

**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 TARGET CANADA CO., TARGET  
CANADA HEALTH CO., TARGET CANADA MOBILE GP  
CO., TARGET CANADA PHARMACY (BC) CORP., TARGET  
CANADA PHARMACY (ONTARIO) CORP. TARGET  
CANADA PHARMACY CORP., TARGET CANADA  
PHARMACY (SK) CORP., AND TARGET CANADA PROPERTY LLC.**

**THIRD REPORT OF THE MONITOR  
ALVAREZ & MARSAL CANADA INC.**

**FEBRUARY 27, 2015**

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## **1.0 INTRODUCTION**

- 1.1 On January 15, 2015, Target Canada Co. (“**TCC**”) and those companies listed in **Appendix “A”** (collectively, the “**Applicants**”), together with the Partnerships also listed in **Appendix “A”** (the “**Partnerships**”, and collectively with the Applicants, the “**Target Canada Entities**”), applied for and were granted protection by the Ontario Superior Court of Justice (Commercial List) (the “**Court**”) under the *Companies’ Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended (the “**CCAA**”). Pursuant to an Order of this Court dated January 15, 2015 (the “**Initial Order**”), Alvarez & Marsal Canada Inc. (“**A&M**”) was appointed Monitor of the Target Canada Entities in the CCAA proceedings (the “**Monitor**”). The proceedings commenced by the Applicants under the CCAA are referred to herein as the “**CCAA Proceedings**”.
- 1.2 On February 11, 2015, this Court issued the “**Amended and Restated Initial Order**” (hereinafter, unless the context otherwise requires, the “**Initial Order**”), which incorporates certain changes to the Initial Order granted January 15, 2015 that are described in the Second Report of the Monitor (the “**Second Report**”) dated February 9, 2015. The Second Report (without Appendices) is attached as **Appendix “B”** to this report.
- 1.3 In connection with the CCAA Proceedings, the Monitor has provided to this Court the First Report of the Monitor (the “**First Report**”) dated January 30, 2015, the Supplemental Report to the First Report (the “**Supplementary Report**”) dated February 3, 2015 and the Second Report (collectively, the “**Monitor’s Reports**”). A&M has also provided to this Court the Pre-Filing Report of the Proposed Monitor (the “**Pre-Filing Report**”) dated January 14, 2015 (together with the Monitor’s Reports, the “**Prior Reports**”), as well as a letter dated February 18, 2015 providing an update on its progress with respect to ascertaining certain requested information regarding inventory balances (the “**Inventory Update Letter**”). The Prior Reports, the Inventory

Update Letter, the Initial Order, and other Court-filed documents and notices in these CCAA Proceedings are available on the Monitor's website at [www.alvarezandmarsal.com/targetcanada](http://www.alvarezandmarsal.com/targetcanada).

1.4 On February 4, 2015, this Court issued an Endorsement providing that:

- (a) the Court would determine the terms of the Real Property Portfolio Sales Process upon a motion returnable on February 11, 2015;
- (b) pending the determination of the terms of the Real Property Portfolio Sales Process:
  - (i) Lazard Frères & Co. LLC ("**Lazard**") was authorized to contact prospective interested parties;
  - (ii) Lazard was authorized to provide such interested parties with a "teaser" and form of confidentiality agreement ("**CA**");
  - (iii) Lazard and the Applicants were authorized to negotiate the terms of such CAs and the Applicants were authorized to enter into such agreements;
  - (iv) interested parties were permitted to undertake due diligence, including:
    - (i) receiving a confidential information memorandum ("**CIM**") from Lazard; (ii) being permitted access to the data room; and (iii) conducting site visits if requested; and
  - (v) Lazard could enter into preliminary discussions with interested parties.

1.5 On February 11, 2015, this Court issued an order (the "**Approval Order – Real Property Portfolio Sales Process and Stay Extension**") approving: (i) the Real Property Portfolio Sales Process and authorizing and directing the Target Canada Entities, Lazard and the Monitor to take

any and all actions as may be necessary or desirable to implement and carry out the Real Property Portfolio Sales Process; (ii) the extension of the Stay Period (as defined in paragraph 17 of the Initial Order) to May 15, 2015; and (iii) the First Report, the Supplementary Report and the Second Report, and the activities of the Monitor described in those reports.

1.6 The purpose of this Third Report of the Monitor (the “**Third Report**”) is to provide this Court with:

- (1) information regarding the following:
  - (a) the Real Property Portfolio Sales Process;
  - (b) the Applicants’ motion for an order (the “**Approval and Vesting Order – Lease Transaction Agreement**”) substantially in the form attached to the Applicants’ Motion Record dated February 27, 2015;
    - (i) approving the transaction contemplated by the agreement by and among TCC and certain Landlord Entities (as defined below) dated February 26, 2015 (the “**Lease Transaction Agreement**”), a redacted copy of which is attached as Exhibit “A” to the Affidavit of Mark J. Wong, General Counsel and Assistant Secretary of TCC, sworn February 27, 2015 (the “**Fifth Wong Affidavit**”);
    - (ii) ordering the surrender of all of TCC’s right, title and interest in and to the Real Property Interests, the Premises and the Leases (each as defined in the Lease Transaction Agreement and collectively, the “**Surrendered Assets**”) free and clear of encumbrances, in and to the Landlord Entities; and

- (iii) providing that the contents of **Confidential Appendices “A” and “B”** attached to this Third Report, be sealed, kept confidential and not form part of the public record until such time as, in the case of **Confidential Appendix “A”**, the Lease Transaction Agreement has closed, and in the case of **Confidential Appendix “B”**, until further Order of the Court;
  - (c) the mutual unwind of the sublease/leaseback arrangement as between TCC and Target Canada Property LLC (“**TCC Propco**”), through a mutual termination agreement as between TCC, TCC Propco and Target Canada Property LP dated February 25, 2015 (the “**Mutual Termination Agreement**”), to facilitate the Real Property Portfolio Sales Process;
  - (d) the receipts and disbursements of the Target Canada Entities from January 15, 2015 through February 21, 2015;
  - (e) the Monitor’s activities since the date of the Second Report; and
- (2) the Monitor’s conclusions and recommendations in connection with the foregoing.

## **2.0 TERMS OF REFERENCE AND DISCLAIMER**

2.1 In preparing this Third Report, the Monitor has been provided with, and has relied upon, unaudited financial information, books and records and financial information prepared by the Target Canada Entities and Target Corporation, and discussions with management of the Target Canada Entities and Target Corporation (collectively, the “**Information**”). Except as otherwise described in this Third Report in respect of the Target Canada Entities’ cash flow forecast:

- (a) the Monitor has reviewed the Information for reasonableness, internal consistency and use in the context in which it was provided. However, the

Monitor has not audited or otherwise attempted to verify the accuracy or completeness of the Information in a manner that would wholly or partially comply with Canadian Auditing Standards (“CASs”) pursuant to the *Chartered Professional Accountants Canada Handbook* and, accordingly, the Monitor expresses no opinion or other form of assurance contemplated under CASs in respect of the Information; and

- (b) some of the information referred to in this Third Report consists of forecasts and projections. An examination or review of the financial forecasts and projections, as outlined in the *Chartered Professional Accountants Canada Handbook*, has not been performed.

- 2.2 Future oriented financial information referred to in this Third Report was prepared based on management’s estimates and assumptions. Readers are cautioned that since projections are based upon assumptions about future events and conditions that are not ascertainable, the actual results will vary from the projections, even if the assumptions materialize, and the variations could be significant.
- 2.3 This Third Report should be read in conjunction with the Second Report, the Fifth Wong Affidavit and the Affidavit of Timothy Pohl, a Managing Director of Lazard, sworn February 27, 2015 (the “**Pohl Affidavit**”).
- 2.4 Capitalized terms not otherwise defined in this Third Report are as defined in the Prior Reports, the Initial Order and the Fifth Wong Affidavit, as applicable.
- 2.5 Unless otherwise stated, all monetary amounts contained in this Third Report are expressed in Canadian dollars.



### **3.0 REAL PROPERTY PORTFOLIO SALES PROCESS**

#### Solicitation of Interest

- 3.1 Since the commencement of the Real Property Portfolio Sales Process, the Monitor has supervised the process in accordance with its terms. From the date of the Court's February 4, 2015 Endorsement through close of business on February 26, 2015, Lazard has been in contact with approximately 346 prospective interested parties and has distributed 266 teasers, and TCC has entered into 51 CAs with potential buyers. Those parties that have executed a CA have been provided with access to the data room established for the Real Property Portfolio Sales Process, which includes the CIM.
- 3.2 In accordance with the Real Property Portfolio Sales Process, the Monitor arranged for a notice of the sales process to be published in the national editions of The Globe and Mail and The Wall Street Journal on February 17, 2015.
- 3.3 The Real Property Portfolio Sales Process is described in the First Report and the Second Report. The first significant deadline in the Real Property Portfolio Sales Process is the Phase 1 Bid Deadline of March 5, 2015, being the date by which Interested Bidders that wish to pursue a Sale Proposal must deliver a non-binding letter of intent to Lazard (or such later date as may be determined by the Target Canada Entities on the consent of the Monitor and in consultation with Lazard and the DIP Lender).

### **4.0 LEASE TRANSACTION AGREEMENT**

#### Unsolicited Expression of Interest

- 4.1 As described in the Fifth Wong Affidavit and the Pohl Affidavit, beginning in late January 2015, during the course of initial meetings conducted with various landlords by TCC and the Monitor,

both Oxford Properties Corporation (“**Oxford**”) and Ivanhoe Cambridge Inc. (“**Ivanhoe**”) informed representatives of the Target Canada Entities, Lazard and the Monitor that they were interested in pursuing a potential transaction involving certain leases for which they were either landlords, sub-landlords or head tenants.

4.2 On February 6, 2015, Oxford and Ivanhoe delivered an unsolicited, non-binding letter of intent (the “**First LOI**”) on a confidential basis to the Target Canada Entities, Lazard and the Monitor. The First LOI summarized the basis on which Oxford, Ivanhoe and certain other landlords (collectively, the “**Landlord Entities**”) were prepared to make a single, aggregate payment to TCC for ten leases, as a “one-time offer”. The Landlord Entities advised Lazard that, to the extent there was interest on the part of the Target Canada Entities, the Landlord Entities wanted to conclude a transaction as quickly as possible. Lazard and TCC, together with the Monitor and Northwest Atlantic Canada Inc. (the “**Broker**”), reviewed and analyzed the First LOI, and concluded that further discussions should be pursued with the Landlord Entities. Those discussions culminated in the delivery, on a confidential basis, of a second non-binding letter of intent (the “**Second LOI**”) dated February 12, 2015.

4.3 The Second LOI included leases pertaining to the eleven retail locations listed below (collectively, the “**Locations**”), and reflected a greater level of consideration than the First LOI:

1. Carrefour De L’Estrie, Sherbrooke, Quebec;
2. Conestoga Mall, Waterloo, Ontario;
3. Hillcrest Mall, Richmond Hill, Ontario;
4. Kingsway Mall, Edmonton, Alberta;
5. Les Galeries De La Capitale, Quebec City, Quebec;
6. Metropolis at Metrotown, Vancouver, British Columbia;
7. Mic Mac Mall, Halifax (Dartmouth), Nova Scotia;

8. Oakridge Centre, Vancouver, British Columbia;
9. Place Laurier, Quebec City, Quebec;
10. Square One, Mississauga, Ontario; and
11. Upper Canada Mall, Newmarket, Ontario.

