifth Report**") in relation to the relief sought by the Payless Canada Entities at a hearing scheduled for September 17, 2019. The Fifth Report noted that the Monitor intended to file a supplemental report to summarize and comment on the proposed CCAA Plan. This is that supplemental report (the "**Supplemental Report**").

**B. PURPOSE**

2. The purpose of this Supplemental Report is to provide the Court with the Monitor's comments and/or recommendations regarding:
  - (a) an update in respect the Second Amended U.S. Plan (as defined below); and
  - (b) the Payless Canada Entities' Plan of Compromise and Arrangement (the "**CCAA Plan**") dated September 17, 2019.

**C. TERMS OF REFERENCE**

3. In preparing this Supplemental Report, the Monitor has relied upon audited and unaudited financial information provided by the Debtors, including their books and records, financial information, forecasts and analysis, in addition to discussions with various parties,

including senior management ("**Management**") of, and advisors to, the Payless Canada Entities, the other Debtors, and Ankura (collectively, the "**Information**").

4. Except as otherwise described in the Supplemental 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 the Supplemental Report in a manner that would comply with the procedures described in the Chartered Professional Accountants of Canada Handbook.
5. Future-oriented financial information reported in or relied on in preparing the Supplemental Report is based on Management's and Ankura's assumptions regarding future events. Actual results will vary from these forecasts and such variations may be material.
6. The Monitor has prepared this Supplemental Report in connection with certain relief originally sought in connection with the September 17 Motion and now scheduled to be heard on September 19, 2019 at 9:15am. The Supplemental Report should not be relied on for any other purpose.
7. Unless otherwise stated, all monetary amounts contained herein are expressed in Canadian Dollars.
8. Capitalized terms not otherwise defined herein have the meanings ascribed to them in the Frankum Affidavit (as defined in the Fifth Report), the Marotta Affidavit (as defined below), the Meetings Order, the Pre-Filing Report, the First Report, the Second Report, the Third Report, the Fourth Report and/or the Fifth Report, as applicable.

**D. UPDATE IN RESPECT OF THE SECOND AMENDED U.S. PLAN**

9. As described in the Affidavit of Stephen Marotta sworn September 17, 2019 (the "**Marotta Affidavit**"), the Monitor understands that the U.S. Debtors have further amended the U.S. Plan and the U.S. Disclosure Statement (the "**Second Amended U.S. Plan**" and the "**Second Amended Disclosure Statement**", respectively). Copies of the Second Amended U.S. Plan and Second Amended U.S. Disclosure Statement are included as Exhibit "B" and Exhibit "C", respectively, to the Marotta Affidavit.
10. The Marotta Affidavit also attaches an information memorandum (the "**Information Memorandum**") which is intended to provide creditors of the Payless Canada Entities with a summary regarding the CCAA Proceedings and the Chapter 11 Proceedings and the impact of the Second Amended U.S. Plan on the CCAA Plan and creditors of the Payless Canada Entities. The Information Memorandum is included as Exhibit "D" to the Marotta Affidavit.
11. As described in more detail in the Marotta Affidavit, the Monitor understands that the Second Amended U.S. Plan provides for distributions to stakeholders as follows:
  - (a) Administrative Claims (post-filing claims entitled to priority under U.S. law), Other Priority Claims (claims entitled to priority) and Other Secured Claims (mostly, claims secured by cash deposits or letters of credit), will be paid in full in cash.
  - (b) Term Loan Lenders holding Tranche A-1 Term Loan Secured Claims will receive their *pro rata* share of US\$68,800,000 in cash (an increase of approximately US\$1.8 million from the prior version filed) and will waive any distributions in respect of related deficiency claims.
  - (c) Term Loan Lenders holding Tranche A-2 Term Loan Secured Claims can elect to receive their *pro rata* share of common ownership units in the reorganized Payless Holdings LLC, or cash in the amount of 10% of their allowed tranche A-2 claims, and in either case, will waive any distributions in respect of related deficiency claims.

