

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

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

TWENTY-THIRD REPORT OF FTI CONSULTING CANADA INC., AS MONITOR

SEPTEMBER 10, 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

**TWENTY-THIRD 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 Period to October 4, 2017 and the Stay Period has been subsequently further extended, most recently to December 18, 2018. The Court also granted an order approving a sale and investor solicitation process (the “**SISP**”) to solicit interest in potential transactions, including investment and liquidation proposals, involving the business, property, assets and/or leases of the Applicants.
 4. On July 18, 2017, the Court issued an order approving an agreement and a process for the liquidation of inventory and FF&E at certain initial closing Sears Canada locations, which liquidation process is now completed.
 5. On October 13, 2017, the Court issued, among other orders, an order (a) approving an agreement and a process (the “**Second Liquidation Process**”) for the liquidation of the inventory and FF&E at all remaining Sears Canada retail locations, which liquidation commenced shortly thereafter and is now completed.
 6. The liquidation of assets at Sears Canada’s retail locations is now completed, all retail locations are closed, and leases in respect of such locations have been disclaimed. The monetization of Residual Assets is now substantially complete. The major assets of the Sears Canada Entities that remain to be realized upon are the Applicants’ remaining real estate assets.
 7. In connection with the CCAA Proceedings, the Monitor has provided twenty-two reports and fifteen 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 twenty-third report of the Monitor (the "**Twenty-Third Report**") is to provide the Court with information regarding contracts and disputes between Sears Canada and Oxford Properties Group, OPGI Management Limited, Oxford Properties Retail Holdings II Inc. and CPPIB Upper Canada Mall Inc. (collectively, "**Oxford**") relating to a building and property municipally known as 17600 Yonge Street, located in Newmarket, Ontario (the "**Newmarket Property**").

C. TERMS OF REFERENCE

9. In preparing this Twenty-Third Report the Monitor has relied upon discussions and correspondence with, among others, the senior management ("**Management**") of, and advisors to, the Sears Canada Entities (collectively, the "**Information**").
10. The Monitor has prepared this Twenty-Third Report in connection with the joint motion of the Applicants and Monitor relating to disputes surrounding the Newmarket Property.
11. Unless otherwise stated, all monetary amounts contained herein are expressed in Canadian Dollars.
12. Capitalized terms not otherwise defined herein have the meanings ascribed to them in the following documents filed as part of the CCAA Proceedings: (i) the affidavit of Mr. of Mr. Philip Mohtadi, General Counsel and Corporate Secretary of Sears Canada, affirmed September 10, 2018; and (ii) the Prior Reports.

D. THE NEWMARKET PROPERTY

Agreement of Purchase and Sale and Option Agreement

13. Sears Canada is the registered owner of the Newmarket Property.

14. Sears Canada (as successor and assignee) is party to an operating agreement dated July 25, 1973 with Oxford (as successor and assignee) (the “**Operating Agreement**”), the registered owner of the neighboring lands comprising the regional shopping centre known as Upper Canada Mall, in respect of the Newmarket Property.
15. The Operating Agreement provided Oxford with a right of first refusal to purchase the Newmarket Property at the price and upon the terms and conditions contained in any offer received by Sears Canada that Sears Canada is willing to accept, by written notice to Sears Canada, within 15 days of receipt of notice of any offer.
16. Sears Canada (as a successor and assignee) is also party to an option agreement with Oxford (as a successor and assignee) made as of January 21, 1994 (the “**Option Agreement**”) in respect of the Newmarket Property.
17. Pursuant to the Option Agreement, Oxford was provided with an option to purchase the Newmarket Property if the Newmarket Property is not operated as a department store by Sears Canada for a period of 91 consecutive days (the “**Option**”) for a purchase price calculated in accordance with Sections 11 and 12 of the Option Agreement. The Option to purchase could be exercised up to July 24, 2018.
18. On June 13, 2018, following a sale process that commenced with the Court-approved SISP, Sears Canada entered into an agreement of purchase and sale with 1979353 Ontario Inc. for the sale of the Newmarket Property (the “**Original Newmarket Offer**”). The agreement was expressly made subject to Oxford’s right of first refusal and Option.
19. On June 14, 2018, Sears Canada provided Oxford with notice of the agreement of purchase of sale and that Oxford’s right of first refusal under the Operating Agreement was triggered. The right of first refusal could be exercised up to June 29, 2018.
20. Oxford elected not to exercise its right of first refusal.
21. Oxford advised on June 29, 2018 that they were exercising the Option.

