

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

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

TWELFTH REPORT OF FTI CONSULTING CANADA INC., AS MONITOR

February 13, 2018

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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., 9370-2751 QUÉBEC INC., 191020 CANADA 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

**TWELFTH 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 “**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, a partnership forming part of the operations of the Applicants (and together with the Applicants, the “**Sears Canada Entities**”). The proceedings commenced under the CCAA by the Applicants 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 Entities (the “**Monitor**”) in the CCAA Proceedings;
 - (b) granted an initial stay of proceedings against the Sears Canada Entities until July 22, 2017; and
 - (c) 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 Entities (“**Employee Representative Counsel**”); and
 - (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 Entities with respect to pension and post-employment benefit matters (“**Pension Representative Counsel**”).
4. Since the date of the Comeback Motion, the stay period has been extended a number of times, most recently to April 27, 2018.
5. On December 8, 2017, the Court issued: (i) an Order (the “**Claims Procedure Order**”) approving a claims process (the “**Claims Process**”) for the identification, determination and adjudication of claims of creditors against the Sears Canada Entities and their current and former officers and directors.
6. The liquidation of assets at Sears Canada’s retail locations is now complete and all of Sears Canada’s retail locations are now closed.

7. In connection with the CCAA Proceedings, the Monitor has provided eleven reports and five supplemental reports (collectively, the “**Prior Reports**”), and prior to its appointment as Monitor, FTI also provided to this Court a pre-filing report of the proposed Monitor dated June 22, 2017 (the “**Pre-Filing Report**”). The Pre-Filing Report, the Prior Reports and other Court-filed documents and notices in these CCAA Proceedings are available on the Monitor’s website at cfcanada.fticonsulting.com/searscanada/ (the “**Monitor’s Website**”).

B. PURPOSE

8. The purpose of this twelfth report of the Monitor (the “**Twelfth Report**”) is to provide the Court with information regarding a Motion by Pension Representative Counsel for the appointment of the Honourable Frank Newbould, Q.C. as Litigation Trustee for the benefit of the creditors of the Sears Canada Entities (the “**Litigation Trustee Motion**”) and the Monitor’s comments and recommendations in connection with this motion.

C. TERMS OF REFERENCE

9. In preparing this Twelfth Report, the Monitor has relied upon the Sears Canada Entities’ books and records, certain financial information prepared by the Sears Canada Entities and discussions and correspondence with, among others, the senior management (“**Management**”) of, and advisors to, the Sears Canada Entities (collectively, the “**Information**”).
10. Except as otherwise described in this Twelfth Report, 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*.
11. The Monitor has prepared this Twelfth Report in connection with the Litigation Trustee Motion. The Twelfth 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. Capitalized terms not otherwise defined herein have the meanings ascribed to them in the affidavits of Mr. Billy Wong, the Chief Financial Officer of Sears Canada, sworn on June 22, 2017, and William Turner, sworn February 12, 2018, and the Prior Reports of the Monitor in these proceedings.

D. PRELIMINARY DISCUSSIONS REGARDING STAKEHOLDER LITIGATION

14. Certain stakeholder groups in these proceedings have had discussions about possible recovery from various litigation options. The Monitor has attended a number of meetings and conference calls to discuss these matters with Employee Representative Counsel, Counsel to the Superintendent of Financial Institutions (the “**Superintendent**”), counsel to Morneau Shepell, as administrator of the Sears Canada Pension Plan (the “**Plan Administrator**”), Pension Representative Counsel and various landlord counsel (collectively, the “**Participating Creditors**”).
15. The Monitor is also aware that, in addition to the Participating Creditors, the general unsecured creditors of the Sears Canada Entities’ (the “**Other Unsecured Creditors**”) have an interest in potential litigation. The amount due to these unsecured may exceed \$500 million.
16. It is expected that there will be significant overlap between the claims that various creditor groups have commenced, or intend to commence, as well as any claims that may be available to the Sears Canada Entities themselves or to the Monitor. The quantum of these potential claims may be significant.
17. The need to coordinate various streams of potential litigation was initially identified by certain Participating Creditors earlier in these proceedings. There was initial support from Participating Creditors for a ‘litigation inspector’ or a ‘litigation trustee’.
18. The Monitor is supportive of efforts toward efficient coordination of future potential litigation in this case, provided that such coordination is effected in a manner that is acceptable to the Participating Creditors, protects the interests of the Other Unsecured

Creditors and is properly coordinated with both the Claims Process and the Employee and Retiree Claims Process that is currently being developed.