4.4 The Second LOI provided that the Landlord Entities would make an aggregate payment to TCC in exchange for the termination or assignment of all of TCC's right, title and interest in each of the lease agreements (the "**Leases**") of the Locations, on an "as-is" basis, free and clear of all mortgages, liens and other encumbrances.

4.5 Other key features of the Second LOI included:

- (a) the Landlord Entities expected that the transaction could be completed on an expedited basis with no due diligence, and wanted to immediately enter into definitive binding agreements with TCC;
- (b) the Landlord Entities would work to accommodate TCC's inventory liquidation objectives;
- (c) the Landlord Entities would be funding the transaction from internal sources and definitive agreements would not be subject to any financing condition; and
- (d) the Landlord Entities would provide certain releases of obligations relating to the Leases.

4.6 Following receipt of the Second LOI, the Target Canada Entities and their legal counsel, Lazard, the Broker, and the Monitor and its counsel, engaged in extensive discussions and analyses of the Second LOI. Those discussions culminated in the Applicants' decision, supported by Lazard and the Monitor, to pursue a definitive agreement with the Landlord Entities.

- 4.7 On February 26, 2015, TCC entered into the Lease Transaction Agreement with the Landlord Entities, being Hillcrest Holdings Inc., Montez Hillcrest Inc., Oxford Properties Retail Holdings II Inc., CPPIB Upper Canada Mall Inc., OMERS Realty Management Corporation, Square One Property Corporation, Kingsway Garden Holdings Inc., Les Galeries de la Capitale Holdings Inc., Ivanhoe Cambridge II Inc., Carrefour de L'Estrie Holdings, Inc., Place Laurier Holdings Inc., Mic Mac Mall Limited Partnership, Oakridge Centre Vancouver Holdings, Inc.
- 4.8 A redacted copy of the Lease Transaction Agreement is attached as Exhibit "A" to the Fifth Wong Affidavit. An un-redacted copy of the Lease Transaction Agreement is attached as **Confidential Appendix "A"** to this Third Report. The Applicants are requesting that this Court seal the un-redacted Lease Transaction Agreement in order to protect commercially sensitive information, including the purchase price and other financial terms, in the event that the transaction does not close. In addition, the Landlord Entities required as a term of the Lease Transaction Agreement that TCC and the Monitor use commercially reasonable efforts to obtain a sealing order with respect to the amount of Consideration under the Lease Transaction Agreement and Schedules "G" and "Q" thereto, which contain certain financial information.

Lease Transaction Agreement

- 4.9 The proposed lease transaction includes the following eleven Locations and Landlord Entities:

Store No.	Location	Address	City	Province	Landlord Group	Landlord Entity(ies)
3590	Carrefour De L'Estrie	3050 boul. de Portland	Sherbrooke	QC	IC / CPPIB	Carrefour de L'Estrie Holdings, Inc.
3672	Conestoga Mall	550 King St N	Waterloo	ON	IC	Ivanhoe Cambridge II Inc.
3666	Hillcrest Mall	9350 Yonge St	Richmond Hill	ON	Oxford / Montez	Hillcrest Holdings Inc. & Montez Hillcrest Inc.
3561	Kingsway Garden Mall	1 Kingsway Garden Mall, Suite 60	Edmonton	AB	Oxford	Kingsway Garden Holdings Inc.
3696	Les Galeries De La Capitale	5401 boul. des Galeries	Quebec City	QC	Oxford / CPPIB	Les Galeries De La Capitale Holdings Inc.
3717	Metropolis At Metrotown	4545 Central Blvd	Burnaby	BC	IC	Ivanhoe Cambridge II Inc.
3697	Mic Mac Mall	21 MicMac Rd	Halifax	NS	IC	Mic Mac Mall Limited Partnership by its

Store No.	Location	Address	City	Province	Landlord Group	Landlord Entity(ies)
						general partner, 4239474 Canada Inc.
3711 (not open)	Oakridge Centre	650 West 41st Avenue	Vancouver	BC	IC	Oakridge Centre Vancouver Holdings, Inc.
3755	Place Laurier	2700 boul. Laurier	Quebec City	QC	IC	Place Laurier Holdings Inc.
3636	Square One	100 City Center Dr	Mississauga	ON	Oxford / AIMCo	OMERS Realty Management Corporation & Square One Property Corporation
3565	Upper Canada Mall	17600 Yonge St	Newmarket	ON	Oxford / CPPIB	Oxford Properties Retail Holdings II Inc. & CPPIB Upper Canada Mall Inc.

4.10 The Monitor understands that the Leases for five of the above locations are guaranteed by Target Corporation.

4.11 The Lease Transaction Agreement is summarized in the table below. Terms capitalized in the table but not defined therein have the meaning ascribed to them in the Lease Transaction Agreement.

<b>Target Canada Co. (the “Tenant”)</b> <b>Summary of Lease Transaction Agreement</b>	
<b>Object and Intent</b>	<ul style="list-style-type: none"> <li>The Tenant agrees to surrender, and the Landlord Entities agree to accept surrender of, each and every one of the Real Property Interests and the Leases.</li> <li>The Tenant agrees to terminate, prior to Closing, any sublease, licence or other agreement granted by Tenant in favour of any Person and providing for a right of occupancy in all or any portion of the Premises or otherwise affecting the Real Property Interests. The Tenant will however be permitted during the Interim Period and the Leaseback Period: (a) to have existing third party pharmacists occupy a portion of the Premises and remain in such Leaseback Premises until no later than March 30, 2015, in accordance with the accommodation confirmed in the Endorsement of RSJ Morawetz dated February 18, 2015; and (b) to conduct through its Agent the Sale on the Leaseback Premises in accordance with the Sale Order and the Initial Order.</li> <li>The Tenant and the Landlord Entities will enter into the Leasebacks on Closing for the Real Property Interests under each Lease other than the Oakridge Location.</li> </ul>
<b>Deposit</b>	<ul style="list-style-type: none"> <li>Concurrently with the execution of the Agreement, the Landlord Entities will have paid or will have caused to be paid to the Monitor, as escrow agent, a deposit of 15% of the Consideration (the “<b>Deposit</b>”). The Monitor will have no obligation to earn or maximize any interest on the Deposit. The Deposit (plus accrued interest, if any) will be applied on Closing in satisfaction of an equivalent amount of Consideration. The Deposit is refundable (plus accrued interest, if any)</li> </ul>

<b>Target Canada Co. (the “Tenant”)</b> <b>Summary of Lease Transaction Agreement</b>	
	if the Closing does not occur on or before the Closing Date for any reason except only in the circumstances provided for in Section 2.1(e) of the Agreement (breach or default by the Landlord Entities).
<b>Adjustments</b>	<ul style="list-style-type: none"> <li>Concurrently with the execution of the Agreement, the parties reconciled and finalized all additional rent matters (including realty taxes) with respect to each of the Leases. Therefore, there will be no post-closing adjustments on account thereof.</li> </ul>
<b>Outside Date &amp; Closing Date</b>	<ul style="list-style-type: none"> <li>The Agreement will automatically terminate at 11:59 p.m. on March 5, 2015 (the “<b>Outside Date</b>”) if the Approval Order has not been obtained on or prior to the Outside Date.</li> <li>The completion of the Transaction (the “<b>Closing</b>”) will take place at 10:00 a.m. (Toronto time) on March 6, 2015, or on such other date as may be agreed upon in writing by the parties (the “<b>Closing Date</b>”). The Closing will be deemed to be effective as of the date and time set out in the Monitor’s Certificate.</li> </ul>
<b>Leasebacks</b>	<ul style="list-style-type: none"> <li>Each Landlord Entity covenants on Closing to lease, sublease or sub-sublease back, as the case may be, to the Tenant, and the Tenant covenants to lease, sublease or sub-sublease (collectively, the “<b>Leasebacks</b>”) each and every one of the Premises except for the Premises at the Oakridge Location (each a “<b>Leaseback Premises</b>”) for the Leaseback Period, on the same terms and conditions as in the applicable Leases as currently applicable under the CCAA Proceedings for the Premises including all Court Orders made in the CCAA Proceedings issued to date (including the Initial Order and the Sale Order). The “<b>Leaseback Period</b>” being the period from and including the Closing Date to the “<b>Vacancy Date</b>” of such Leaseback, where the Vacancy Date in respect of a Leaseback is June 30, 2015, unless advanced by the Tenant to an earlier date (as early as April 30, 2015) on written notice.</li> <li>The Tenant will pre-pay to the Monitor, for each Leaseback Premises and for the entire Leaseback Period, gross rent on account of basic rent, minimum rent and additional rent, without adjustment, plus applicable GST/HST, QST or BCPST corresponding to the amount set out in Schedule “G” in respect of each Leaseback Premises for the period from the Closing Date to June 30, 2015 (collectively, for all Leaseback Premises, the “<b>Pre-Paid Leaseback Rent</b>”). The Pre-Paid Leaseback Rent will be paid out of the Consideration payable by the Landlord Entities on Closing and will be held by the Monitor, as escrow agent. The Monitor will make regular gross rent payments to the landlord/sub-landlord/sub-sublandlord of the Leasebacks payable under the Leasebacks from the Pre-Paid Leaseback Rent as per the Initial Order up to the Vacancy Date. Any part of such Pre-Paid Leaseback Rent not paid or not required to be paid under any Leaseback will be refunded to the Tenant on the Business Day following the Vacancy Date on a Leaseback Premises by Leaseback Premises basis.</li> <li>Notwithstanding the duration of the Leaseback Period, the Tenant may provide notice (an “<b>Early Vacancy Notice</b>”) to the landlord/sub-landlord/sub-sublandlord of the Leasebacks on or before the dates provided for in the Agreement, being: (i) Early Vacancy Notice to be given on or before April 15, 2015 for Vacancy Date effective April 30, 2015; (ii) on or before April 30, 2015 for May 15, 2015; (iii) on or before May 15, 2015 for May 30, 2015; and (iv) on or before May 30, 2015 for June 15, 2015.</li> <li>On the earlier of the expiry of the Leaseback Period or the Vacancy Date of any Leaseback, the Tenant will leave each Leaseback Premises in broom-swept condition as required by the provisions of the Initial Order and the Sale Order, and the Landlord Entity which is the landlord/sub-landlord/sub-sublandlord of that Leaseback will accept the Leaseback Premises in such condition, and notwithstanding anything to the contrary in the Leaseback, the Tenant will not be responsible for making any repairs, replacements, renovations, alterations, improvements or upgrades in or to any of the Leaseback Premises, except as provided for in the Initial Order or</li> </ul>

