

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

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

SECOND REPORT OF FTI CONSULTING CANADA INC., AS MONITOR

August 16, 2017

Contents

Section	Page
A. INTRODUCTION.....	3
B. TERMS OF REFERENCE.....	6
C. THE ACTIVITIES OF THE SEARS CANADA GROUP AND THE MONITOR	7
SISP Process	7
Suppliers	8
Licensees and Consignees.....	8
Landlords	8
Construction Lien Claimants	9
DIP Lenders	9
Employees.....	10
KERP	10
Disclaimers of Contracts.....	11
Other Activities of the Monitor.....	11
D. UPDATE ON THE LIQUIDATION PROCESS	12
E. CONSTRUCTIVE TRUST CLAIMS.....	13
F. PENSION MATTERS	13
G. CLASS ACTION MATTERS.....	14
H. CONSTRUCTION LIEN MATTERS	14

I.	RECEIPTS AND DISBURSEMENTS FOR THE FIVE-WEEK PERIOD ENDING AUGUST 5, 2017	15
J.	EMPLOYEE HARDSHIP FUND.....	18
	Monitor’s Recommendation	20
K.	WINNIPEG GARDEN CITY: REQUEST FOR APPROVAL AND VESTING ORDER...20	
	The Garden City Property	21
	The Sale Process	22
	The APA	23
	Monitor’s Comments on the Sale Process and APA.....	24
	Reasonableness of the Process Leading to the Garden City Transaction	26
	Comparison to Sale in Bankruptcy	27
	Consultations with Creditors.....	27
	Effect of the Garden City Transaction on Creditors and Other Interested Parties.....	28
	Fairness of the Consideration.....	28
	Distribution	29
	Sealing Order	29
	Monitor’s Recommendation	30

**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

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

A. INTRODUCTION

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

- (a) appointed FTI Consulting Canada Inc. as monitor of the Sears Canada Group (the “**Monitor**”) in the CCAA Proceedings;
 - (b) granted an initial stay of proceedings against the Sears Canada Group until July 22, 2017;
 - (c) authorized the Sears Canada Group to enter into the DIP Facilities; and
 - (d) scheduled a comeback motion for July 13, 2017 (the “**Comeback Motion**”).
3. Following the Comeback Motion, the Court extended the stay of proceedings to October 4, 2017. In addition, the following orders were issued:
 - (a) the amended and restated Initial Order;
 - (b) an order setting out the terms of the appointment of Ursel Phillips Fellows Hopkinson LLP as representative counsel for the non-unionized active and former employees of the Sears Canada Group (“**Employee Representative Counsel**”);
 - (c) an order setting out the terms of the appointment of Koskie Minsky LLP as representative counsel to the non-unionized retirees and non-unionized active and former employees of the Sears Canada Group with respect to pension and post-employment benefit matters (“**Pension and Retiree Representative Counsel**”);
 - (d) an order authorizing the eventual suspension of special payments under the Sears Canada Pension Plan, certain payments in connection with supplemental pension plans and certain payments under post-retirement benefit plans; and
 - (e) an order approving a sale and investor solicitation process (the “**SISP**”) to solicit interest in potential transactions, including investment proposals, involving the business, property, assets and/or leases of the Applicants (the “**SISP Approval Order**”).
4. On July 18, 2017, the Court issued a Liquidation Sale Approval Order, which approved
 - (i) a process for the liquidation of inventory and furniture, fixtures and equipment at 59

locations scheduled for closure (the “**Liquidation Process**”); and (ii) in connection with that Liquidation Process, an Amended and Restated Agency Agreement and a Consulting Agreement between Sears Canada and the agent and consultant described therein.

5. The purpose of this second report of the Monitor (the “**Second Report**”) is to provide the Court with updated information and, where appropriate, the Monitor’s comments and recommendations, regarding the following:
- (a) the activities of the Sears Canada Group and the Monitor since July 12, 2017, the date of the Monitor’s First Report;
 - (b) the Liquidation Process;
 - (c) constructive trust claims raised since the commencement of the CCAA Proceedings;
 - (d) pension matters;
 - (e) class action matters;
 - (f) construction lien matters;
 - (g) the receipts and disbursements of the Sears Canada Group for the five-week period ended August 5, 2017;
 - (h) the Employee Representative Counsel’s motion to establish a proposed Employee Hardship Fund (as such term is defined below); and
 - (i) the Sears Canada Group’s motion requesting the approval and vesting order (the “**AVO**”) contemplated in the asset purchase agreement dated April 12, 2017 (the “**Original APA**”), as amended by an amending agreement dated July 28, 2017 (the “**Amendment**”, and together with the Original APA, the “**APA**”) between Sears Canada and WCRE Investments Ltd. (“**WCRE**”)¹, a company related to

¹ The Monitor has been advised that WCRE’s interest in the APA has been assigned to 2311 McPhillips Street Properties Limited Partnership pursuant to an Assignment of Purchase Agreement dated August 14, 2017.

Hungerford Properties Inc., pursuant to which WCRE, will acquire real property owned by Sears Canada and located at the Garden City Shopping Centre in Winnipeg, Manitoba (the “**Garden City Property**”). The proposed AVO would also approve a distribution of proceeds of the sale to the lenders under the DIP Term Loan Agreement (the “**DIP Term Lenders**”).

B. TERMS OF REFERENCE

6. In preparing this Second 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**”).
7. Except as otherwise described in this Second 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 Second Report in a manner that would comply with the procedures described in the *Chartered Professional Accountants of Canada Handbook*.
8. Future-oriented financial information reported in or relied on in preparing this Second Report is based on Management’s assumptions regarding future events. Actual results will vary from these forecasts and such variations may be material.
9. The Monitor has prepared this Second Report in connection with the hearing on August 18, 2017.