19. A litigation inspector/trustee can perform a constructive role in that coordination process. However, the Monitor believes the effectiveness of a litigation inspector/trustee role is directly related to the level of support the litigation inspector/trustee has from stakeholders. In particular, the Monitor believes it is essential to build consensus among stakeholders who may have material litigation claims regarding: (i) the candidate who is appointed; and (ii) the scope of the litigation inspector/trustee's mandate.
20. At this time, there is no consensus on the selection of a litigation inspector/trustee and that lack of consensus has impeded discussions about the appropriate scope of the mandate and other procedural issues inherent in the appointment of any litigation inspector/trustee.
21. In the period leading up to the Litigation Trustee Motion, the Monitor has repeatedly advised the Participating Creditors that, in the Monitor's view, a consensus as to the person appointed and role of the litigation trustee/inspector is most likely to lead to the efficient management of litigation and has on a number of occasions requested that stakeholders work toward agreement on this matter. Most recently on February 6th, the Monitor suggested that a meeting of Participating Creditors be held on February 8th to try to come to agreement on this matter and avoid a disputed hearing. However, certain key parties refused to attend a meeting and at this time the Monitor understands the Litigation Trustee Motion remains a contested matter.

E. LITIGATION TRUSTEE MOTION

22. The Litigation Trustee Motion seeks to appoint the Honourable Frank Newbould, Q.C. as Litigation Trustee for the benefit of the creditors of the Sears Canada Entities.
23. The proposed Litigation Trustee role would be a court officer role that would involve:

- (a) investigating, considering and reporting to the Court and a committee of creditor representatives (the “**Committee**”) regarding the rights and claims that the Sears Canada Entities, or the Litigation Trustee acting on behalf of creditors of the Sears Canada Entities, may have (the “**Litigation Claims**”) as against any parties, including, but not limited to, the current and former directors, officers, shareholders and advisors of any of the Sears Canada Entities (the “**Mandate**”); and
 - (b) if so authorized by further order of the court, acting on behalf of creditors to prosecute any of the foregoing claims.
24. The Litigation Trustee Motion would require the Monitor to provide certain assistance to the Litigation Trustee and disclosure of information from the Monitor’s investigations to the Litigation Trustee and the Committee.
25. The primary preliminary work product of the Litigation Trustee under the Mandate would be a report to be provided by the Litigation Trustee to the Court and to the Committee setting out the Litigation Trustee’s recommendations regarding a proposed litigation plan that includes: (i) the rights and claims of the Sears Canada Entities and potentially creditors who may have claims against third parties that should be pursued; (ii) the proposed steps in pursuing those claims, including coordination of the prosecution of such claims and other similar or related claims that may be asserted by different parties, and a proposed governance structure for an instructing committee for the purposes of providing instructions to the Litigation Trustee in any prosecution of those rights and claims; and (iii) options available for funding of those claims.
26. The Committee with which the Litigation Trustee is to consult would be appointed by or on behalf of Employee Representative Counsel, Pension Representative Counsel, landlords, class action plaintiffs and such other unsecured creditors as the Sears Canada Entities, the Litigation Trustee and the Committee may agree. The Litigation Trustee Motion proposed that a representative of the Monitor would be on the Committee as well.

27. The Litigation Trustee Motion seeks to exclude the Litigation Claims from the Claims Process.
28. The Litigation Trustee would not have a role in determining, advising on, opposing, supporting or articulating any claim of any creditor or stakeholder filed in the Claims Process or for distribution purposes from the estates of the Sears Canada Entities.
29. The Litigation Trustee's reasonable fees and disbursements, including legal counsel fees, would be paid by the Sears Canada Entities subject to a budget to be approved by the Committee prior to commencement of the Mandate. These fees and disbursements would be secured by the Administration Charge under the Initial Order.