- (d) General Unsecured Creditor recovery has been revised to reflect the global settlement with the Official Committee of Unsecured Creditors including:
    - i. General Unsecured Creditors of Payless ShoeSource Worldwide, Inc. and Collective Brands Logistics Limited (Class 5A) ("**Class 5A General Unsecured Creditors**") will receive their *pro rata* share of US\$8.4 million, plus certain unused amounts currently designated for professional fees; and
    - ii. General Unsecured Creditors of all other U.S. Debtors (Class 5B) ("**Class 5B General Unsecured Creditors**"), will receive their *pro rata* share of US\$5.1 million, plus certain unused amounts currently designated for professional fees (less the Canadian GUC Amount of US\$900,000);
  - (e) Intercompany claims will be reinstated or cancelled as determined by the U.S. Debtors and the Requisite Plan Support Parties, and with respect to the Payless Canada Entities, with the consent of the Payless Canada Entities;
  - (f) Intercompany equity interests will be reinstated or cancelled as determined by the U.S. Debtors and the Requisite Plan Support Parties; and
  - (g) Equity interests in Payless Holdings LLC will be cancelled for no consideration.
12. The fixed amount for distribution to the general unsecured creditors of the Payless Canada Entities is US\$900,000 (being referred to as the "**Canadian GUC Amount**"), which the Monitor understands will be converted to Canadian dollars in the amount of \$1,183,500.00 (using the exchange rate of 1.315).
13. The Payless Canada Entities, as guarantors, are indebted to the Term Loan Lenders in the aggregate amount of US\$277.2 million as of the Filing Date under and in respect of the Terms Loan Credit Facility. The Monitor has received an opinion from its independent counsel that, subject to the typical assumptions and qualifications, the security in respect of the Terms Loan Credit Facility is valid and enforceable. Since all, or substantially all, of the Payless Canada Entities' assets are subject to liens of the Terms Loan Lenders (who will not be paid in full), the Canadian GUC Amount is a "gift", which the Terms Loan Lenders advise would not be available in a bankruptcy.

14. The Class 5A General Unsecured Creditors will receive a distribution larger than the Class 5B General Unsecured Creditors because Payless ShoeSource Worldwide, Inc. and Collective Brands Logistics Limited have certain additional unencumbered assets to support a higher distribution to unsecured creditors of those entities.
15. The Monitor is of the view that the unsecured creditors of the Payless Canada Entities are similarly situated to the Class 5B General Unsecured Creditors, and as such should be treated equitably with the Class 5B General Unsecured Creditors.
16. As described in the Marotta Affidavit, the U.S. Debtors and the Payless Canada Entities, with the assistance of the Monitor, compared the total amount of claims asserted in the Chapter 11 Claims Process and in the CCAA Proceedings pursuant to the Claims Procedure Order. Although a formal claims reconciliation process has not yet been undertaken in either jurisdiction, solely for purposes of this analysis:
  - (a) all suspected duplicate claims, including claims filed against the Payless Canada Entities which were properly considered to be filed against the U.S. Debtors, were eliminated;
  - (b) all unliquidated claims were estimated at zero;
  - (c) all intercompany claims were disregarded;
  - (d) the restructuring period claim in respect of each Canadian Lease was calculated under the landlord formula provided for in the United States Bankruptcy Code, which limits landlord claims to the greater of one lease year or 15 percent, not to exceed three years, of the remaining lease term plus any pre-filing amounts owed; and
  - (e) all other claims were assumed allowed in full in the amounts set out in the U.S. schedules, the U.S. proofs of claim, the Claim Statements, the Amended Claim Statements or the Proofs of Claim.
17. Based on this analysis, the U.S. Debtors and the Payless Canada Entities, with the assistance of the Monitor, estimated that the recovery to unsecured creditors of the



applicable U.S. Debtors and the recovery (on a *pro rata* basis) to unsecured creditors of the Payless Canada Entities would be approximately 3.2%, subject to further reconciliation and finalization of Claims.

**E. THE CCAA PLAN**

18. The Monitor had input into the development of the CCAA Plan, has reviewed it, and is of the view that it is appropriate and reasonable for the Payless Canada Entities to seek the approval of the CCAA Plan by affected creditors at this time. A copy of the CCAA Plan is included as Exhibit "A" to the Marotta Affidavit.