<p align="center"><b>Target Canada Co. (the “Tenant”)</b>  <b>Summary of Lease Transaction Agreement</b></p>	
	<p>the Sale Order and other than to leave the Leaseback Premises in broom-swept condition and in the condition required by the provisions of the Initial Order and the Sale Order.</p>
<b>Landlord Claims</b>	<ul style="list-style-type: none"> <li>On Closing, the Landlord Entities will execute a release in the form attached as Schedule “N” (each a “<b>Release of Landlord Claims</b>”) in favour of the Tenant Releasees whereby each Landlord Entity on its own behalf and on behalf of its Affiliates that own or owned a direct or indirect interest in the real properties of which any of the Premises form a part (collectively, the “<b>Properties</b>”) and on behalf of each beneficial owner that now owns an interest in its respective Properties will: (a) fully and unconditionally release and forever discharge each of the Tenant Releasees of and from any and all Claims which each Landlord Entity ever had, now has or hereafter can, shall or may have against any of the Tenant Releasees in any way relating to or arising from any of the Release Matters, but excluding Claims against the Tenant in any way relating to or arising from (i) the Tenant’s obligations or liabilities under the Agreement which are expressly stated to survive the Closing of the Agreement, and (ii) the Leasebacks or any other Closing Documents; and (b) fully and unconditionally release and forever discharge each of the Tenant Affiliate Releasees of and from any and all Claims which each Landlord Entity ever had, now has or hereafter can, shall or may have against any of the Tenant Affiliate Releasees in any way related to or arising from any of the Properties. None of the Landlord Entities shall have any Claims in the CCAA Proceedings in connection with the Release Matters or in connection with any matter relating to or arising from the Properties.</li> <li>“<b>Release Matters</b>” means the Real Property Interests, the Leases and the Premises.</li> <li>“<b>Tenant Releasees</b>” mean collectively, the Tenant Affiliate Releasees and the HBC Entities.</li> <li>“<b>Tenant Affiliate Releasees</b>” means collectively, the Applicants, the Partnerships and Target Corporation and all predecessors in interest to the Tenant under any of the Leases (other than the HBC Entities) each of their respective Affiliates, directors, officers, employees, agents, shareholders, members, partners, general partners, limited partners, successors and permitted assigns.</li> <li>“<b>HBC Entities</b>” means collectively, Zellers Inc. and Hudson’s Bay Company and their respective successors and assigns.</li> </ul>
<b>Tenant Claims</b>	<ul style="list-style-type: none"> <li>On Closing, the Tenant and Target Corporation will execute a release in the form attached as Schedule “O” to the Agreement in favour of the Landlord Releasees whereby the Tenant and Target Corporation will fully and unconditionally release and forever discharge each of the Landlord Releasees of and from any and all Claims which each of Tenant and Target Corporation ever had, now has or hereafter can, shall or may have against any of the Landlord Releasees, whether in respect of the period prior to or after Closing, in any way relating to or arising from: (a) any of the Release Matters; and (b) the properties of which any of the Premises form a part, but excluding Claims in any way relating to or arising from (i) the Landlord Entities’ obligations or liabilities under the Agreement which are expressly stated to survive the Closing of the Agreement; and (ii) the Leasebacks or any other Closing Documents.</li> <li>“<b>Landlord Releasees</b>” mean collectively, the Landlord Entities and their respective Affiliates, directors, officers, employees, agents, shareholders, members, partners, general partners, limited partners, and successors and permitted assigns.</li> </ul>
<b>Guarantees</b>	<ul style="list-style-type: none"> <li>On Closing, each Landlord Entity, on its own behalf and on behalf of its Affiliates that own or owned a direct or indirect interest in the Properties and on behalf of each beneficial owner that now owns an interest in its respective Properties, and all of their respective successors and assigns, which holds a guarantee or indemnity from any of the Tenant Affiliate Releasees in connection with any Lease, including without limitations, the Guarantees, will provide full and</li> </ul>

<b>Target Canada Co. (the “Tenant”)</b> <b>Summary of Lease Transaction Agreement</b>	
	final releases in favour of the Tenant Affiliate Releasees in respect of all covenants, obligations, liabilities, Claims, indemnities and guarantees of the Tenant Affiliate Releasees in any way relating to or arising from or under the Guarantees, the Release Matters and/or the properties of which any of the Premises form a part.
<b>Other Terms and Conditions</b>	<ul style="list-style-type: none"> <li>Except as otherwise expressly set out in the Agreement and except for the Tenant’s covenant to leave the premises in broom-swept condition on the Vacancy Date, the Landlord Entities are accepting a surrender of the Real Property Interests on the Closing Date and accepting the Premises on an “as is, where is” basis and subject to the Permitted Encumbrances.</li> <li><b>“Permitted Encumbrance”</b> means, collectively: (a) any Encumbrances encumbering the fee simple ownership or Landlord Entity interest of the properties on which the Premises are located, but excluding, for greater certainty, any Encumbrances which were created or caused by Tenant or were consented by Tenant (unless at the request of a Landlord Entity); and any Encumbrances charging the leasehold interest (or the rights of the Tenant as lessee) in and to the properties on which the Premises are located; (b) the Leasebacks; and (c) the Site Plan Agreement.</li> </ul>
<b>No Shop</b>	<ul style="list-style-type: none"> <li>From the date of execution of the Agreement until the earlier of the Closing or termination of the Agreement pursuant to its terms, neither the Tenant, Target Corporation nor the Monitor, Lazard or the Broker will solicit or approach another party or enter into or participate in any negotiations or discussions with another party, or invite another party to submit any offer, regarding any transaction for all or some of the Real Property Interests or in respect of the assignment of any of the Leases or Premises without the prior written consent of the Landlord Entities; provided however that nothing in the No Shop shall otherwise prohibit the Tenant, Target Corporation, the Monitor or Lazard from undertaking the Real Property Portfolio Sales Process as may be modified, supplemented or amended by the Court from time to time, including the distribution of process letters and other instructions from potential bidders and provision of access to the data room.</li> </ul>

#### Monitor Support of the Lease Transaction Agreement

4.12 In assessing whether to provide its support to the Applicants’ entering into, and seeking the Court’s approval of, the Lease Transaction Agreement at this relatively early stage of the Real Property Portfolio Sales Process, the Monitor considered the following:

- (a) the proposed consideration, which in the view of Lazard, and as supported by the Broker’s analysis (attached as **Confidential Appendix “B”** to this Third Report), is at the high end of the value range for the Leases and significantly greater when factoring in the estimated value to TCC of claims waivers;



- (b) the Landlords indicated that the consideration which is provided for in the Lease Transaction Agreement was a “one-time offer”, and as such there was no certainty that a transaction(s) on similar terms would have been available at a later time if the offer was rejected and the Leases remained in the Real Property Portfolio Sales Process;
- (c) the Leaseback and Vacancy Date arrangements provided for in the Lease Transaction Agreement allow Target Canada, through its Agent, to continue to advance and conclude the Inventory Liquidation Process and to continue to provide the accommodation to the pharmacy franchisees;
- (d) the Lease Transaction Agreement provides a mechanism to allow TCC to conduct a managed exit on a store-by-store basis, designed to help minimize payments related to “go dark” periods for certain premises;
- (e) the speed and certainty of Closing (including the en bloc nature of the Transaction) provided for in the Lease Transaction Agreement, including that there is no requirement to seek an assignment of the Leases on behalf of a new tenant or Landlord consent of same if required under the Leases;
- (f) there are no financing or other non-customary, material conditions to the Lease Transaction Agreement;
- (g) the Lease Transaction Agreement provides for a release of claims in favour of TCC, thereby eliminating certain claims that might otherwise be provable against the Target Canada Entities in a claims process, and reducing potential aggregate claims;

- (h) the Lease Transaction Agreement also provides for a release in favour of Target Corporation under guarantees or indemnities provided to the Landlord Entities in respect of five of the Leases (as referenced above), or by third party predecessors thereby eliminating certain potential subrogated claims that Target Corporation or third party predecessors might otherwise have against the Target Canada Entities in a claims process, and reducing potential aggregate claims;
- (i) the intended flexibility of paragraph 44 of the Real Property Portfolio Sales Process, which provides the Applicants, in consultation with Lazard and the Monitor, with the ability to withdraw any Leases or Real Property from the Real Property Portfolio Sales Process in accordance with the CCAA, the Applicants' rights under the Initial Order, or if any agreement is reached with a landlord of the relevant Leases;
- (j) the process leading to the Lease Transaction Agreement and the consideration to be received in light of the requirements of, *inter alia*, section 36 of the CCAA, including that the Monitor does not believe that a realization of the Surrendered Assets under a bankruptcy would be more beneficial to the creditors of the Target Canada Entities; and
- (k) Lazard recommends and supports the approval of the Lease Transaction Agreement, as described in the Pohl Affidavit.

4.13 In the Monitor's view, the premium consideration offered by the Landlord Entities, Lazard's assessment of the benefits and their support of the proposed Transaction, the valuation analysis prepared by the Broker supporting the Transaction, and the other factors set out above are sufficiently compelling such that the Monitor supports and recommends that the Court approve the Lease Transaction Agreement.

## **5.0 TERMINATION OF THE SUBLEASE/LEASEBACK ARRANGEMENTS WITH TARGET CANADA PROPERTY LLC**

5.1 As described in the Wong Affidavit sworn in support of the application for the Initial Order granted January 15, 2015 and the First Report, pursuant to agreements between TCC, TCC Prop LP and TCC Propco (each as defined below) (collectively, the “**TCC Propco Agreements**”):

- (a) almost all of the retail store leases held by TCC were subleased (and three retail stores owned by TCC were leased) by TCC to Target Canada Property LP (“**TCC Prop LP**”), a limited partnership organized under the laws of Ontario, and TCC Prop LP subsequently sub-subleased the properties back to TCC (the “**TCC Propco Arrangement**”). TCC Prop LP subsequently assigned all of its rights relating to the TCC Propco Arrangement to Target Canada Property LLC (previously defined herein as “**TCC Propco**”), a limited liability company organized under the laws of Minnesota. TCC Prop LP and/or TCC Propco made and financed real property improvements to the premises, including improvements to fixtures; and
- (b) TCC Prop LP and, following the assignment, TCC Propco paid for all leasehold improvements at the retail stores, which collectively totaled approximately \$1.45 billion. TCC and TCC Propco had been making the following payments prior to the CCAA filing:

Monthly: TCC paid its monthly lease payments directly to its landlords and TCC Propco reimbursed TCC approximately USD \$8 million per month under the sublease arrangements;

Quarterly: TCC paid TCC Propco approximately USD \$60 million per quarter comprised of: (i) USD \$24 million for its sublease obligations of USD \$8 million per month for three months; and (ii) USD \$36 million for additional rent in connection with TCC Propco's payment for real property improvements (the "**Real Property Improvement Payments**"); and

Annually: TCC Propco paid TCC an administrative fee of approximately USD \$9 million for property management, business and procurement services (which services or payments were not covered by the Master Agreement previously described to the Court).

- (c) Upon early termination of any of the property leases by TCC Propco to TCC, a termination payment from TCC to TCC Propco is crystallized in accordance with the methodology set out in the TCC Propco Agreements.

5.2 As part of the Orderly Wind-down, TCC will be closing its stores and is winding down its business, including the TCC Propco Arrangement. Prior to and since the date of the Initial Order granted January 15, 2015, the Applicants and their legal counsel have conducted extensive review and analyses of the TCC Propco Agreements, with particular focus on the impact of the TCC Propco Arrangement on TCC's ability to disclaim, assign or surrender its right, title and interest in its real property leases on a free and clear basis. The Monitor and/or its legal counsel have been included in and/or kept apprised of all significant aspects of this work.

5.3 As described in the Fifth Wong Affidavit, the Applicants and their legal counsel concluded that the wind down of the TCC Propco Arrangement is necessary in order to disclaim, assign or surrender leases and certain other agreements and that the TCC Propco Arrangement should be unwound in accordance with its contractual terms in the manner described below. In addition, the proposed Lease Transaction Agreement specifically requires that TCC "agrees to terminate, prior

to Closing, any sublease, licence or other agreement granted by Tenant in favour of any Person and providing for a right of occupancy in all or any portion of the Premises or otherwise affecting the Real Property Interests”.

5.4 As such, TCC, TCC Propco and TCC Prop LP, in consultation with and on the consent of the Monitor, entered into a mutual termination agreement (the “**Mutual Termination Agreement**”), whereby the TCC Propco Agreements were terminated effective February 25, 2015 (the “**Mutual Termination**”) in accordance with their terms.