References herein to WCRE include, to the extent required, 2311 McPhillips Street Properties Limited Partnership and its nominee and general partner 2311 McPhillips Street Properties GP Ltd.

10. Unless otherwise stated, all monetary amounts contained herein are expressed in Canadian Dollars.
11. 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 (the “**First Wong Affidavit**”), July 5, 2017 (the “**Second Wong Affidavit**”), and July 12, 2017 (the “**Third Wong Affidavit**”), the affidavit of Mr. Stephen Champion, Executive Vice-President, Real Estate and Strategic Opportunities of Sears Canada, affirmed on August 11, 2017 (the “**Champion Affidavit**”) and the APA.

C. THE ACTIVITIES OF THE SEARS CANADA GROUP AND THE MONITOR

12. The activities of the Sears Canada Group and the Monitor since the date of the First Report are summarized below.

SISP Process

13. Following the issuance of the SISP Approval Order, the Sears Canada Group together with its legal counsel and the Sale Advisor have taken steps to implement the SISP. The Monitor and the Special Committee (as defined in the SISP Approval Order) have supervised the implementation of the SISP by the Sears Canada Group and its advisors.
14. In particular, the Monitor has:
 - (a) assisted in the preparation of documentation and information to be made available to participants in the SISP;
 - (b) ensured that appropriate protections were put in place to preserve the integrity and fairness of the SISP, including with respect to senior management’s involvement in the SISP; and
 - (c) participated in various meetings and discussions with SISP participants.
15. Pursuant to the SISP Approval Order, the deadline for potential bidders to submit bids under the SISP is August 31, 2017.

Suppliers

16. Since the date of the First Report, Sears Canada has continued, with the assistance of the Monitor, to liaise with its merchandise and service suppliers to agree on supply terms, including continued shipment of goods from overseas. Where appropriate, Sears Canada and the Monitor continue their efforts to reach agreements with suppliers.
17. In the Monitor's view, the Sears Canada Group has been working diligently and in good faith to address supplier issues as they arise.

Licensees, Concession Operators and Consignees

18. Since the date of the Initial Order, a number of licensees, consignees and concession operators have contacted Sears Canada and the Monitor with respect to amounts they claim are owed by Sears Canada.
19. In certain cases, parties have alleged trust or constructive trust claims. The claims of these parties are discussed in greater detail below.
20. In other cases, parties have approached Sears Canada to discuss the consensual wind-up or the transition of their relationships with Sears Canada. Discussions amongst Sears Canada, the Monitor and these parties continue.
21. In circumstances where Sears Canada collected sales taxes on sales made at concessions, Sears Canada has agreed to remit to its counterparty the funds collected by Sears Canada, so long as the counterparty confirms that the funds will be remitted to the applicable tax authority.

Landlords

22. Pursuant to the SISP Approval Order, the Applicants were directed to, on the request of a holder ("**Holder**") of a Property Agreement (as defined in such Order), advise the Holder by August 4, 2017 if the Applicants intended to take the position that the Holder's right of first refusal (or similar right) was no longer in force.

23. The Applicants received a number of requests from Holders and responded to these requests within the required timeline.
24. The Applicants also received communications from certain landlords relating to the calculation and payment of real property taxes during the post-filing period and, with the assistance of the Monitor and counsel, are considering these requests.
25. Since the date of the First Report, the Applicants, in consultation with the Monitor and the Sale Advisor, have considered the renewal of certain of the Applicants' leases and have taken steps in respect of such renewals that are, in the Monitor's view, consistent with the objectives of the CCAA Proceedings, the SISF and the Applicants' obligations in the circumstances.

Construction Lien Claimants

26. Since the commencement of the CCAA Proceedings, the Applicants, with the assistance of the Monitor, have worked to address various issues in respect of the payment of pre-filing amounts to parties who supplied services in connection with construction work at various Sears 2.0 stores. These dealings are discussed in further detail below.

DIP Lenders

27. The Sears Canada Group, with the assistance of the Monitor, is providing the DIP Lenders with the information and reporting required pursuant to the terms of the agreements governing the DIP Financing (collectively, the "**DIP Credit Agreements**").
28. Since the date of the Comeback Motion, the Applicants have drawn approximately \$160 million of advances under the DIP Credit Agreements. In addition, approximately US\$11.7 million of letters of credit have been issued under the DIP Revolving Credit Agreement.²

² The Sears Canada Group has requested the issuance of further letters of credit under the DIP Revolving Credit Agreement in an aggregate amount of approximately US\$6.3 million.

29. In accordance with the terms of the DIP Credit Agreements, the Sears Canada Group has consulted with, and where required, sought the consent of, the DIP Lenders in respect of various matters arising in the CCAA Proceedings.

Employee Matters

30. The Applicants, with the assistance of the Monitor, have worked with Employee Representative Counsel, Pension and Retiree Representative Counsel, counsel to the Financial Services Commission of Ontario (FSCO), and their respective advisors, to provide these parties with the information that they are entitled to receive pursuant to the terms of a term sheet which was attached as Appendix “A” to the Supplement to the First Report of the Monitor.
31. In addition, the Applicants, with the assistance of the Monitor, have explored with Employee Representative Counsel alternatives that would alleviate the burden of the CCAA proceedings on certain of the Applicants’ terminated head office employees and store associates. These discussions culminated in the creation of the Employee Hardship Fund, which is discussed in detail below.
32. The Monitor understands that, since the commencement of the CCAA Proceedings, a number of management employees have resigned or indicated their intention to resign.
33. On August 15, 2017, the Executive Chairman stepped away from the day-to-day operations of Sears Canada. Becky Penrice, the Executive Vice-President of Sears Canada will lead Sears Canada’s executive team in the interim. A copy of the notice informing employees of these management changes is attached to this report as Appendix “A”.