Classification of, and Distributions to, Affected Creditors

19. As described in the Fifth Report and the Marotta Affidavit, the CCAA Plan provides for two (2) classes of voting under the CCAA Plan: (i) the General Unsecured Creditor class and (ii) the Landlord class.
20. It is proposed that each General Unsecured Creditor with a Proven Claim will receive a distribution in an amount equal to its *pro rata share* of the General Unsecured Pool. It is estimated that each General Unsecured Creditor will receive a recovery of approximately 3.2% of its Proven Claim subject to further reconciliation and finalization of Claims. With respect to Landlords, the CCAA Plan provides that each Landlord will receive the lesser of:
- (a) \$3,840.00 per Lease (provided that if there are multiple Landlords per Lease, only one payment of \$3,840.00 shall be made); or
  - (b) the amount asserted in the Landlord's Notice of Dispute of Claim Statement or Proof of Claim, or if no Notice of Dispute of Claim Statement or Proof of Claim was filed, then the amount in the Landlord's Claim Statement.
21. A summary of the Claims filed pursuant to the Claims Procedure Order was provided in the Fifth Report. The Landlords are cumulatively the largest unsecured creditor group of the Payless Canada Entities. To date, the Monitor has received 254 Notices of Dispute of Claim Statement from the Landlords. As described in the Marotta Affidavit, because of the

relatively modest pool of funds available for unsecured creditors in Canada and the difficulty in reconciling Landlord Claims, the CCAA Plan proposes a fixed recovery per Landlord Claim. If the Payless Canada Entities and/or the Monitor were required to reconcile each Landlord Claim, including reviewing the specific terms of each relevant lease and the Landlord's efforts to mitigate damages, the Monitor believes that most (if not all) funds that would otherwise be available for distribution to unsecured creditors would be spent on professional fees. Fixing the recovery in respect of Landlord Claims allows the Payless Canada Entities and the Monitor to undertake a much more limited review of such Claims, which in turn, reduces professional costs and returns more value to unsecured creditors. The Monitor believes that this approach is appropriate and reasonable in the unique circumstances of this case, particularly the fixed Canadian GUC Amount available and relatively modest estimated recovery.

22. The Monitor is of the view that the fact that the Claims of Landlords and General Unsecured Creditors are being treated differently (although equitably) under the CCAA Plan justifies two separate voting classes.
23. The Payless Canada Entities and the Monitor arrived at the estimated distribution of \$3,840.00 per Lease by examining the estimated percentage recovery to General Unsecured Creditors and Landlords under various scenarios.
24. The Monitor is of the view that the quantum of the proposed fixed distribution to Landlords is appropriate in the circumstances because:
  - (a) it is subject to reduction if the amount asserted in the Landlord's Notice of Dispute of Claim Statement, or, in the Landlord's Claim Statement if no Notice of Dispute of Claim Statement was filed, is less than \$3,840.00;
  - (b) based on current estimates, it will result in an estimated recovery to General Unsecured Creditors of approximately 3.2% subject to further review and finalization of Claims, which is consistent with the current estimated recovery for Class 5B General Unsecured Creditors under the Second Amended U.S. Plan; and

- (c) subject to any reduction referred to in (a) above, based on current estimates, it will result in a recovery to Landlords of approximately 3.2% based on how their claims would be calculated under the United States Bankruptcy Code, which is consistent with the current estimated recovery for landlords who are Class 5B General Unsecured Creditors.
25. The Monitor recognizes and acknowledges that under the CCAA, Landlord Claims are not to be calculated based on the formula set out in the United States Bankruptcy Code. However, given the unique circumstances of this case, as discussed above, the Monitor believes it is fair and appropriate to consider what Landlords would have received under the United States Bankruptcy Code in determining the appropriate distribution for the Landlords.
26. The Monitor has been very focused on ensuring that unsecured creditors of the Payless Canada Entities are treated equitably with similarly situated unsecured creditors of the U.S. Debtors, and the Monitor believes that has been achieved in the CCAA Plan. The Monitor notes that the Payless Canada Entities are U.S. Debtors and as such, any Canadian GUC Amount contemplated under the CCAA Plan ought to be equivalent to what they would have otherwise received under the U.S. Plan.
27. Pursuant to the terms of the CCAA Plan, no distributions will be made to Landlords or General Unsecured Creditors until documentation in form and content satisfactory to the Payless Canada Entities, the Supporting Term Loan Lenders and the Monitor (the "**Comfort Letter**") is received from the applicable Governmental Entity authorizing the Monitor to make the distributions, disbursements, or payments without any liability to any of the Payless Canada Entities, the Monitor, or each of their respective Directors, Officers, employees or agents in respect of the ITA, *Excise Tax Act*, and any other legislation pertaining to Taxes is received. The CCAA Plan provides that in the event the Comfort Letter is not received by December 31, 2019, the Payless Canada Entities may seek further directions from the Court.
28. The Monitor is of the view that receipt of the Comfort Letter prior to making distributions is necessary in order to eliminate the risk of any potential tax-related liability that could