5.5 As noted above, pursuant to the TCC Propco Agreements, upon the early termination of the TCC Propco Agreements, a termination payment is crystallized (the “**Termination Payment**”) in connection with the remaining payment obligations of TCC to TCC Propco for leasehold improvements made and financed by TCC Propco. The Termination Payment is calculated using the present value of the sum of the Real Property Improvement Payments (being 12.5% per annum of the total cost of the real property improvements) over the remaining term of the sub-leases, discounted at a rate of 7% per annum. Based on this formula, the Applicants have calculated the Termination Payment to be approximately \$1.9 billion. The Monitor has reviewed the Applicants’ calculation on a preliminary basis. In addition, certain obligations relating to rent and fees payable pursuant to the TCC Propco Agreements crystallized as part of the Mutual Termination. It is anticipated that the amount of any potential claims by TCC Propco against TCC and by TCC against TCC Propco will be subject to a broader review and future report to the Court by the Monitor with respect to all intercompany claims, pursuant to a court-approved claims process to be conducted later in these CCAA Proceedings.

## **6.0 CASH FLOW RESULTS RELATIVE TO FORECAST**

6.1 Receipts and disbursements for the period January 15, 2015 to February 21, 2015 (the “**Reporting Period**”), as compared to the updated and extended cash flow forecast that was

attached as Appendix “B” to the Supplementary Report (the “Cash Flow Forecast”), are summarized in the table below.

(\$ in 000's CAD, unless otherwise noted)

<i>Period Ended</i>	Cumulative		
	Budget 21-Feb	Actual 21-Feb	Variance B / (W)
<b>OPERATING RECEIPTS</b>			
Sales Receipts	\$ 291,644	\$ 306,728	\$ 15,084
Other Receipts	941	1,906	964
<b>TOTAL RECEIPTS</b>	<b>292,586</b>	<b>308,634</b>	<b>16,048</b>
<b>OPERATING DISBURSEMENTS</b>			
Employee Payments	50,181	47,816	2,365
Rent & Occupancy	17,849	14,937	2,911
DC / Logistics	31,229	22,331	8,898
Normal Course Taxes	48,447	23,001	25,446
Professional Fees	9,140	7,926	1,214
All Other	18,857	11,277	7,580
Current Operating Disbursements	175,702	127,288	48,414
<b>OPERATING CASH FLOW</b>	<b>116,884</b>	<b>181,346</b>	<b>64,462</b>
<b>INTERCOMPANY DISBURSEMENTS</b>			
Intercompany Services	6,989	201	6,787
DIP Interest	60	76	(15)
Intercompany Disbursements	7,049	277	6,772
<b>NET CASH FLOW</b>	<b>\$ 109,834</b>	<b>\$ 181,069</b>	<b>\$ 71,235</b>
<b>WEEKLY LIQUIDITY</b>			
Beginning Bank Cash Balance [1][2]	\$ 3,169	\$ 3,169	\$ -
( +/- ) Net Cash Flow	109,834	181,069	71,235
( +/- ) Change in Cheque Float	750	510	(240)
( +/- ) DIP Draws/(Repayments)	-	-	-
( +/- ) FX Translation	(1,183)	(1,144)	39
Ending Bank Cash Balance [1]	112,571	183,604	71,033
<b>DIP Balance - USD</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>

[1] Actuals assume \$1.255 CAD/USD

[2] Beginning Cash Balance was actualized in the updated and extended cash flow forecast that was attached as Appendix "B" to the Supplementary Report

- 6.2 During the Reporting Period, the Target Canada Entities' total receipts were approximately \$16.1 million greater than projected in the Cash Flow Forecast. Management attributes this variance primarily to better than anticipated results during the store liquidation sales.
- 6.3 The Target Canada Entities' total disbursements during the Reporting Period were approximately \$48.4 million less than projected in the Cash Flow Forecast. Management attributes this variance primarily to timing differences in disbursement items such as sales taxes, distribution centre/logistics expenses and freight, shared services, utilities, and professional fees, much of which is due to delayed invoice receipts. It is anticipated that much of this variance will reverse as delayed disbursements are caught up.
- 6.4 Overall, during the Reporting Period, the Target Canada Entities experienced a positive net cash flow variance of approximately \$71.2 million relative to the Cash Flow Forecast. However, as noted above, it is anticipated that this variance will decline as the Orderly Wind-down progresses and delayed disbursements are ultimately made.
- 6.5 The closing cash balance as at February 21, 2015 was approximately \$183.6 million, as compared to the projected cash balance of \$112.6 million. The variance was due almost entirely to the net positive variance in receipts and disbursements described above.
- 6.6 The Initial Order entitles the Target Canada Entities to continue to utilize their existing Cash Management System, as described in the Pre-Filing report. The Cash Management System of the Target Canada Entities continues to operate in the same manner as it had prior to the commencement of the CCAA Proceedings.

## **7.0 MONITOR'S ACTIVITIES**

- 7.1 Since the granting of the Initial Order on January 15, 2015, the Monitor has worked closely with the Target Canada Entities to assist in stabilizing its business and operations. All 133 open stores

in Canada have remained operational to date. As summarized in the First and Second Reports and below, this has included concerted efforts to address urgent supply chain and other logistical issues essential to the Orderly Wind-down and extensive communications with stakeholders, as well as assisting with other activities essential to the Orderly Wind-down, including matters related to the Inventory Liquidation Process and the Real Property Portfolio Sales Process. The Monitor will continue to communicate with stakeholders and assist with and facilitate the stabilization of the business and the Orderly Wind-down, in the interests of all stakeholders.

7.2 In the Second Report and in submissions to the Court on February 11, 2015, the Monitor undertook to provide information regarding the quantity of TCC's inventory: (a) received and in-transit (where title had transferred to TCC) as at January 15, 2015; and (b) received and/or where title had transferred to TCC and had not been paid for during the 30-day period immediately preceding January 15, 2015 (the "**Requested Information**"). The Monitor was also asked by the Court to update the Service List as to its progress in assembling the Requested Information no later than February 18, 2015. The Monitor served the Inventory Update Letter on the service list on February 18, 2015. The Monitor anticipates that the Requested Information will be available within the 14 business day timeframe from February 11, 2015, subject to any unforeseen delays in completing the remaining work.

7.3 In addition to the Monitor's ongoing supervision and involvement with the Inventory Liquidation Process (as described in the First Report and the Second Report) and the Real Property Portfolio Sales Process (as described above), the activities of the Monitor from the date of the Second Report have included the following:

- assisting the Applicants with communications with employees, PFAC, pharmacy franchisees, suppliers and other parties;



- assisting TCC in stabilizing its supply chain, including extensive communications with the third-party operator of TCC's distribution centres, vendors, freight forwarders and consolidators, ocean freight carriers and other transportation companies, and TCC's customs broker, with a view to minimizing supply disruption and continuing the movement of goods-in-transit to the distribution centres and stores;
- numerous discussions with the Applicants and the Agent regarding the Inventory Liquidation Process;
- participating in ongoing discussions with the Applicants, Lazard and the Broker regarding the Real Property Portfolio Sales Process;
- assisting the Applicants in responding to questions from creditors related to inventory balances and goods received within 30 days prior to the date of the Initial Order granted on January 15, 2015;
- numerous discussions with suppliers and other creditors, including with respect to requests for critical supplier status;
- responding to a high volume of enquiries from stakeholders, including addressing questions or concerns of parties who contacted the Monitor on the toll-free number or email account established by the Monitor;
- monitoring the receipts, disbursements, purchase commitments and arrangements for deposits with certain suppliers and creditors of the Applicants, including tracking outstanding balances and commitments due to critical service providers;

- assisting the Applicants in assessing certain components of the Orderly Wind-down, including the disclaimer of contracts and agreements, employee reductions and other matters;
- responding to the Applicants' requests for consents to disclaimer of agreements;
- corresponding with and tracking claims transfers and assignments received from purchasers of creditor claims and responding to questions regarding same;
- in its capacity as Administrator of the Employee Trust: communications with and among TCC, Target Corporation (in its capacity as Settlor), Employee Representative Counsel, Monitor counsel, Applicants' counsel and the Trustee regarding the Employee Trust; assisting TCC in its calculation of specific entitlement amounts for Eligible Employees; and with the consent of the Trustee, issuing two payments from the Trust to TCC totaling approximately \$9.2 million; and
- posting non-confidential materials filed with the Court to the website established by the Monitor for the CCAA Proceedings.

**8.0 MONITOR'S RECOMMENDATION**

8.1 For the reasons set out in this Third Report, the Monitor is of the view that the relief requested by the Applicants is reasonable and respectfully recommends that this Court make the Order granting the relief requested by the Applicants.

All of which is respectfully submitted to this Court this 27<sup>th</sup> day of February, 2015.

**Alvarez & Marsal Canada Inc., in its capacity  
as Monitor of Target Canada Co., and  
the other Applicants listed on Appendix "A"**

Per:



Name: Douglas R. McIntosh  
Title: President

Per:



Name: Alan J. Hutchens  
Title: Senior Vice President

## **APPENDIX “A”**

### **Applicants**

Target Canada Co.

Target Canada Health Co.

Target Canada Mobile GP Co.

Target Canada Pharmacy (BC) Corp.

Target Canada Pharmacy (Ontario) Corp.

Target Canada Pharmacy (SK) Corp.

Target Canada Pharmacy Corp.

Target Canada Property LLC

### **Partnerships**

Target Canada Pharmacy Franchising LP

Target Canada Mobile LP

Target Canada Property LP

## **APPENDIX “B”**

**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 OR COMPROMISE OR  
ARRANGEMENT OF TARGET CANADA CO., TARGET  
CANADA HEALTH CO., TARGET CANADA MOBILE GP  
CO., TARGET CANADA PHARMACY (BC) CORP., TARGET  
CANADA PHARMACY (ONTARIO) CORP. TARGET  
CANADA PHARMACY CORP., TARGET CANADA  
PHARMACY (SK) CORP., AND TARGET CANADA PROPERTY LLC.**

**SECOND REPORT OF THE MONITOR  
ALVAREZ & MARSAL CANADA INC.**

**FEBRUARY 9, 2015**

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## 1.0 INTRODUCTION

1.1 On January 15, 2015, Target Canada Co. (“**TCC**”) and those companies listed in **Appendix “A”** (collectively, the “**Applicants**”), together with the Partnerships also listed in **Appendix “A”** (the “**Partnerships**”, and collectively with the Applicants, the “**Target Canada Entities**”), applied for and were granted protection by the Ontario Superior Court of Justice (Commercial List) (the “**Court**”) under the *Companies’ Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended (the “**CCAA**”). Pursuant to an Order of this Court dated January 15, 2015 (the “**Initial Order**”), Alvarez & Marsal Canada Inc. (“**A&M**”) was appointed Monitor of the Target Canada Entities in the CCAA proceedings (the “**Monitor**”). The proceedings commenced by the Applicants under the CCAA are referred to herein as the “**CCAA Proceedings**”.

1.2 In connection with the CCAA Proceedings, the Monitor has provided to this Court the First Report of the Monitor (the “**First Report**”) dated January 30, 2015 and the Supplemental Report to the First Report (the “**First Supplemental Report**”) dated February 3, 2015, and A&M has provided to this Court the Pre-Filing Report of the Proposed Monitor (the “**Pre-Filing Report**”) dated January 14, 2015 (collectively, the “**Prior Reports**”). The Prior Reports, Initial Order and other Court-filed documents and notices in these CCAA Proceedings are available on the Monitor’s website at [www.alvarezandmarsal.com/targetcanada](http://www.alvarezandmarsal.com/targetcanada). For ease of reference, the First Report is attached as **Appendix B** to this Second Report.