F. MONITOR'S OBSERVATIONS AND RECOMMENDATIONS ON THE LITIGATION TRUSTEE MOTION

Identification of Litigation Inspector / Trustee

30. The appointee to the role of litigation inspector/trustee remains the subject of disagreement among stakeholders.
31. The Superintendent and the Plan Administrator have stated they believe that appointing the proposed nominee would create a conflict of interest. In particular, the current nominee is counsel at a law firm that currently represents a potentially significant landlord who is a Participating Creditor. The Superintendent and Plan Administrator note that their interests diverge from those of the landlord group. In these circumstances, the Superintendent and Plan Administrator oppose the appointment of the proposed nominee. Accordingly, the Plan Administrator has suggested a number of alternate nominees for the litigation inspector/trustee role. However, to date no agreement has been reached regarding a candidate.
32. The Monitor has no reason to believe the proposed litigation inspector/trustee would perform the role other than in an impartial manner. The proposed form of order appointing the litigation inspector/trustee does mitigate conflict concerns by ensuring the litigation inspector/trustee's role would not extend to any matters related to any claim of any creditor or stakeholder filed in the Claims Process or any distribution

related matters. However, the Monitor does acknowledge that the potential for a perceived conflict in the circumstances remains. The Monitor itself identified this as a potential issue when the nominee for the litigation inspector/trustee role was first raised.

33. In the Monitor's view, the coordinating role of the litigation inspector/trustee will function most efficiently if all parties holding potential claims and the Monitor are in agreement on the candidate put forward to act in that role. Once an agreement on the candidate is achieved, the specific terms of an appointment order can be considered. It is unclear whether the Litigation Trustee Motion seeks to force any and all potential third party litigation claims to proceed through the litigation inspector/trustee review. Stakeholders wishing to assert claims against third parties are far more likely to work constructively within the litigation inspector/trustee process if they are in full agreement with the appointment of the litigation inspector/trustee. The Monitor is concerned about the workability of an arrangement that affects the rights of non-applicant parties to pursue their claims if that process is not voluntary.
34. The Monitor is supportive of continued efforts to arrive at a consensus.

Mandate of the Litigation Inspector/Trustee

35. The proposed draft order appointing the Litigation Trustee describes a coordination, investigation and reporting role that the Monitor believes would be of assistance to the overall litigation process in this case. The Monitor notes that the Mandate includes the possibility that the Litigation Trustee may report on, provide recommendations on, and investigate claims held by creditors (in addition to any claims of the Sears Canada Entities themselves) against third parties and may, following further court order, take steps to prosecute claims.
36. The Litigation Trustee is contemplated to have a very influential role in connection with creditors' claims and the claims of the Sears Canada Entities. In the Monitor's view, the scope of this Mandate further reinforces the need for consensus among stakeholders regarding the terms of appointment of the litigation inspector/trustee.

Any other option would most likely lead to continued disputes regarding the proper scope of the litigation inspector/trustee's Mandate and any steps taken under that Mandate. The Monitor believes it is reasonable for a holder of a potential material claim against a non-Applicant, whose claim may be the subject of the litigation inspector/trustee process, to require that such process be reasonably acceptable to the claim holder.

The Committee

37. The Committee with which the Litigation Trustee is to consult does not include any parties appointed by or on behalf of the Superintendent or the Plan Administrator. As noted above, these parties have asserted that they have material claims against various parties related to the Sears Canada Pension Plan. The Monitor believes that there would be challenges in developing a properly representative consultation Committee that excludes these parties given the nature and quantum of their respective potential claims.
38. The proposed form of Order provides the Committee with certain approval powers and consultation rights, but does not identify the manner in which decisions on approvals would be made by the Committee. Should the Litigation Trustee Motion be granted, the Monitor believes this decision making process should be clarified.
39. The Monitor believes it should have a consultation role in connection with the Committee based upon the Monitor's position in these proceedings and the potentially overlapping litigation claims the Monitor may have. However, the Monitor would propose that it not be a member of the Committee, as the Monitor has no direct interest in the claims that may be asserted by members of the Committee.