22. The terms of the Option provide that the exercise price for the Option is based upon a specific definition of Current Value of the property less set-offs for amounts owing by Sears Canada to Oxford.
23. The Option Agreement provides that following exercise of the Option, the Current Value of the property is to be determined by:
 - (a) agreement among the parties within seven days;
 - (b) if no agreement is reached, appraisals by an appraiser for each of Sears Canada and Oxford, separately.
 - (c) if the foregoing appraisals are not within a 5% value range and no further agreement reached, arbitration.
24. The appraisal process described above has now been completed, with each of Sears Canada and the Oxford obtaining a separate appraisal. The two appraisals were not within a 5% value range and the parties have not subsequently been able to agree on a current value for the property. Notably, the Oxford appraised value is significantly lower than the purchase price under the Original Newmarket Offer and the Sears Canada appraised value is significantly higher than the Original Newmarket Offer. As a result, the terms of the Option require that the determination of Current Value be submitted to an arbitrator.
25. Sears Canada, in consultation with the Monitor, and Oxford have not agreed on an arbitrator to determine this matter within the time periods permitted under the terms of the Option. Oxford have delivered a motion record seeking the appointment of John Keefe as arbitrator. Sears Canada, through the Monitor, previously proposed the Honourable James Farley Q.C., as arbitrator, and have jointly submitted a motion record seeking the appointment of the Honourable James Farley as arbitrator and directions that Justice Farley determine certain related issues, described below, relating to the validity and quantum of claims asserted by Oxford in respect of the Newmarket Property, and the availability of set-off against amounts payable under the Option in respect of same.

Other Asserted Liabilities in Respect of the Newmarket Property

26. By proof of claim dated March 2, 2018 (the “**Proof of Claim**”), Oxford submitted claims against Sears Canada in the context of this CCAA proceeding.
27. The Proof of Claim included, among things, the following restructuring claims relating to the Newmarket Property:
 - (a) A claim for \$1,821,178 in respect of alleged site work and repair costs on the Newmarket Property pursuant to the Operating Agreement, approximately \$1.77 million of which relates to parking lot repairs; and
 - (b) A claim for \$5,596,026 in respect of the present value of lost annual common area maintenance and promotion fund contributions under the Operating Agreement.
28. These claims were rejected by the Monitor’s Notice of Revision or Disallowance dated July 27, 2018 (the “**NORD**”).
29. In response, Oxford submitted its notice of dispute dated August 24, 2018 (the “**Notice of Dispute**”) in respect of claims in the amount of \$7,397,241. In providing the Notice of Dispute, Oxford asserted confidentiality over the document. Accordingly, a copy of the NORD, Notice of Dispute and the Proof of Claim have been submitted as **Confidential Appendices “A”, “B” and “C”** to this Report, pending any sealing order that Oxford may apply for in connection with same.
30. The Notice of Dispute was made “expressly without prejudice to all rights of [Oxford] pursuant to (i) the provisions of the Option Agreement, including as it relates to the closing of the APA; and (ii) Section 21 of the CCAA”.

The Disputes are Inextricably Linked

31. The Monitor is of the view that the disputes relating to Current Value of the Newmarket Property, on the one hand, and the disputes set out in the Notice of Dispute are inextricably linked, such that they should be determined concurrently:

- (a) The Option Agreement provides that at closing “all amounts due by Sears to [Oxford] or by [Oxford] to Sears in respect of the [Newmarket Property] shall be settled and set-off or paid in full”;
 - (b) The Option Agreement further provides that Oxford “shall assume, from and after the Closing, all liabilities and obligations of Sears in connection with the [Newmarket Property] being acquired”; and
 - (c) By referencing Section 21 of the CCAA, which addresses a claimant’s rights of set-off, in the Notice of Dispute, Oxford apparently intends to assert a right of set-off in respect of the amounts claimed under the Notice of Dispute against the amounts payable under the Option Agreement;
32. In order for any transaction to be completed in respect of the Option, the following issues must be determined: (i) the Current Value of the Newmarket Property; (ii) whether there are any valid and enforceable rights of set-off in the context of these CCAA proceedings; and (iii) if valid, the quantum of such set-offs. Subsequently, the entire transaction must be brought for approval of the CCAA Court.
33. For the sake of efficiency and consistency, the Monitor is of the view these issues should be determined together and not in a piecemeal fashion. Separate proceedings to determine these interrelated issues would likely result in additional cost and delay.
34. Accordingly, the Monitor, together with Sears Canada, seek to have: (i) the Honourable Justice Farley, James Farley Mediation and Arbitration Services, appointed as the arbitrator to determine the issues of Current Value and; (ii) the Honourable James Farley directed to concurrently determine the validity and quantum of the claims asserted in Oxford’s Notice of Dispute and any set-off rights that may be asserted in the context of the CCAA proceedings. In the Monitor’s view, during a CCAA proceeding the interests of the debtor company’s stakeholders in an expedited and value maximizing resolution

should be prioritized provided that the material substantive rights of counterparties are respected.

35. The Monitor is of the opinion that Justice Farley, as an experienced arbitrator, a former Commercial List Judge, and the Claims Officer appointed pursuant to the Claims Procedure Order dated December 8, 2017, is uniquely situated to determine these issues, which involve the resolution of an arbitral dispute, a claims dispute, and a set-off dispute in a CCAA context.
36. In the alternative, Sears Canada and the Monitor seek an order and directions that Justice Hainey, or such other judge of the Commercial List who may be available, shall determine all issues relating to the Option Agreement, Notice of Dispute, and the validity and quantum of any set-off or other deductions to the amount payable to Sears Canada under the Option Agreement concurrently.

The Monitor respectfully submits to the Court this, its Twenty-Third Report.

Dated this 10th day of September, 2018.

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



Paul Bishop
Senior Managing Director



Greg Watson
Senior Managing Director

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.*

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**ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST**

Proceeding commenced at TORONTO

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

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