1.3 The Initial Order, among other things:

- (a) granted a stay of proceedings (the “**Stay**”) through February 13, 2015 (the “**Stay Period**”) in favour of the Target Canada Entities;
- (b) provided the Target Canada Entities with the ability to, among other things, engage in discussions with and solicit proposals and agreement(s) from third

parties in respect of the liquidation of the inventory, furniture, equipment and fixtures located in and/or forming part of the Property (the “**Liquidation Agent Solicitation Process**”) and return to Court for approval of such agreement(s);

- (c) approved the engagement of Lazard Frères & Co. LLC (“**Lazard**”) as financial advisor and of Northwest Atlantic (Canada) Inc. (“**Northwest**”) as broker advisor;
- (d) authorized and directed the DIP Entities to enter into and borrow under the DIP Facility provided by Target Corporation;
- (e) approved the creation of the Employee Trust on substantially the terms and conditions set out in the Employee Trust Agreement, including without limitation, the appointments of Hon. John D. Ground as trustee (the “**Trustee**”) and the Monitor as administrator (the “**Administrator**”) of the Employee Trust;
- (f) approved the Key Employees Retention Plan (“**KERP**”);
- (g) appointed Koskie Minsky LLP (“**Koskie Minsky**” or “**Employee Representative Counsel**”) as counsel for all employees other than officers and directors (the “**Employees**”) of the Target Canada Entities in these CCAA Proceedings, any proceeding under the *Bankruptcy and Insolvency Act* (the “**BIA**”) or in any other proceeding respecting the insolvency of the Applicants which may be brought before this Court (the “**Insolvency Proceedings**”) for any issues affecting the Employees in the Insolvency Proceedings including, without limitation, with respect to the Employee Trust Agreement and the Claims Process (as defined in the Employee Trust Agreement);

- (h) provided the Target Canada Entities with the ability, but not the requirement, to pay, among other things, the following expenses whether incurred prior to, on or after the Initial Order to the extent that such expenses are incurred and payable by the Target Canada Entities:
  - (i) all outstanding and future wages, salaries, employee benefits (including, without limitation, employee medical, dental and similar benefit plans or arrangements), vacation pay and expenses payable on or after the date of the Initial Order, in each case incurred in the ordinary course of business and consistent with existing compensation policies and arrangements, and all other payroll processing expenses;
  - (ii) all outstanding or future amounts owing in respect of customer rebates, refunds, discounts or other amounts on account of similar customer programs or obligations;
  - (iii) all outstanding or future amounts related to honouring gift cards issued before or after the date of the Initial Order;
  - (iv) the fees and disbursements of any Assistants retained or employed by the Target Canada Entities at their standard rates and charges;
  - (v) with the consent of the Monitor, amounts owing for goods and services actually supplied to the Target Canada Entities prior to the date of the Initial Order by:
    - (A) logistics or supply chain providers, including customs brokers and freight forwarders and security and armoured truck carriers;

(B) providers of credit, debit and gift card processing related services;

(C) other third party suppliers up to a maximum aggregate amount of \$10 million, if, in the opinion of the Target Canada Entities, the supplier is critical to the Orderly Wind-down; and

(D) any and all sums due and owing to Amex Bank of Canada and JPMorgan in respect of credit cards issued to management and employees of the Target Canada Entities; and

(i) approved the Administration Charge, the KERP Charge, the Directors' Charge, the Financial Advisor Subordinated Charge and the DIP Lender's Charge in the amounts and relative priority as set out in the Pre-Filing Report.

1.4 On January 29, 2015, the Applicants brought a motion returnable February 4, 2015 for, among other things, Orders:

(a) approving the Agency Agreement (defined below), including the Sales Guidelines attached thereto (the "**Sales Guidelines**");

(b) approving the Real Property Portfolio Sales Process; and

(c) extending the Stay Period to May 15, 2015.

1.5 On February 4, 2015, this Court issued an order (the "**Approval Order – Agency Agreement**") approving: (i) the Agency Agreement, including the Sales Guidelines, entered into between TCC, Target Canada Pharmacy Corp. and Target Canada Pharmacy (Ontario) Corp. (collectively, "**Target Canada**"), and a contractual joint venture comprised of Merchant Retail Solutions ULC, Gordon Brothers Canada ULC and GA Retail Canada, ULC (collectively, the "**Agent**") on January 29, 2015 (the "**Agency Agreement**"), and certain related relief; and (ii) the granting of

the Agent's Charge and Security Interest (as defined in the Approval Order – Agency Agreement).

1.6 The Approval Order – Agency Agreement, authorized the Agent to conduct the Sale of inventory and furniture, fixtures and equipment in accordance with the Order, the Agency Agreement and the Sales Guidelines, and to advertise and promote the Sale within the Stores (each as defined in the Approval Order – Agency Agreement) in accordance with the Sales Guidelines. The Inventory Liquidation Process commenced in the retail stores on February 5, 2015.

1.7 Also, on February 4, 2015, this Court issued an Endorsement providing that:

- (a) the Court will determine the terms of the Real Property Portfolio Sales Process upon a motion returnable on February 11, 2015;
- (b) pending the determination of the terms of the Real Property Portfolio Sales Process:
  - (i) Lazard is authorized to contact prospective interested parties;
  - (ii) Lazard is authorized to provide such interested parties with a “teaser” and form of confidentiality agreement (“CA”);
  - (iii) Lazard and the Applicants are authorized to negotiate the terms of such CAs and the Applicants are authorized to enter into such agreements;
  - (iv) Interested parties are permitted to undertake due diligence, including: (i) receiving a confidential information memorandum (“**CIM**”) from Lazard; (ii) being permitted access to the data room; and (iii) conducting site visits, if requested; and

(v) Lazard can enter into preliminary discussions with interested parties; and

(c) the stay extension motion will be heard on February 11, 2015.

1.8 The purpose of this second report (the “**Second Report**”) is to provide this Court with:

(1) information regarding the following:

(a) the proposed amendments to the Initial Order;

(b) the Applicants’ motion for approval of the Real Property Portfolio Sales Process;

(c) the motion by the Employee Representatives (as defined later in this Second Report), on behalf of all employees of the Applicants as at January 15, 2015, to seek the appointment of the Employee Representatives to represent the Target Employees (excluding Opt-Out Individuals, if any) in the CCAA Proceedings or in any other Insolvency Proceedings, and certain related relief;

(d) pharmacy matters and the motion by the Pharmacy Franchisee Association of Canada (“**PFAC**”) to seek: (i) the appointment of PFAC as the representative of the Pharmacists and Franchisees under the Pharmacy Franchise Agreements in the CCAA Proceedings; (ii) the appointment of Sutts, Strosberg LLP as Pharmacist Representative Counsel; (iii) the appointment of BDO Canada as Pharmacist Financial Advisor; (iv) payment from the estate of legal and other authorized professional expenses of PFAC, including funding for the involvement of a second law firm, Gardiner Roberts LLP; (v) an administrative charge in favour of the legal fees and other professional expenses of PFAC; (vi) direction pursuant to section 32(2) of the CCAA seeking a declaration that the Pharmacy Franchise Agreements and/or related agreements are not to be

disclaimed or resiliated without further Court order and related relief; and (vii) such further relief as the Court may seem just;

(e) the Applicant's motion for an extension of the Stay Period until May 15, 2015;

(f) the Monitor's activities since the date of the First Report; and

(2) the Monitor's conclusions and recommendations in connection with the foregoing.

## **2.0 TERMS OF REFERENCE AND DISCLAIMER**

2.1 In preparing this Second Report, the Monitor has been provided with, and has relied upon, unaudited financial information, books and records and financial information prepared by the Target Canada Entities and Target Corporation, and discussions with management of the Target Canada Entities and Target Corporation (collectively, the "**Information**"). Except as otherwise described in this Second Report in respect of the Target Canada Entities' cash flow forecast:

(a) the Monitor has reviewed the Information for reasonableness, internal consistency and use in the context in which it was provided. However, the Monitor has not audited or otherwise attempted to verify the accuracy or completeness of the Information in a manner that would wholly or partially comply with Canadian Auditing Standards ("**CASs**") pursuant to the *Chartered Professional Accountants Canada Handbook* and, accordingly, the Monitor expresses no opinion or other form of assurance contemplated under CASs in respect of the Information; and

(b) some of the information referred to in this Second Report consists of forecasts and projections. An examination or review of the financial forecasts and

projections, as outlined in the *Chartered Professional Accountants Canada Handbook*, has not been performed.

- 2.2 Future oriented financial information referred to in this Second Report was prepared based on management's estimates and assumptions. Readers are cautioned that since projections are based upon assumptions about future events and conditions that are not ascertainable, the actual results will vary from the projections, even if the assumptions materialize, and the variations could be significant.
- 2.3 This Second Report should be read in conjunction with the First Report, the Affidavit of Mark J. Wong, General Counsel and Assistant Secretary of TCC, sworn January 29, 2015 (the "**Second Wong Affidavit**"), the Supplemental Affidavit of Mark J. Wong sworn February 9, 2015 (the "**Third Wong Affidavit**") and the Affidavit of Mark J. Wong dated February 9, 2015 (the "**Fourth Wong Affidavit**").
- 2.4 Capitalized terms not otherwise defined in this Second Report are as defined in the Prior Reports, the Initial Order, the Third Wong Affidavit and the Fourth Wong Affidavit, as applicable.
- 2.5 Unless otherwise stated, all monetary amounts contained in this Second Report are expressed in Canadian dollars.

### **3.0 PROPOSED AMENDMENTS TO INITIAL ORDER**

- 3.1 As described in the Second Wong Affidavit, the Target Canada Entities have initiated extensive communications with TCC's landlords as part of the CCAA filing, including several meetings in person or by phone during the weeks of January 26, 2015 and February 2, 2015 involving representatives of the Target Canada Entities, the Monitor and counsel for (and in some cases, business representatives of) several large retail landlords who hold or manage, in aggregate, the majority of the TCC store leases (the "**Landlord Group**"). Following these meetings, a group of



counsel representing the Landlord Group provided a consolidated mark-up of the Initial Order to the Applicants (the “**Landlord Consolidated Comments**”). The Landlord Consolidated Comments primarily related to changes to: (a) provisions in the Initial Order regarding obligations, rights and remedies under the leases that were additions to the model order language; and (b) the stay in respect of Target US.

3.2 The Applicants, the Monitor and their respective counsel reviewed the Landlord Consolidated Comments and discussed those comments with counsel for the Landlord Group and counsel for Target Corporation (the latter given that the requested changes would affect the stay of Target US guarantees granted with respect to certain of TCC’s leases).

3.3 Following extensive discussions and negotiations regarding the Initial Order and the Real Property Portfolio Sales Process (as described further below), the following summarizes the key agreed changes to the Initial Order to form part of an Amended and Restated Initial Order<sup>1</sup>:

- (a) clarification that the Target Canada Entities may vacate, abandon or quit the whole but not part of any leased premises and may permanently but not temporarily cease, downsize or shut down;
- (b) clarification as to what was intended by inserting the word “normally” before “payable to the landlord under its lease” in paragraph 13 of the Initial Order, namely, that penalties, fees or other charges arising as result of the insolvency of the Target Canada Entities or the making of the Initial Order are not required to be paid pending disclaimer of a lease;

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<sup>1</sup> A blackline of the Amended and Restated Initial Order to the Initial Order is attached as Exhibit “D” to the Third Wong Affidavit.