KERP

34. In accordance with the Initial Order, the Sears Canada Group has implemented the Court-approved KERP. The first payment under the KERP was to be made 45 days following the date of the Initial Order. As such, Sears Canada paid the first instalment of the KERP to the KERP participants on August 8, 2017, other than those instalments that are to be used to fund the Employee Hardship Fund if approved by the Court.

Disclaimers of Contracts

35. The Applicants, with the assistance of the Monitor, are continuing to review their contractual arrangements and identify those that, in the Applicants' view, should be disclaimed. The Applicants have sought and obtained the consent of the Monitor and the DIP Lenders to disclaim seven agreements as of the date of this Report and the Monitor expects that the Applicants will continue to issue disclaimer notices as warranted by the circumstances and subject to approval of the Monitor.

Other Activities of the Monitor

36. The Monitor has also undertaken the following activities:

- (a) monitored the Sears Canada Group's receipts and disbursements including the receipts and disbursements of S.L.H. Transport Inc. and Corbeil Électrique Inc.;
- (b) maintained the current Service List for these CCAA Proceedings and posted regular updates of the Service List to the Monitor's Website;
- (c) with the assistance of the Applicants where appropriate, responded to stakeholders who have contacted the Monitor via the Monitor's hotline or email address;
- (d) worked with Management to review and monitor the Sears Canada Group's ongoing merchandise and purchasing requirements, and related commitments;
- (e) monitored the status of the Sears Canada Group's process to liquidate inventory, fixtures and equipment at stores identified for closure;
- (f) supervised and assisted in activities related to the SISP, and worked with the Special Committee and advisors to ensure that the SISP is conducted in a manner consistent with standards expected of similar processes under the CCAA;
- (g) worked with Representative Counsel and their advisors to respond to questions and provide information to their respective constituents;

- (h) worked with the Sears Canada Group and the DIP Lenders on matters relating to the DIP Financing; and
- (i) worked with the Sears Canada Group to ensure appropriate accounting for pre-filing and post-filing obligations.

D. UPDATE ON THE LIQUIDATION PROCESS

- 37. The Monitor has reviewed the progress of the Liquidation Process on an ongoing basis from the commencement of that process.
- 38. The Monitor has not identified any matters in connection with the Liquidation Process that result in any material concerns.
- 39. Pursuant to the agreements governing the Liquidation Process, the Liquidation Process is scheduled to be completed by October 12, 2017. The Monitor is in regular communication with the Sears Canada Group employees with carriage of the Liquidation Process and is unaware of any issues or other matters that would indicate the process will not be completed on schedule.
- 40. Sears Canada has received notice from the agent in the Liquidation Process that inventory sales will be completed at 15 of the liquidating Home Stores owned by Sears Canada by the first week of September.
- 41. Sears Canada has notified the Monitor of its intention to disclaim the agreements governing dealer arrangements at seven Hometown Dealer Stores that were included in the Liquidation Process. The Monitor has been advised that the target dates for completion of the liquidation sale at these seven Hometown Dealer Stores will occur before the end of August.
- 42. The Liquidation Process at the remaining closing locations continues at this time.

E. CONSTRUCTIVE TRUST CLAIMS

43. Following the issuance of the Initial Order, a number of suppliers to the Sears Canada Group approached the Applicants and the Monitor to express their belief that, in each of their individual circumstances, trust or constructive trust claims arose.
44. The Sears Canada Group reviewed these parties' claims in consultation with the Monitor. While the individual contractual arrangements varied, the Applicants determined in each case that either (i) no trust relationship had arisen; or (ii) no funds had ever been segregated and therefore a constructive trust claim did not arise in the context of the CCAA. The Monitor agreed with these conclusions.
45. One potential claimant has discussed with the Applicants and Monitor the possibility of bringing a motion to address its claims. The Applicants, with the support of the Monitor, proposed that such claims, which in essence relate to creditor priorities, be deferred, if brought at all, until after the conclusion of the SISP. To date, no motion has been scheduled.

F. PENSION MATTERS

46. On August 3, 2017, Pension and Retiree Representative Counsel contacted the Applicants and the Monitor to advise of its intention to bring a motion for a wind-up of the Sears Canada Registered Retirement Plan as of September 30, 2017.³ The Applicants and the Monitor have advised Pension and Retiree Representative Counsel that in their view any motions that were not urgent or the postponement of which would not give rise to further prejudice should be deferred until after the conclusion of the SISP, in order to conserve the resources of the Applicants and the Court.
47. Pension and Retiree Representative Counsel remains of the view that it is necessary to serve the motion to preserve or protect certain statutory remedies but otherwise has been receptive to the Applicants' and Monitor's view. Accordingly, the motion record has

³ This date was subsequently changed to October 1, 2017.

been served but only for the purpose of establishing service and being spoken to at the hearing of August 18, 2017.

G. CLASS ACTION MATTERS

48. Prior to the commencement of these CCAA Proceedings, certain of the Applicants were defendants in a proposed class proceeding commenced in London, Ontario, known as *Kenny v. Sears et al* (Court file No 208/15) and for which a certification motion was scheduled to take place on October 10, 2017.
49. After the commencement of the CCAA Proceedings, counsel for the proposed representative plaintiff served a Motion Record and suggested to the Applicants and the Monitor that the stay of proceedings be lifted to allow for certification, in the event that such a step might be of assistance in a future claims process. Consistent with the approach taken with other non-urgent litigation matters, the Monitor and the Applicants proposed that any motions to lift the stay be delayed until the conclusion of the SISP, in order to allow the Applicants and the Court to focus on asset realization matters. Counsel for the proposed representative plaintiff has advised the certification motion judge of this concern, and counsel for the Applicants and the Monitor have agreed to make themselves available for any case conference requested by the certification motion judge to obtain additional information on these matters.