Monitor Claims

40. The Monitor notes that the proposed draft order suggests the Litigation Trustee may pursue "Monitor Claims", defined in the Claims Procedure Order as: "a Claim, including a D&O Claim and any claim pursued in accordance with Section 36.1 of the CCAA, that may be asserted by the Monitor."

41. The Monitor does not believe the Monitor Claims should be the subject of a litigation inspector/trustee mandate, other than insofar as it is important that the steps the Monitor may take in connection with any Monitor Claims should be coordinated with the steps that are taken in claims that are covered by the litigation inspector/trustee's mandate.
42. In the event the Monitor determines not to pursue any Monitor Claims that other creditors believe should be pursued, stakeholders wishing to pursue such claims would have rights under Section 38 of the Bankruptcy and Insolvency Act (Canada) and Section 36.1 of the CCAA.

Information Sharing

43. The Monitor would in all circumstances cooperate with the litigation inspector/trustee in performing his mandate. However, the Monitor cannot consent at this time to an Order, as proposed by Pension Representative Counsel, that would require the Monitor to disclose and deliver to the Litigation Trustee or the Committee all of the results of the Monitor's investigations and research on the 'Transactions of Interest'. These investigations and this research were undertaken by the Monitor for very specific purposes in fulfilling the Monitor's statutory mandate, and information was shared by the Sears Canada Entities and others with the Monitor for those specific purposes and on specific understandings regarding the uses of such information. The Monitor does not believe it is appropriate at this time to require the Monitor to share all such information, much of which may be subject to confidentiality and privilege concerns, with third parties.
44. The Monitor also notes that the proposed Order requires the cooperation of the Sears Canada Entities and "all persons acting on behalf of the Sears Canada Entities", which could include parties that may have reasonable concerns about the extent of such required cooperation to the extent they may be defendants in future litigation pursued by the litigation inspector/trustee.

Monitor's Recommendation

45. The Monitor believes that, prior to advancing the Litigation Trustee Motion, further efforts should be made among stakeholders to arrive at a consensus on the above issues, specifically:
- (a) the selected litigation inspector/trustee;
 - (b) the scope of the Mandate, and in particular the types of claims that will be investigated, reported upon and potentially pursued, including whether this will extend to claims that individual creditors or creditor groups may have and how the litigation inspector/trustee claims interact with the Claims Process and the Employee and Retiree Claims Process. At the initial stage, the Monitor believes consensus could more likely be achieved by establishing a more limited investigation role that could be expanded if appropriate at a later date;
 - (c) the composition of the Committee and the exact process by which the Committee will grant approvals and make recommendations; and
 - (d) appropriate funding mechanisms for the litigation inspector/trustee and its counsel.
46. Once these matters are resolved, the Monitor can then work with the litigation inspector/trustee, the Committee, the Sears Canada Entities and other interested parties to establish a protocol for cooperation and sharing of information regarding litigation matters.
47. The Monitor believes there are benefits to the creation of a structure to coordinate litigation in this case and has no objection to the concept of a litigation inspector/trustee. However, the Monitor does not believe that this is a process that will function optimally if it is forced upon stakeholders without their agreement. The Monitor notes that while the parties who are supportive of the Litigation Trustee Motion are a substantial creditor group, there are other large creditor groups who at this time either appear to be non-supportive of, or not actively involved in, this motion.

48. The Monitor understands that discussions on the proposed form of order are ongoing among certain Participating Creditors. The Monitor notes that there are several issues that the parties would need to work through before an agreed form of Order could be presented to the Court for consideration.

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

Dated this 13th day of February, 2018.

FTI Consulting Canada Inc.
in its capacity as Monitor of
the Sears Canada Entities

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

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

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

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