arise in connection with the distributions to be made to the General Unsecured Creditors and the Landlords.

29. The CCAA Plan provides that further information regarding the treatment of Intercompany Claims will be provided in the Plan Supplement (which is described below).

#### Reserves

30. The CCAA Plan contemplates the creation of certain reserves (collectively, the "**Reserves**") in respect of Priority Claims and Claims that are required to be paid by Court order. In particular, the CCAA Plan provides for:
  - (a) an Administrative Reserve, which will hold the estimated costs of administering the CCAA Plan;
  - (b) a Directors' Claim Reserve, which will hold amounts secured by the Directors' Charge until applicable Claims have been resolved or paid;
  - (c) Priority Claim Reserve, which will hold amounts necessary to pay any Crown Priority Claims or Employee Priority Claims that remain unpaid; and
  - (d) a Post-Filing Claim Reserve, which will include an amount to pay for any unpaid Post-Filing Claims as estimated by the Monitor prior to implementation.
31. The Reserves will be subject to the security of the Term Loan Agent.
32. The CCAA Plan provides that the amount of the Reserves will be set out in the Plan Supplement, which must be acceptable to the Payless Canada Entities, the Monitor and the Supporting Term Loan Lenders.
33. To the extent that a Claim may be payable from more than one Reserve, the Monitor understands that the Payless Canada Entities will only reserve for such Claim once. To the extent that the Payless Canada Entities or the Monitor determine (with the consent of the other party) that there are funds in any Reserve sufficiently in excess of the amount required to fund payments that may be required to be made from such Reserve, the Payless Canada

Entities, with the consent of the Monitor and in consultation with the Term Loan Lenders, may transfer such excess funds to another Reserve.

34. To the extent that the Payless Canada Entities or the Monitor determine, with the consent of the other party, that there are insufficient funds in any Reserve to fund payments that may be required to be made from such Reserve, no excess amounts from any other Reserves will be distributed to the Payless Canada Entities without ensuring that sufficient funds are added to the applicable Reserve.
35. In the event that a dispute arises in respect of the Reserves, the parties to such dispute may seek a further order of the Court.
36. The Monitor intends to report on the Reserves in a further report to Court once they are determined.

#### Releases

37. The CCAA Plan contains broad releases of the Payless Canada Entities, the Term Loan Agent, the Term Loan Lenders and the Monitor, and each of their respective directors, officers, agents, professionals and certain other parties. The Monitor notes that the releases specifically do not release:
  - (a) the Payless Canada Entities and their respective assets, undertaking and properties from any Unaffected Claim that has not been paid in full under the CCAA Plan or the Plan Supplement to the extent of such non-payment;
  - (b) a Released Party (as defined below) from its obligations under the CCAA Plan or the Plan Supplement;
  - (c) subject to provisions in the CCAA Plan pertaining to insurance, a Released Party found by a court of competent jurisdiction by final determination on the merits to have committed fraud or willful misconduct in relation to a Released Claim for which it is responsible at law; or
  - (d) subject to provisions in the CCAA Plan pertaining to insurance, the Directors from any Claims which have been preserved in accordance with the Claims Procedure

Order that cannot be compromised due to the provisions of Section 5.1(2) of the CCAA. To the extent not released, the proposed Sanction Order will limit recovery for such claims against the Directors to available insurance.