H. CONSTRUCTION LIEN MATTERS

50. At the time of the Initial Order, the Applicants were conducting renovations at a number of their store locations. Subsequent to the Initial Order, various lien claimants have sought to preserve and perfect their potential rights under applicable construction lien legislation. Approximately 28 construction liens have been filed relating to work performed at 14 store locations and one call centre located in New Brunswick.
51. Several construction lien claimants approached the Applicants and the Monitor on an individual basis seeking to lift the stay to allow for perfection of their liens. The Applicants, with the support of the Monitor, have, on a case by case basis, followed an approach of agreeing to lift the stay for the purpose of issuing (or serving) a claim for

purposes of perfection, in return for confirmation that in so doing the Applicants and the Monitor would not be taken to be agreeing to any further steps moving forward in the proceedings.

52. In addition, a group of lien claimants, being APM Construction Services Inc, 152610 Canada Inc. o/a Laurin Company, Traugott Building Contractors Inc., Décor Craft Inc. o/a Nelnor Construction, and ROSSCLAIR Contractors Inc., all represented by Koskie Minsky LLP, have asserted an intention to bring a motion to lift the stay to commence an action against the officers and directors of Sears Canada alleging, among other things, negligent misrepresentation and oppression.
53. The Monitor has advised these lien claimants of its view that such motions should be delayed until the conclusion of the SISP in order to conserve the resources of the Applicants and the Court for asset realization matters.
54. Notwithstanding this view, the lien claimants have requested a 9:30 or other scheduling attendance for the purpose of addressing their request, and the issue of the scheduling of the motion will be addressed at the Court hearing on August 18, 2017.

I. RECEIPTS AND DISBURSEMENTS FOR THE FIVE-WEEK PERIOD ENDING AUGUST 5, 2017

55. The Sears Canada Group's actual net cash outflow for the five-week period ended August 5, 2017 was approximately \$269.5 million, compared to a forecast net cash outflow of \$321.8 million, resulting in a positive variance of approximately \$52.3 million as indicated in the table below:

VARIANCE REPORT	Actual	Forecast	Variance
(CAD in Millions)	For the 5 Week Period Ending August 5, 2017		
Operating Receipts	215.6	214.0	1.6
Operating Disbursements			
Payroll and Employee Related Costs	(55.9)	(56.9)	1.0
Merchandise Vendors	(75.5)	(85.7)	10.2
Non-Merchandise Vendors	(30.5)	(53.1)	22.6
Rent and Property Taxes	(17.6)	(20.8)	3.2
Sales Taxes	(5.9)	(10.9)	5.0
Pension	(3.7)	(3.7)	-
IT Costs	(7.2)	(12.8)	5.6
Recovery of Expenses from Agent	3.0	5.0	(2.0)
Capital Expenditures	-	(3.4)	3.4
Total Operating Disbursements	(193.3)	(242.3)	49.0
Net Operating Cash Inflows / (Outflows)	22.3	(28.3)	50.6
Professional Fees	(13.2)	(16.6)	3.4
Repayments of Existing Credit Facilities	(273.8)	(271.7)	(2.1)
DIP Fees and Interest Paid	(4.8)	(5.2)	0.4
Net Cash Inflows / (Outflows)	(269.5)	(321.8)	52.3
Cash			
Beginning Balance	160.7	160.7	-
Net Cash Inflows / (Outflows)	(269.5)	(321.8)	52.3
DIP Draws / (Repayments)	160.0	219.6	(59.6)
Others incl. FX Valuation	(2.8)	-	(2.8)
Ending Balance	48.4	58.5	(10.1)

56. Explanations for the key variances are as follows:

- (a) the positive variance in Operating Receipts of approximately \$1.6 million is a timing difference which is expected to reverse in future forecast periods;
- (b) the positive variance in Payroll and Employee Related Costs of approximately \$1.0 million is a timing difference related primarily to the timing of remittances in respect of source deductions for KERP payments which will reverse in future forecast periods;

- (c) the positive variance in Merchandise Vendor disbursements of \$10.2 million is a timing difference resulting from lower purchases than forecast due to on-going discussions with vendors regarding order quantities in light of the Sears Canada Group's restructuring proceedings combined with lower-than-forecast disbursements in respect of critical vendors. The positive variance in Merchandise Vendor disbursements is expected to reverse in future forecast periods;
- (d) the positive variance in Non-Merchandise Vendor disbursements of approximately \$22.6 million consists of a positive permanent variance of approximately \$8 million as a result of lower-than-forecast disbursements in respect of critical vendors and cost savings achieved in advertising and logistics, combined with a timing difference of approximately \$15 million which is expected to reverse in future forecast periods once Sears Canada Group has finalized its post-Filing order quantities and service levels with vendors;
- (e) the positive variance in Rent and Property Taxes of approximately \$3.2 million is due to differences in the timing of actual property tax payments compared to the CCAA Cash Flow Forecast which assumed equal monthly installments;
- (f) the positive variance in Sales Tax disbursements of approximately \$5.0 million is a permanent difference resulting from the receipt of sales tax refunds which were not included in the CCAA Cash Flow Forecast due to uncertainty regarding timing;
- (g) the positive variance in IT Cost disbursements of approximately \$5.6 million consists primarily of certain IT vendor payments to be paid in the future forecast periods;
- (h) the negative variance in Recovery of Expenses from Agent of approximately \$2.0 million is a timing difference resulting from delays in the reimbursement of certain expenses associated with the Court-approved liquidation sales process which are expected to reverse in future forecast periods;