- (c) deletion of a provision that the Landlord Group interpreted as an authorization to override terms of their leases, as opposed to a possible breach in respect of which their rights and remedies would be stayed;
- (d) an exception to the stay in favour of Target US such that the stay does not apply to any landlord in connection with any right, remedy or claim such landlord may have against Target US in connection with any indebtedness, indemnity, liability or obligation of Target US pursuant to a written contractual indemnity, guarantee or surety provided by Target US to such landlord;
- (e) approval of an orderly process to determine Landlord Guarantee Claims (as defined therein) of any landlord against Target US relating to a lease of real property, including that such claims: (i) shall be determined by a judge of the Ontario Superior Court of Justice (Commercial List), notwithstanding any federal or provincial statutes with respect to procedural matters relating to Landlord Guarantee Claims; provided that any landlord holding such guarantees or indemnities that has not consented to the foregoing may, within 15 days of the making of the Order, bring a motion to have the matter of the venue for the determination of its Landlord Guarantee Claim adjudicated by the Court; (ii) shall not be determined in the CCAA Proceedings; (iii) shall be unaffected by any determination of any rights, remedies and claims of such landlords as against the Target Canada Entities in the CCAA Proceedings or in any subsequent proposal or bankruptcy proceedings under the BIA (other than that any recoveries under such proceedings received by such landlords shall constitute a reduction and offset to any Landlord Guarantee Claims); and (iv) shall be treated as unaffected and shall not be released or affected in any plan filed under the CCAA or any proposal filed under the BIA.

3.4 Counsel for the Landlord Group advised that the Real Property Portfolio Sales Process proceeding on a consensual basis as described below is conditional on the proposed changes to the Initial Order.

3.5 The Monitor recommends approval of the Amended and Restated Initial Order as it reflects: (a) revisions negotiated as among the Target Canada Entities, the Landlord Group and Target US (in conjunction with revisions to the Real Property Portfolio Sales Process), with the assistance of the Monitor; and (b) a fair and reasonable balancing of interests.

#### **4.0 REAL PROPERTY PORTFOLIO SALES PROCESS**

4.1 The Real Property Portfolio Sales Process is described in detail in the First Report (attached as **Appendix B** to this Second Report).

4.2 Following the February 4, 2015 Court hearing, the Applicants and the Monitor have participated in several discussions with counsel for the Landlord Group, and with Lazard, in an effort to resolve matters with respect to the Real Property Portfolio Sales Process. These discussions have culminated in certain changes to the Real Property Portfolio Sales Process from the version included in the Applicants' Motion Record dated January 29, 2015, of which the key changes are summarized below<sup>2</sup>:

- (a) Monitor Supervision and Control – The initial Real Property Portfolio Sales Process explicitly referenced that the Monitor will supervise, in all respects, the Real Property Portfolio Sales Process (including any attendant sales and the Financial Advisor's performance under its engagement with TCC) and included many procedures requiring Monitor consent. The revised Real Property Portfolio

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<sup>2</sup> A blackline of the Real Property Portfolio Sales Process to the version included in the Motion Record dated January 29, 2015 is attached as Exhibit "C" to the Third Wong Affidavit.

Sales Process incorporates additional specific instances requiring Monitor consent. In aggregate, the following procedures under the Real Property Portfolio Sales Process require Monitor consent (in addition to other procedures requiring consultation with the Monitor):

- (i) extension of the bid deadlines;
- (ii) waiver of compliance with requirements relating to Qualified LOIs and Qualified Bids;
- (iii) extension of the timing to assess Qualified LOIs received;
- (iv) the determination (if one or more Qualified LOIs is received) of whether there is a reasonable prospect of obtaining a Qualified Bid and to continue the sale process;
- (v) determination of whether to proceed with a stalking horse bid and the selection of the stalking horse bid, including specifically with respect to any Break Fee and Expense Reimbursement;
- (vi) determination of which is the most favorable Qualified Bid (including which would be the baseline bid at auction);
- (vii) modification of auction procedures;
- (viii) modifications to the process (with any material modification now requiring Court approval); and
- (ix) rejection of any or all bids.

- (b) Landlord Bid Participation for their Leases – Certain requirements for Qualified LOIs and Qualified Bids are not applicable to proposals or bids that may be submitted by landlords for their respective Leases. Accordingly, definitions of a Landlord LOI and Landlord Qualified Bid were added and provisions were included deeming a Landlord LOI and a Landlord Qualified Bid to be a Qualified LOI and Qualified Bid, respectively.
- (c) LOI Considerations / Bid Requirements – Considerations for assessing Qualified LOIs were revised to include, among other things, the financial capability of the Interested Bidder to comply with terms of the applicable Lease(s) and requirements for Qualified Bids were revised to include, among other things, evidence of the Competing Bidder's ability to meet the financial obligations under the Lease(s) subject to the bid and details of any amendments that the Competing Bidder is seeking to such Lease(s) from the applicable landlord.<sup>3</sup>
- (d) Outside Dates – Revisions were made to provide more clarity on outside dates as follows:
  - (i) the definition of "Targeted Outside Date" was revised to mean May 15, 2015, or such later date as may be determined by the Applicants, on the consent of the Monitor, and in consultation with the Financial Advisor and the DIP Lender, provided that in no event shall such date be after June 1, 2015;
  - (ii) paragraphs were added providing that:

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<sup>3</sup> With the revisions also providing that, for greater certainty, nothing in the Real Property Portfolio Sales Process shall be construed to: (i) permit or require any amendments to the terms of any Lease(s) without the consent of the applicable landlord(s); or (ii) obligate any landlord to negotiate with a Competing Bidder regarding any such amendments.

- (1) if a definitive agreement with respect to a particular Lease(s) is not executed on or before June 1, 2015, any such Lease(s) that is not subject to a definitive executed agreement on or before such date (or not earlier disclaimed, which disclaimer has become effective by June 1, 2015) shall be released from the stay of proceedings and shall be disclaimed in accordance with the CCAA and the Initial Order on June 1, 2015; and
- (2) if a transaction with respect to a particular Lease(s) has not been completed on or before June 30, 2015 or such later date as may be ordered by the Court, any such Lease(s) that is the subject of such transaction shall be released from the stay of proceedings and shall be disclaimed in accordance with the CCAA and the Initial Order on the later of (i) June 30, 2015, and (ii) such later date as may be ordered by the Court, as applicable.

- (e) Without Prejudice re: Court Approval – A provision was added confirming that nothing in the Real Property Portfolio Sales Process or in any arrangements made during the course thereof with a Successful Bidder shall prejudice a landlord's right to object to the Court approval of a Successful Bid.

4.3 The Real Property Portfolio Sales Process and Sales Process Procedures were developed by the Target Canada Entities and the Financial Advisor in consultation with the Monitor. As indicated above, following the February 4, 2015 Court hearing, extensive discussions and negotiations continued between and among the Applicants, the Monitor, Target Corporation, their respective counsel and counsel to the Landlord Group. These efforts have culminated in the agreed amendments to the Initial Order and the Real Property Portfolio Sales Process described above.

The Monitor understands that the motion for approval of the Real Property Portfolio Sales Process and the Sales Process Order is now proceeding on a consensual basis without opposition from the Landlord Group.

- 4.4 The Monitor recommends that the Court approve the Real Property Portfolio Sales Process and the Sales Process Order in order for the Applicants to: (i) continue to advance and facilitate the Orderly Wind-down; (ii) realize on the Leases and Real Property in a comprehensive and coordinated manner through a single process on a timely basis; and (iii) maximize net realizations for the benefit of all stakeholders.

## **5.0 EMPLOYEE REPRESENTATIVES**

- 5.1 The Initial Order approved the creation of the Employee Trust on substantially the terms and conditions set out in the Employee Trust Agreement and also included the appointment of Koskie Minsky as Employee Representative Counsel for all Employees in the CCAA Proceedings or any other Insolvency Proceedings for any issues affecting Employees in such proceedings, including without limitation, with respect to the Employee Trust Agreement and the Claims Process.
- 5.2 The Initial Order also provided that Koskie Minsky commence a process of identifying no more than seven Employees to be nominated as Court-appointed representatives of the Target Employees as soon as practicable (the “**Employee Representatives**”). The Employee Representatives, once appointed, are to represent the Employees in the CCAA Proceedings or Insolvency Proceedings, including, without limitation, for the purpose of settling or compromising claims of the Employees in such proceedings.
- 5.3 The process undertaken by Koskie Minsky to identify and nominate the Employee Representatives is described in the Affidavit of Natercia McLellan, an employee of Koskie Minsky, sworn February 9, 2015 (the “**McLellan Affidavit**”).

5.4 As described in the McLellan Affidavit, Frederick Payette, Sylvie Gautier, Jennifer Lindsay, Catherine Bédard, Michael O'Neill, Alyssa Morin and Joshua Gordon, each an Employee, have consented to being appointed to the role of Employee Representative.

5.5 The Employee Representatives are seeking an Order (the “**Employee Representatives Order**”) of this Court that:

- (a) approves the Employee Representatives as representatives of the Target Employees (excluding Opt-Out Individuals, as defined below, if any) in these CCAA Proceedings or in any other Insolvency Proceedings which has been or may be brought before this Court (the “**Proceedings**”) and such representatives shall determine, advance and compromise any and all Target Employees’ claims which now have arisen or may arise at law or equity or under federal or provincial legislation, including but not limited to actual or deemed trust claims, secured or unsecured claims under the BIA, contractual claims, and any claims arising under provincial employment standards, retirement savings arrangements, human rights, workplace safety and insurance legislation which may be made against the Applicants, its estate, or the Employee Trust established, as the case may be, relating to or arising out of the Target Employees’ employment with the Applicants;
- (b) the Employee Representatives or Employee Representative Counsel are authorized to take all steps and to do all acts necessary or desirable to carry out the terms of the Employee Representatives Order, including dealing with any Court, regulatory body and other government ministry, department or agency, and to take all such steps as are necessary or incidental thereto;
- (c) notice of the granting of the Employee Representatives Order be:



- (A) published by Employee Representative Counsel on its website within 2 calendar days of the date of the Employee Representatives Order;
  - (B) published by the Applicants, with the assistance of the Monitor, in The Globe and Mail and La Presse within seven calendar days of the date of the Employee Representatives Order; and
  - (C) posted by the Applicants, with the assistance of the Monitor, in each of the Applicants' stores, within two calendar days of the date of the Employee Representatives Order;
- (d) any individual Target Employee who does not wish to be represented by the Employee Representatives and Employee Representative Counsel in the Proceedings shall, within 30 days of publication in The Globe and Mail and La Presse of the notice referred to above, notify the Monitor, the Applicants and Employee Representative Counsel in writing, that he or she is opting out of representation by the Employee Representatives and Employee Representative Counsel (an “**Opt-Out Notice**”), and shall thereafter not be bound by the actions of the Employee Representatives or Employee Representative Counsel and shall represent himself or herself or be represented by any counsel that he or she may retain exclusively at his or her own expense in the Proceedings (any such persons who deliver an Opt-Out Notice in compliance with the terms of the Employee Representatives Order, being “**Opt-Out Individuals**”);
- (e) the Employee Representatives and Employee Representative Counsel have no obligation to represent the Opt-Out Individuals;

- (f) with the exception of the Opt-Out Individuals, the Employee Representatives shall represent all Target Employees, which persons shall be bound by the actions of the Employee Representatives and Employee Representative Counsel in the Proceedings;
- (g) the Employee Representatives shall have no liability as a result of their respective appointment or the fulfilment of their duties in carrying out the provisions of the Employee Representatives Order save and except for any gross negligence or unlawful misconduct on their part; and
- (h) the Employee Representatives and Employee Representative Counsel shall be at liberty and are authorized at any time to apply to this Court for advice and directions in the discharge or variation of their powers and duties.