38. The breadth and scope of the releases were developed by the Payless Canada Entities with input from the Monitor. The Monitor notes that all of the parties benefiting from the proposed releases under the CCAA Plan (each a "**Released Party**" and collectively, the "**Released Parties**") have played a significant role in the Payless Canada Entities' CCAA Proceedings. The Monitor also understands that the releases being sought by the Payless Canada Entities are critical to the Released Parties' support of the CCAA Plan.

#### Conditions to Implementation of CCAA Plan

39. The Monitor notes that there are a number of conditions to the implementation of the CCAA Plan that must be satisfied or waived, each of which is set out below:
- (a) the CCAA Plan must be approved by the Required Majorities;
  - (b) the Court must grant the Sanction Order, the operation and effect of which must not be stayed, reversed or amended, and in the event of an appeal or application for leave to appeal, final determination must be made by the appellate court;
  - (c) the Reserves and the Affected Creditor Distribution Account must be funded by the Payless Canada Entities;
  - (d) the U.S. Proceedings with respect to the Payless Canada Entities must be dismissed;
  - (e) the U.S. Plan must be effective;
  - (f) the Monitor must receive written confirmation from the Term Loan Agent/Supporting Term Loan Lenders that the Supporting Term Loan Lenders are satisfied with:
    - i. the treatment of the Post-Filing Intercompany Loans,
    - ii. the form and substance of the Plan Supplement; and

- iii. all variations and modifications of, and amendments and supplements to the Plan, the Plan Supplement and the Sanction Order, to and including the Implementation Date; and
  - (g) the Implementation Date must occur no later than the Outside Date.
- 40. The condition in (e) above may not be waived without the consent of the Supporting Term Loan Lenders, and the condition in (f) above may only be waived by the Supporting Term Loan Lenders.

#### Plan Supplement

- 41. The Payless Canada Entities, the Monitor and the Supporting Term Loan Lenders are continuing to consider the technical steps required to implement the CCAA Plan and the most efficient way to distribute funds in respect of the Term Loan Claims outside of the CCAA Plan. The Monitor expects that the determination of such steps will not impact Affected Creditors' recoveries, but will be necessary to quantify the Reserves. Additionally, given that the Term Loan Claims are Unaffected Claims under the CCAA Plan, the determination of such steps will also be necessary to quantify and determine the mechanics in respect of the distributions to be made to the Term Loan Claims outside of the CCAA Plan.
- 42. The proposed Meetings Order contemplates that the Payless Canada Entities file a Plan Supplement no later than five (5) Business Days prior to the Creditors' Meetings (or such other date as may be agreed to by the Monitor) providing such additional information in respect of the CCAA Plan. The Plan Supplement will be served on the Service List and posted on the Monitor's Website.
- 43. The Plan Supplement will be in form and substance acceptable to the Payless Canada Entities, the Monitor and the Supporting Term Loan Lenders.

#### **F. CONCLUSION**

- 44. The Monitor believes that the CCAA Plan should be accepted for filing and should be put out for a vote at the Creditors' Meetings as:

- (a) The CCAA Plan was negotiated at arm's length, in good faith between the Payless Canada Entities and its stakeholders, with significant input and oversight from the Monitor;
  - (b) It is reasonable for the CCAA Plan to be subject to approval by two classes of creditors, being:
    - i. the General Unsecured Creditor class; and
    - ii. the Landlord class;
  - (c) In the Circumstances, the CCAA Plan represents the best possible recovery for Affected Creditors; and
  - (d) The recoveries for General Unsecured Creditors and Landlords are expected to be commensurate with similarly situated creditors of the U.S. Debtors;
45. For the reasons stated in the Fifth Report and this Supplemental Report, the Monitor supports the relief sought by the Payless Canada Entities in connection with the September 17 Motion.

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

Dated this 17<sup>th</sup> day of September, 2019.

FTI Consulting Canada Inc.,  
solely in its capacity as Monitor of Payless ShoeSource Canada Inc.,  
Payless ShoeSource Canada GP Inc. and Payless ShoeSource Canada LP,  
and not in its personal capacity



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Greg Watson  
Senior Managing Director



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Paul Bishop  
Senior Managing Director