- (i) the positive variance in Capital Expenditure disbursements of approximately \$3.4 million is a timing difference as a result of a delay by the vendors in submitting invoices;
- (j) the positive variance in Professional Fees of approximately \$3.4 million is a timing variance that is expected to reverse in future forecast periods;
- (k) the variance in DIP Draws / (Repayments) is the result of the positive cash flow variances noted above; and
- (l) the negative variance in “Others incl. FX Valuation” of approximately \$2.8 million captures the impact on US Dollar denominated cash balances held by the Sears Canada Group from a strengthening Canadian Dollar since date of the CCAA Cash Flow Forecast.

57. The Initial Order allowed the Sears Canada Group to continue to utilize their existing Cash Management System as described in the First Wong Affidavit and the pre-filing report of the Monitor. The Sears Canada Group has continued to utilize its Cash Management System in a manner consistent with past practice.

J. EMPLOYEE HARDSHIP FUND

58. Since the commencement of the CCAA Proceedings, approximately 3,100 employees of the Sears Canada Group entities have had their employment terminated, either immediately or with working notice. Employees who have been terminated will not receive post-retirement benefits and will not receive termination or severance pay at this time.

59. Employee Representative Counsel has worked with the Sears Canada Group and the Monitor to establish, and now seeks court approval for, a proposed hardship fund (the “**Employee Hardship Fund**”) to be made available to former employees of the Sears Canada Group who apply and whose application is accepted by the Monitor or by a committee established by the Monitor, the Sears Canada Group and Employee Representative Counsel. To be accepted, an applicant must show, among other things,

that he or she faces urgent or immediate hardship in dealing with his or her financial obligations and that funds are not otherwise available from alternative sources to satisfy the obligations for which the Employee Hardship Fund was established.

60. The proposed Employee Hardship Fund includes the following terms:

- (a) prescribed eligibility criteria, which will be made available on the Monitor's Website at <http://cfcanada.fticonsulting.com/searscanada> and on the website established by Employee Representative Counsel: <http://www.upflaw.ca/areas-of-practice/sears-canada-employees-and-former-employees>;
- (b) the Monitor will complete the initial assessments of hardship applications submitted and eligibility of applicants. Any disagreements regarding eligibility to participate in the Employee Hardship Fund will be referred to a committee including one appointee of the Sears Canada Group, one appointee of the Monitor and one appointee of Employee Representative Counsel;
- (c) funding for the Employee Hardship Fund will not exceed \$500,000, subject to potential increases in certain circumstances. The first tranche will be in the amount of \$300,000. Additional amounts up to \$200,000 may also be received. This funding will be provided by the Sears Canada Group from otherwise earned but foregone executive payment entitlements under the KERP to the extent that those payments are secured by the KERP Priority Charge. The proposed funding mechanism is intended to maintain the status quo for all creditors other than those KERP participants who have agreed to forego a portion of their KERP entitlements;
- (d) the maximum payment available to any one recipient is eight weeks' regular wages up to a maximum of \$1,200 per week for eight weeks plus potential discretionary increases of up to \$2,500. In determining the amount to be paid to any recipient, the amounts otherwise payable by the Sears Canada Group to such recipient that have been stayed in the CCAA Proceedings will be considered.

Payments will only exceed such stayed amounts in exceptional circumstances;
and

(e) any payments made from the Employee Hardship Fund will be deducted from any distributions on any allowed claims of the recipient in the CCAA Proceedings.

61. In connection with the proposed Employee Hardship Fund, Employee Representative Counsel has agreed not to oppose the KERP as approved in the Initial Order, to withdraw with prejudice the responding motion record returnable July 13, 2017, including the notice of motion contained therein to the extent that it deals with the KERP, and not to oppose the stay of termination and severance payments to former employees of the Sears Canada Group.
62. If any amounts remain in the Employee Hardship Fund at the completion of the CCAA Proceedings, those amounts will be returned to the Sears Canada Group entities.

Monitor's Recommendation

63. The Monitor is of the view that in the circumstances of this case, including the number of employees terminated and the unique financial circumstances in which these employees find themselves, the Employee Hardship Fund requested by Employee Representative Counsel is appropriate in the circumstances. The Monitor accordingly supports the approval of the Employee Hardship Fund.
64. The Monitor notes that no creditor is prejudiced as a result of the establishment of the proposed Employee Hardship Fund without such creditor's consent.

K. WINNIPEG GARDEN CITY: REQUEST FOR APPROVAL AND VESTING ORDER

65. Once a Sears Full Line department store, the property owned by Sears Canada located at the Winnipeg Garden City Shopping Centre, 2311 McPhillips Street, Winnipeg, Manitoba (as defined above, the Garden City Property) has more recently been informally operated as an Outlet store selling excess discounted inventory. Prior to the CCAA filing, the Garden City store was operating at a net loss of over \$1 million per year.

66. Given its current financial situation, Sears Canada cannot afford to maintain or improve the Garden City Property, and the significant annual losses associated with the Garden City store are a financial strain on the Sears Canada Group.
67. Since early 2016, prior to the commencement of the CCAA Proceedings, Sears Canada undertook efforts to sell the Garden City Property.
68. As part of that process, Sears Canada entered into the Original APA, pursuant to which WCRE agreed to purchase the Garden City Property for \$5 million (the “**Purchase Price**”).
69. Pursuant to the terms of the SISP Approval Order and section 16 of the Sale Process approved therein, Sears Canada, in its business judgment and in consultation with the Sale Advisor, the Monitor and the DIP Lenders, is permitted to withdraw any Leases or Assets from the Sale Process. With the support of the Sale Advisor, the Monitor and the DIP Lenders, Sears Canada has decided to withdraw the Garden City Property from the Sale Process in order to complete the Garden City Transaction (as defined below).