5.6 The Monitor recommends that the Court approve the Employee Representatives Order as the terms of the order are consistent with the Initial Order and the Employee Trust Agreement, and will assist the Applicants in achieving the intended objectives of the Employee Trust Agreement.

#### Employee Trust Update

5.7 As described in the First Report, on January 23, 2015 (the “**First Separation Date**”), TCC notified approximately 560 salaried Eligible Employees (the “**Notified Employees**”) that their services were no longer required. As the First Separation Date corresponded with the end of TCC’s bi-weekly payroll cycle, the Notified Employees received their final working pay from TCC on January 30, 2015. It is anticipated that the first payment to the Notified Employees by TCC that is to be funded from the Employee Trust Account (as defined below) will be made on February 13, 2015, at the end of the following bi-weekly payroll cycle.

5.8 Since the date of the First Report (January 30, 2015), TCC has notified approximately 175 additional salaried Eligible Employees that their services are no longer required. Accordingly, as of February 6, 2015, TCC employed approximately 165 salaried Eligible Employees in its group, district and corporate head offices, including 44 international assignees. To date, no hourly employees have been notified by TCC of their separation date.

5.9 On January 29, 2015, the Monitor, in its capacity as Administrator under the Employee Trust, and the Trustee jointly opened the Target Canada Employee Trust bank account at Royal Bank of Canada (the “**Employee Trust Account**”). On February 3, 2015, counsel to the Monitor transferred the full \$90 million of contributions received from the Settlor to the Employee Trust Account.

## 6.0 PHARMACY MATTERS

### Overview

6.1 As previously identified in the Monitor’s Pre-Filing Report, the Wong Affidavit, the Second Wong Affidavit and the Monitor’s First Report, Target branded pharmacy businesses are operated in most of TCC’s stores, through corporate and franchise arrangements. Set out below is a summary regarding such arrangements and the current status of the pharmacies:

#### **Quebec Pharmacies**

- (a) In Quebec, pharmacies in TCC stores are co-branded with the Target trade-mark and the “Brunet” trade-mark, which is owned by McMahon Distributeur Pharmaceutique Inc. (“**McMahon**”). Target Pharmacy has sub-licensed the Target trade-marks to McMahon, which in turn has sub-licensed to third-party franchisees, the right to operate co-branded Target and “Brunet” pharmacies within 14 TCC stores.

- (b) There is a closure plan in place with McMahon, such that the 14 Quebec-based pharmacies will be closed on or before February 11, 2015. As of February 9, 2015, 12 have already closed, with the remaining two scheduled to close on February 11, 2015. McMahon has confirmed arrangements for the transfer of all patient files from all 14 Quebec pharmacies.

### **Corporate Pharmacies**

- (a) With respect to the three corporate-owned pharmacies, an agreement regarding the orderly transfer of patient information to Wal-Mart Canada Corp. was reached and such transfer was completed on January 29, 2015.

### **Remaining Franchised Pharmacies**

- (a) Target Pharmacy is the franchisor of 93 in-store pharmacies outside Quebec operated by third party corporate franchisees which, in the vast majority of cases, are wholly-owned by licensed pharmacists (the “**Franchisees**”).
- (b) Regulated “Schedule I and II” drugs such as narcotics and antibiotics (behind-the-counter (“**BTC**”) drugs), that either require a prescription to be sold or that must be held behind the counter, are owned by the Franchisees. The Franchisees maintain their own point of sale (“**POS**”) terminals at the pharmacies and sales of BTC drugs are for the account of the pharmacist.
- (c) “Schedule III” drugs such as pain relievers and cough medicines (over-the-counter (“**OTC**”) drugs) are owned by TCC until immediately prior to the retail sale to a customer, when title passes from TCC to the Franchisee and the Franchisee pays TCC the retail price at the time of the retail sale by the Franchisee to the customer.

- (d) Pursuant to the franchise arrangements, on a monthly basis, the Franchisees pay to Target Pharmacy, among other things, franchise fees, operation fees, licensed space fees, and advertising fund fees (collectively the “**Franchisee Payments**”) and Target Pharmacy pays to the Franchisees, among other things, generic prescription purchase rebates, OTC royalty payments and EBIT support payments (collectively the “**Franchisor Payments**”). A reconciliation of individual Franchisee accounts is completed on a monthly basis such that the Franchisee Payments and the Franchisor Payments are netted against one another and the net balance is either paid by the Franchisee to Target Pharmacy or paid by Target Pharmacy to the Franchisee. The draft December 31, 2014 month-end calculation indicates that Target Pharmacy was in a net payable position in respect of 84 of the Franchisees (approximately \$595,000, in aggregate) and in a net receivable in respect of 9 Franchisees (approximately \$44,000, in aggregate)
- (e) Since the granting of the Initial Order, the Monitor has worked closely with the Target Canada Entities to assist in the timely transition of patient files to alternative pharmacies, and in facilitating and implementing the Orderly Wind-down that will ultimately result in the cessation of the Target Canada Entities’ operations. A key component of the Orderly Wind-down is the orderly disclaimer of contracts in order to facilitate the wind-down and to ensure a corresponding reduction in costs and expenses to the estate in the interests of stakeholders.
- (f) As outlined in the Second Wong Affidavit, immediately following the granting of the Initial Order, and in anticipation of the disclaimer of pharmacy franchise agreements as part of the Orderly Wind-down, the Target Canada Entities contacted each of the applicable pharmacy colleges across Canada to advise that

the CCAA Proceedings will ultimately result in the closure and/or relocation of Target Pharmacy branded pharmacies in Canada. The Target Canada Entities, in consultation with the Monitor, then initiated extensive communications with pharmacy franchisees regarding the impact of the Initial Order and the Orderly Wind-down, and the steps that franchisees would be required to take to comply with their regulatory and professional requirements regarding the safeguarding of patient files, communication with patients, and the ongoing sale and relocation of scheduled drug inventory.

- (g) Pursuant to a master services and lease agreement between TCC and Kroll Computer Systems Inc. (“**Kroll**”), the patient data and Franchisee POS are located on the computer systems used by the Franchisees, all of which systems are provided by Kroll. The Monitor has been instrumental in efforts to ensure continuity of patient care by assisting Target Pharmacy in making arrangements with Kroll, at no cost to the Franchisees (but at a cost to the Target Canada Entities of approximately \$140,000), for the seamless transfer of patient data from each Franchisee to wherever they direct.<sup>4</sup>
- (h) On January 26, 2015, as provided for, and in accordance with, subsection 32(1) of the CCAA, the Target Canada Entities provided notice in the prescribed form and with the approval of the Monitor to 94 pharmacy franchisees<sup>5</sup> of the Target Canada Entities’ intention to disclaim or resiliate their franchise agreements and all other ancillary agreements (“**Disclaimer Notices**”).

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<sup>4</sup> Notwithstanding paragraph 40 of the Gavrilidis Affidavit (as defined below), the arrangements have been made between Kroll and TCC with the Monitor’s assistance and not by A&M.

<sup>5</sup> The 94 Disclaimer Notices included notices for 93 operating Franchisees and one pharmacy franchisee in respect of an unopened store.

6.2 The delivery of the Disclaimer Notices to the Franchisees on January 26, 2015 was reasonable, appropriate and necessary in the circumstances, including for the following reasons:

- (a) As a result of the Initial Order, in accordance with the Orderly Wind-down, all of TCC's stores are going to be closing in the near future. By definition, the liquidation sale process is quite fluid. While the outside date for store closings is May 15, 2015, several stores are expected to close as early as March, 2015. Further, the practical reality is there is simply no way of knowing with complete precision exactly when each particular store location will be closing. To utilize guess work in trying to match the timing of individual disclaimer notices with individual store closings would have created confusion (at both a Franchisee and patient level) and, more importantly, would have had significant adverse consequences for individual Franchisees if the effective notice period proved to be less than 30 days prior to a store closing. Accordingly, it was important to ensure that the Disclaimer Notices were issued on a timely basis so as to eliminate any possible risk that an individual Franchisee would receive a notice of disclaimer that did not ensure the full 30-day notice period was provided before individual stores began to close. Further, as a practical matter, as was then anticipated, and subsequently, as a result of the Approval Order-Agency Agreement, the timing of individual store closings is now in the control of the Agent and hence not in the control of TCC or the Monitor.
- (b) Ongoing costs to the estate of maintaining the pharmacist operations network and support functions in the context of the fact that the stores were closing, particularly in view of declining inventory volume over time. As previously noted, for the majority of the Franchisees, the Franchisor Payments exceed the Franchisee Payments. During the period from February 1, 2014 through to

December 31, 2014, on a monthly basis, the EBIT top-up was on average approximately \$410,000, the OTC royalty payments were on average approximately \$320,000, and the Kroll costs are approximately \$200,000, with net aggregate average payments from the Franchisor to the Franchisees of approximately \$930,000 per month.

6.3 The alternative of the continued operation of individual pharmacies after the termination of TCC's retail sales at each location is impractical and unadvisable for several reasons:

- (a) the terms of the Approval Order-Agency Agreement require that on the date the Agent vacates the store, it must sell/remove all remaining merchandise and FF&E (including pharmacy FF&E, which FF&E is owned by Target Pharmacy) and leave the store in "broom-swept" and clean condition;
- (b) the proposed Amended and Restated Initial Order clarifies that the Target Canada Entities may vacate the whole but not part of any leased premises;
- (c) the cost of keeping the entirety of the store open for such purpose, including the cost for services such as security, utilities and POS system;
- (d) Franchisees would have to continue to employ staff and maintain inventory when there is limited or no store traffic;
- (e) due to the overall lower store traffic, it is possible that the EBIT and OTC royalty payments would very significantly increase, at a cost to the estate;
- (f) the Kroll lease arrangements are with respect to the entirety of the pharmacy franchise arrangements. It would be impractical to continue to provide the entire pharmacy support services for only a small number of Franchisees; and



- (g) it is anticipated that certain leases will be disclaimed as the Real Property Portfolio Sales Process proceeds.

6.4 From the Monitor's perspective, it was of paramount importance that the Franchisees were provided with sufficient time to comply with the professional regulatory notice requirements (re: the upcoming closure of their pharmacy operations) of their respective provinces (which range from 7 days to 30 days, depending on the province), and to ensure the continuity of patient care. The Disclaimer Notices were not issued to the Franchisees at the outset of the filing. However, Target Pharmacy took steps at that time to ensure that it was clear to the Franchisees that their pharmacies would need to close, the Disclaimer Notices would need to be issued and that Franchisees should anticipate having to close or relocate at an early date. The Franchisees were advised on January 15, 2015 by email that they would be responsible for closing or relocating their pharmacies. As well, by way of conference call on that date, the Franchisees were advised to take steps to close or relocate their pharmacies as soon as possible. They were also told to contact their pharmacies regulator to obtain advice on the retention and transfer of patient files. On January 19, 2015, by way of email from Target Pharmacy, the pharmacists were advised that a decision would be made as to the timing for disclaimer of the franchise agreements in the coming week(s). The Franchisees were also advised on January 23, 2015 not to wait until they received the Disclaimer Notices to close and/or relocate their pharmacy operations. Accordingly, the delivery of the Disclaimer Notices on January 26, 2015 should not have been a surprise to the Franchisees. Further, as set out above, the Monitor helped to facilitate Target Pharmacy's arrangements with Kroll for new services related to the transfer of patient data for the benefit of each Franchisee, at no cost to the Franchisees, so as to ensure continuity of patient care.