The Garden City Property

70. The Garden City store was listed as a store that the Applicants intend to close in the First Wong Affidavit.
71. The Garden City Property is comprised of land and a building that requires significant redevelopment. Sears Canada has advised the Monitor of its view that the Garden City Property is too large to accommodate a single retail tenant in the market in which the property is situated. The Garden City Property will accordingly need to be repurposed to accommodate multiple smaller tenants. Sears Canada also believes that additional improvements would need to be made to make the building a commercially viable space. The Monitor believes that Sears Canada’s assessment of the Garden City Property is reasonable.
72. The Monitor understands that an operating agreement between Sears Canada and a predecessor in interest to a subsidiary of RioCan Real Estate Investment Trust

(“**RioCan**”), who owns the adjacent Garden City Shopping Centre proper, was in place but appears to have expired.

The Sale Process

73. The Monitor understands that for several months prior to the CCAA filing, Sears Canada undertook a solicitation process pursuant to which it identified and contacted potentially interested buyers. The parties contacted by Sears Canada included large retailers, property developers and managers, and RioCan, which owns the remainder of the Garden City Shopping Centre.
74. Sears Canada received three proposals with respect to the Garden City Property:
 - (a) in November 2016, Sears Canada received a letter of interest from a party that was interested in leasing (but not purchasing) certain properties from Sears Canada, including the Garden City Property. The proposal, as it related to the Garden City Property, required Sears Canada to provide tenant allowances for redevelopment and capital expenditures. The Monitor understands that, given its financial circumstances, Sears Canada was unwilling to commit to paying the capital expenditures. Sears Canada accordingly did not pursue further discussions with this party;
 - (b) on April 4, 2017, Sears Canada received a letter of interest from WCRE, which offered to purchase the Garden City Property for \$5 million on an “as is, where is basis”. WCRE’s offer did not contain any leaseback requirement or any requirement that the Sears Canada Group incur any capital expenditures with respect to the Garden City Property; and
 - (c) on or around June 20, 2017, Sears Canada received a non-binding proposal relating to a number of properties, which specified a purchase price of \$6.75 million for the Garden City Property. The proposed transaction was conditional on Sears Canada leasing back the property from the new owner. The proposed leaseback transaction did not address the improvement costs needed to allow the

Garden City Property to be leased. Without a leaseback arrangement, the proposed purchase price would decrease to \$4.5 million.

75. Sears Canada determined that WCRE's proposal represented the best offer available with respect to the Garden City Property. Accordingly, on April 12, 2017, prior to the commencement of the CCAA Proceedings, Sears Canada entered into the Original APA.

The APA

76. Under the Original APA, WCRE agreed to purchase the Garden City Property on an "as is, where is" basis for the Purchase Price of \$5 million, subject to usual adjustments (the "**Garden City Transaction**").
77. The Original APA was amended by the Amendment dated July 28, 2017 to reflect the requirements of the Initial Order and the CCAA. As amended, the APA requires that the AVO be issued and entered by this Court on or before August 25, 2017 as a condition precedent to the closing of the Garden City Transaction.
78. The APA also contains the following terms:
- (a) an Initial Deposit of \$20,000 was provided to WCRE's counsel in trust within two business days of the execution of the Original APA. In accordance with the Amendment, the Initial Deposit has been transferred to the Monitor and is now held in trust by the Monitor;
 - (b) an Additional Deposit of \$380,000, which was paid to the Monitor in trust by WCRE within two business days of satisfaction or waiver of WCRE's conditions precedent;
 - (c) the requirement that the Garden City Transaction be completed on an "as is, where is" basis;
 - (d) the requirement that WCRE's conditions precedent be waived or satisfied by July 26, 2017. As set out in the Amendment, WCRE has waived its conditions precedent set out in section 6.1 of the Original APA; and

- (e) closing of the Garden City Transaction is to occur five business days after issuance of the AVO, provided that Sears Canada will have the right (subject to the Monitor's approval) to extend the Completion Date of the transaction until no later than October 16, 2017 in order to allow the ongoing liquidation process at the premises to be completed.

79. A copy of the APA is attached as Exhibit "B" to the Champion Affidavit.

Subsequent Communication from RioCan

- 80. On the morning of August 15, 2017, counsel to RioCan contacted the Monitor and its counsel to advise that RioCan intended to make an unspecified "higher" offer for the Garden City Property by August 31, 2017. The Monitor discussed this communication, as well as previous communications between counsel to RioCan and Sears Canada, with Sears Canada, the Sale Advisor and counsel to Sears Canada. The Monitor also made independent enquiries concerning RioCan's activities in the context of the SISP.
- 81. The Monitor was informed by Sears Canada and its advisors that RioCan has been aware of Sears Canada's intention to sell the Garden City Property to WCRE for several weeks. The Monitor understands that RioCan was invited to submit an offer for the purchase of the Garden City Property on more than one prior occasion and that RioCan declined to do so.
- 82. Neither the Monitor, the Sale Advisor nor Sears Canada has received an offer from RioCan to purchase the Garden City Property.
- 83. Counsel to RioCan advised the Monitor that RioCan believed it had until August 31, 2017 to make an offer to purchase the Garden City Property. While this may have been the case, the Monitor notes that, pursuant to paragraph 16 of the SISP, Sears Canada is permitted to, in its business judgment and in consultation with the Sale Advisor, the Monitor and the DIP Lenders, withdraw assets from the SISP at any time. Sears Canada consulted with the Sale Advisor, the Monitor and the DIP Lenders before exercising that right in respect of the Garden City Property.

84. Following the communication from RioCan's counsel, the Monitor asked Sears Canada and the Sale Advisor whether they still believed that the Garden City Transaction was appropriate. Each party answered in the affirmative. The Monitor has no reason to believe that Sears Canada failed to exercise reasonable business judgment in deciding to withdraw the Garden City Property from the SISP and in negotiating the Original APA and the Amendment. The Monitor also has no reason to question the good faith of WCRE in entering into the APA.
85. In the circumstances, and for the reasons described above and below, the Monitor believes that it is appropriate for the Garden City Property to be sold to WCRE on the terms set out in the APA, outside the SISP.

Monitor's Comments on the Sale Process and APA

86. Section 36(1) of the CCAA states:

36(1) Restriction on disposition of business assets - A debtor company in respect of which an order has been made under this Act may not sell or otherwise dispose of assets outside the ordinary course of business unless authorized to do so by a court. Despite any requirement for shareholder approval, including one under federal or provincial law, the court may authorize the sale or disposition even if shareholder approval was not obtained.

87. Section 36(3) of the CCAA states:

(3) Factors to be considered - In deciding whether to grant the authorization, the court is to consider, among other things,

(a) whether the process leading to the proposed sale or disposition was reasonable in the circumstances;

(b) whether the monitor approved the process leading to the proposed sale or disposition;

(c) whether the monitor filed with the court a report stating that in their opinion the sale or disposition would be more beneficial to the creditors than a sale or disposition under a bankruptcy;

(d) the extent to which the creditors were consulted;

(e) the effects of the proposed sale or disposition on the creditors and other interested parties; and

(f) whether the consideration to be received for the assets is reasonable and fair, taking into account their market value.

Reasonableness of the Process Leading to the Garden City Transaction

88. The Sears Canada Group has been pursuing the sale of the Garden City Property since 2016 – prior to the commencement of the CCAA Proceedings and prior to the Court’s approval of the SISP.
89. During this time, Sears Canada canvassed the market for potential buyers in an attempt to sell the Garden City Property. Parties contacted by Sears Canada included national retailers, real estate developers and managers, and RioCan, the owner of the Garden City Shopping Centre.
90. Sears Canada received and reviewed a number of proposals related to the Garden City Property. In its business judgment, the offer put forward by WCRE was determined to be the best proposal compared to any other proposal. The proposal was accepted and the Original APA was executed on April 12, 2017.
91. Following the commencement of these CCAA Proceedings on June 22, 2017, the APA was amended to make the sale subject to Court approval in accordance with the terms of the CCAA and the Initial Order.
92. As the process to sell the Garden City Property was undertaken prior to the commencement of the CCAA Proceedings, the Monitor was not involved in this sale process.
93. However, based upon the information the Monitor has received from Sears Canada, the Monitor believes that the process was reasonable in the circumstances, resulted in the opportunity to purchase the Garden City Property being made available to potentially interested buyers, and appears to have achieved a fair and reasonable result.

Comparison to Sale in Bankruptcy

94. The Monitor has considered whether the Garden City Transaction would be more beneficial to the creditors and stakeholders of the Sears Canada Group than a sale or disposition of the Garden City Property under a bankruptcy.
95. Given the proposals received and the liquidation alternatives available, the options available for sale or disposition of the Garden City Property are the same regardless of whether such sale or disposition is carried out as proposed by the Sears Canada Group in these CCAA Proceedings or in a bankruptcy.
96. It is the Monitor's view that the process to obtain the AVO, which is a condition of the APA, and close the Garden City Transaction would be the same in both the CCAA Proceedings or a bankruptcy. The costs associated therewith would be essentially the same whether the sale was completed in the CCAA Proceedings or a bankruptcy.
97. However, a sale in bankruptcy would delay the approval and closing of the Garden City Transaction as it would be necessary to first assign Sears Canada into bankruptcy or obtain a Bankruptcy Order, convene a meeting of creditors, appoint inspectors and obtain their approval of the Garden City Transaction prior to seeking the AVO. Given the ongoing CCAA Proceedings and SISP for the rest of the Sears Canada Group's business and assets, a bankruptcy would not be feasible at this time without jeopardizing the SISP and the Sears Canada Group's ongoing operations.
98. Any delay in completing the Garden City Transaction would be detrimental to the Sears Canada Group and its stakeholders generally. Accordingly, it is the Monitor's view that a sale or disposition of the Garden City Property in these CCAA Proceedings would be more beneficial than a transaction in a bankruptcy process.

Consultations with Creditors

99. The Sears Canada Group has consulted with the DIP Lenders with respect to the Garden City Transaction. During that consultation process, the DIP Lenders were provided with a copy of the APA.

100. The Monitor has been advised that the DIP Lenders have reviewed the APA, including the Amendment, and have provided their support for the Garden City Transaction.
101. Other than beneficiaries of the Administration Charge, the KERP Priority Charge and the Directors' Priority Charge (each as defined in the Initial Order), the DIP Term Lenders are the only parties with an interest in the proceeds of the Garden City Transaction at this time and, as noted below, they will receive a distribution of those proceeds in accordance with the terms of the DIP Term Loan Agreement.
102. No other creditors were consulted in connection with the transaction.
103. The Monitor is of the view that the degree of creditor consultation was appropriate in the circumstances. The Monitor does not consider that any material change in the outcome of the efforts to sell the Garden City Property would have resulted from additional consultation.

Effect of the Garden City Transaction on Creditors and Other Interested Parties

104. As noted above, the only creditors with an economic interest in the proceeds of the Garden City Transaction are the DIP Term Lenders and the proceeds of the transaction are to be distributed in accordance with the priorities established in the DIP Term Loan Agreement.

Fairness of the Consideration

105. The Monitor is of the view that the APA represents the best proposal for the Garden City Property. As described above, while Sears Canada received one higher offer of \$6.75 million, that offer was conditional on Sears Canada leasing back the property. This higher offer would have also required Sears Canada to undertake significant expenditures to improve and redevelop the Garden City Property, which the Sears Canada Group cannot afford given its current financial circumstances.
106. The APA represents the highest offer to purchase the Garden City Property on an "as is, where is" basis.

107. The Monitor understands that Sears Canada received an appraisal for the Garden City Property from a leading valuation firm dated December 31, 2016. A second appraisal dated May 31, 2017 was prepared at the request of the DIP Term Lenders. Copies of these appraisals are attached to this Second Report as Confidential Appendices “B” and “C”.
108. The Sears Canada Group has been unable to identify a potential purchaser who is willing to purchase the Garden City Property on the assumptions contained in the appraisals.

Distribution

109. Pursuant to the AVO, the net proceeds of the Garden City Transactions shall be paid forthwith to the DIP Term Lenders in partial repayment of the obligations owing under the DIP Term Loan Agreement.
110. Pursuant to the DIP Term Loan Agreement, the net proceeds of a sale of Term Priority Collateral (as defined in the DIP Term Loan Agreement to include the Garden City Property) shall be applied promptly, and in any event no later than three business days after receipt thereof, to repay the obligations under the DIP Term Loan Agreement. The DIP Term Lenders were granted the DIP Term Lenders’ Charge (as defined in the Initial Order) to secure the obligations under the DIP Term Loan Agreement.
111. The DIP Term Lenders’ Charge ranks, with respect to the Garden City Property, subordinate only to the Administration Charge, the KERP Priority Charge and the Directors’ Priority Charge (each as defined in the Initial Order) and in priority to all other security interests attaching to the Garden City Property that the Monitor is aware of.

Sealing Order

112. As indicated in the Champion Affidavit, the Applicants are seeking an order sealing Confidential Appendices “B” and “C” to this Second Report. Confidential Appendices “B” and “C” contain commercially sensitive appraisal information relating to the Garden City Property. If the Garden City Transaction does not close, the public disclosure of this appraisal information would be detrimental to any subsequent attempts to market the Garden City Property.

Monitor's Recommendation

113. The Garden City Transaction is the best transaction resulting from the marketing of the Garden City Property. The Monitor is of the view that the Purchase Price is fair and reasonable in the circumstances.
114. Accordingly, and based on the foregoing, the Monitor is of the view that the approval of the Garden City Transaction is in the best interests of creditors and the Sears Canada Group's stakeholders generally. The Monitor supports the Applicants' request for approval of the Garden City Transaction and the granting of the AVO.
115. As the net proceeds of the Garden City Transaction are required to be paid to the DIP Term Lenders pursuant to the DIP Term Loan Agreement and based upon the ranking of the DIP Term Lenders' Charge described above, the Monitor also supports the Applicants' request to make the proposed distribution of proceeds to the DIP Term Lenders.
116. The Monitor is not aware of any party that would be prejudiced by the proposed sealing order. The Monitor also understands the concerns of Sears Canada regarding the public disclosure of the appraisal information for the reasons set out above.
117. The Monitor believes the requested sealing order is reasonable in the circumstances.

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

Dated this 16th day of August, 2017.

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

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

Paul Bishop
Senior Managing Director

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

Greg Watson
Senior Managing Director

APPENDIX "A"

NOTICE TO EMPLOYEES

August 16, 2017

To Sears Canada Associates at RSC and Initium:

As you are aware, Brandon Stranzl, our Executive Chairman, has been focusing his efforts on developing plans for the business to continue as a going concern. The intention is to formulate these plans into a bid that can be submitted as part of the Sale and Investment Solicitation Process, or "SISP". The SISP, part of the CCAA process, seeks out proposals for the acquisition of, or investment in, the Sears Canada Group's business or assets. The goal of any such proposal is to facilitate a path for Sears Canada to emerge from CCAA and so that all of us can continue with the company's reinvention plans. The deadline for SISP submissions is August 31, 2017 meaning Brandon needs to spend significant time during this period developing the bid proposal.

In light of the approaching bid deadline and the focus required to assemble all necessary components of a bid, the Board thought it was best for Brandon to focus exclusively on putting the bid together and step away from the day-to-day operations of Sears Canada.

Becky Penrice, Executive Vice-President and Chief Operating Officer, will now lead the executive team of the Company and any of Brandon's direct-reports will report to her. Any matters which formerly required Brandon's input should now be put forward to Becky and the management team instead. To the extent that Brandon requires any support from the Company regarding the bid, that support will be coordinated through Greg Watson or Paul Bishop of FTI Consulting Canada Inc., the Court-appointed Monitor.

If you have any questions, please reach out to Becky or to your executive leadership team member. Otherwise, thank you for your continued outstanding efforts on behalf of Sears Canada as we move through the restructuring process.

Graham Savage,
Chair, Special Committee of the Board of Directors,
Sears Canada Inc.

CONFIDENTIAL APPENDIX "B"
APPRAISAL DATED DECEMBER 31, 2016

CONFIDENTIAL APPENDIX "C"
APPRAISAL DATED MAY 31, 2017

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

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

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