6.5 As of the date of this report, of the 93 Franchisees, 10 have already closed and 15 have given notice that they will be closing and have provided specific departure dates. Of the foregoing, 14 are among the 75 individuals listed at Exhibit "E" of the Gavrilidis Affidavit.

- 6.6 While the Franchisees may indeed experience financial hardship in this case, such hardship is attributable to the Applicants' CCAA filing, the Orderly Wind-down and the reality of the closing of all 133 TCC stores, not the issuance of the Disclaimer Notices, which were inevitable and necessary in the circumstances. It is most unfortunate that the pharmacies are having to close, but that is the regrettable reality given that the stores are all closing.

Pharmacy Franchisee Association of Canada ("PFAC")

- 6.7 On January 29, 2015, the Monitor received the letters from counsel to PFAC which are attached as Exhibits "N" and "O" to the Affidavit of Stavros Gavrilidis sworn February 3, 2015 (the "**Gavrilidis Affidavit**") requesting information regarding the Disclaimer Notices.
- 6.8 By letter and cover email dated February 3, 2015, attached as Appendix C, Alan Mark, counsel for the Monitor, responded, reflecting the Monitor's understanding that the requested information was sought from the Applicants and suggesting a call among counsel.
- 6.9 On February 3, 2015, counsel for PFAC delivered a motion record wherein PFAC is seeking an Order (the "**PFAC Motion**") for:
- (a) the appointment of PFAC as the representative of the Franchisees;
  - (b) the appointment of Sutts, Strosberg LLP as Pharmacist Representative Counsel;
  - (c) the appointment of BDO Canada as "Pharmacist Financial Advisor";
  - (d) legal and other professional expenses of PFAC to be paid from the estate of the Target Canada Entities with an administrative charge; and

- (e) setting aside the Disclaimer Notices, and directing that Target Pharmacy cannot deny access to premises, discontinue supplies or otherwise interfere with the Pharmacists' and Franchisees' operations.

6.10 One of the fundamental requests set out in the PFAC Motion is that the Franchisees be provided with more "breathing space" related to the wind-down and relocation of their operations. The Monitor is sympathetic to the needs of the Franchisees who may desire such additional time, and accordingly, has no issue with TCC permitting Franchisees who may wish to continue to operate in TCC's stores after the expiration of the notice period under the Disclaimer Notices on February 25, 2015 to remain, subject to certain parameters, including the practical necessity of a very short vacate notice period due to the uncertainties related to TCC's lack of control over the timing of individual store closings and the rights of the applicable landlord. The Monitor has encouraged, and supports, the following plan to be implemented by the Target Canada Entities:

- (a) To provide additional time to assist the pharmacists in the transfer or relocation of patient files and drug inventory and in the relocation of their respective pharmacy businesses, TCC will permit and facilitate the pharmacists to continue to operate, in compliance with their professional obligations and applicable law, at their respective existing Target locations, subject to any applicable landlord rights, while the pharmacists wind down their respective operations, until the earlier of: (i) March 30, 2015; and (ii) three (3) days following written notice by TCC to the pharmacist of anticipated store closure at such pharmacist's location (such earlier date being the "**Accommodation Date**"). TCC, in consultation with the liquidation agent under the Agency Agreement approved by the Court on February 4, 2015, will use commercially reasonable efforts to provide each pharmacist with as much advance notice of their anticipated store closure date as possible.

- (b) The Notices of Disclaimer of the franchise agreements and all ancillary agreements delivered on January 26, 2015 shall remain in full force and effect and the disclaimer of such agreements will take effect on February 25, 2015 in accordance therewith and with the CCAA, and, for greater certainty, without any further payment obligations on any party thereunder relating to the period after February 25, 2015.
- (c) As per the Closing Checklist provided to the Franchisees, once the pharmacist has made arrangements to close and/or relocate its pharmacy operations, the pharmacist shall notify TCC at [targetcanadarx@target.com](mailto:targetcanadarx@target.com) immediately and advise of the pharmacist's last day at the Target Pharmacy, which in any event shall be on or before the Accommodation Date.

6.11 The March 30, 2015 outside date was established as it represents the provision of an additional month of support services (such as arrangements with Kroll with respect to the patient data and POS system) required to allow the pharmacists to continue to operate, at the Target Canada Entities' cost. Further, while the Monitor expects that many stores will be closing before March 30, 2015, these arrangements would provide the pharmacists with up to 75 days' effective notice (since the January 15, 2015 filing date) of the need to close their respective pharmacies and/or relocate. While neither the Franchisor Payments nor the Franchisee Payments would continue with respect to the period following February 25, 2015, the provision of infrastructure support services for another month by Target Pharmacy (at a cost of approximately \$200,000) in order to facilitate such operations is, in the view of the Monitor, a reasonable and appropriate balancing of interests of the Franchisees and other stakeholders.

6.12 Set out below are responses to certain of the factual inaccuracies contained in the Gavrilidis Affidavit regarding the conduct of the Monitor (all numbered references are to the Gavrilidis Affidavit):

- (a) In response to paragraphs 4 and 25, the Monitor has never said nor suggested that the closing of the Target Canada Stores will not cause significant financial harm to the pharmacists and Franchisees. However, as set out above, such financial harm is the unfortunate practical consequence of the Orderly Wind-down and closure of all of TCC's 133 stores, and not as a result of the Disclaimer Notices. It is understood that the discontinuation of the business at the Target Canada stores and of the Franchisees in the Target Canada locations would have adverse economic consequences for the Franchisees.
- (b) In response to paragraph 7, in respect of a concern for the continuity of patient care, the Monitor is of the view that the patient records can be readily transferred to a responsible pharmacy within the timeframe provided to the Franchisees. In fact, this has already happened with the Quebec and corporate pharmacies and has been done or is underway for the 25 Franchisees that, as of the date of this report, have closed their location or have advised that they are in the process of closing their location. The Monitor is aware of steps taken by the Target Canada Entities to notify the necessary regulatory authorities and to ensure compliance with regulatory obligations, and is satisfied that patients can be serviced in a manner to facilitate continuity of patient care.
- (c) In response to paragraph 53, as set out above, the Monitor is aware of and has worked with the Target Canada Entities to ensure that the following communication with Franchisees has occurred:

- (i) email communications were sent to all Franchisees on January 15, advising of the CCAA Filing and of the arranging of a conference call (Gavrilidis Affidavit, Exhibit "F").
- (ii) a conference call took place on January 15, and a transcription thereof was circulated to Franchisees (Gavrilidis Affidavit, Exhibit "G").
- (iii) email communications were sent to Franchisees on January 16, 19 and 23 (Gavrilidis Affidavit, Exhibits "H", "I" and "J").
- (iv) email communications were sent to Franchisees on February 3, 2015 providing a franchise closing checklist, confirming arrangements with Kroll regarding transfer of patient data and confirming arrangements with respect to forwarding of pharmacy telephone numbers.

6.13 With respect to legal representation, the Monitor understands from Sutts, Strosberg that they have been retained by 82 individual Franchisees. The Monitor has no objection to Sutts, Strosberg's representation of such Franchisees individually without being formally appointed as Representative Counsel. In the circumstances, the Monitor does not see the reason for PFAC to act as representative plaintiff in these proceedings given that Sutts, Strosberg has such individual retainers. The plaintiffs are free to organize their communications internally however they want, but, from the perspective of the estate, there does not appear to be any additional purpose served by having PFAC designated as representative. As well, it is not clear that all of the Franchisees are in the same circumstances.

6.14 Having regard to the interests of the estate and past practice, the Monitor does not support funding from the estate for the purpose of the Franchisees obtaining advice or assistance resulting from the fact that their independent pharmacy businesses are being closed or relocated. In this

regard, it appears that the roles of Gardiner Roberts and BDO are with respect to re-establishing or transitioning the pharmacies and, thereby dealing with the consequences of the closure of the Target business, rather than the negotiation, for example, of a continuation of the business in the context of a restructuring.

## **7.0 EXTENSION OF THE STAY PERIOD**

7.1 Pursuant to the Initial Order, the Stay Period is to expire on February 13, 2015. The Applicants are seeking an extension of the Stay Period to May 15, 2015.

7.2 The Monitor supports the Applicants' motion to extend the Stay Period to May 15, 2015 for the following reasons:

- (a) the stay is required to provide the necessary stability and certainty to enable the Target Canada Entities to continue the Inventory Liquidation Process and to continue to advance the Real Property Portfolio Sales Process in furtherance of the Orderly Wind-down;
- (b) the extension corresponds with the Targeted Outside Date under the Real Property Portfolio Sales Process and the date by which the Inventory Liquidation Process is required to be completed;
- (c) the stay will permit the Target Canada Entities to continue to take all other necessary steps in furtherance of the Orderly Wind-down;
- (d) management of the Target Canada Entities' have been focused on the Orderly Wind-down process, and need to maintain this level of focus to ensure the success of the Orderly Wind-down;

- (e) the DIP Facility remains available to the DIP Entities and is projected to provide the Applicants with sufficient liquidity to conclude the Orderly Wind-down process; and
- (f) the Applicants continue to act in good faith and with due diligence.

## **8.0 MONITOR'S ACTIVITIES TO DATE**

- 8.1 Since the granting of the Initial Order, the Monitor has worked closely with the Target Canada Entities to stabilize their business and operations (all 133 open stores in Canada have remained operational since the granting of the Initial Order). As summarized in the First Report and below, this has included concerted efforts to address urgent supply chain and other logistical issues essential to the Orderly Wind-down and extensive communications with stakeholders, as well as assisting with other activities essential to the Orderly Wind-down, including matters related to the Inventory Liquidation Process and the Real Property Portfolio Sales Process. The Monitor will continue to communicate with stakeholders and assist with and facilitate the stabilization of the business and the Orderly Wind-down, in the interests of all stakeholders.
- 8.2 Certain suppliers have requested information regarding inventory balances and purchases as at and prior to the commencement of the CCAA Proceedings. In order to respond to these inquiries in an efficient and appropriate manner, the Applicants have requested that the Monitor review the matters raised and provide an update in a subsequent report following its review. Given this review to be performed by the Monitor and reported on in due course, the Monitor is of the view that any cross-examination of Mr. Wong at this time is premature as it may not be necessary.
- 8.3 In addition to the Monitor's ongoing supervision and involvement with the Real Property Portfolio Sales Process (as described above and in the First Report) and with the Inventory



Liquidation Process (as described in the First Report), the activities of the Monitor from the date of the First Report have included the following:

- assisting the Applicants with communications with employees, PFAC, pharmacy franchisees, suppliers and other parties;
- assisting TCC in stabilizing its supply chain, including extensive communications with the third-party operator of TCC's distribution centres, vendors, freight forwarders and consolidators, ocean freight carriers and other transportation companies, and TCC's customs broker, with a view to minimizing supply disruption and continuing the movement of goods-in-transit to the distribution centres and stores;
- discussions and meetings with landlords, the Applicants, the Financial Advisor and counsel in respect of the CCAA proceedings, Inventory Liquidation Process, Approval Order – Agency Agreement and the proposed Real Property Portfolio Sales Process;
- numerous discussions with suppliers and other creditors, including with respect to requests for critical supplier status;
- responding to a high volume of enquiries from stakeholders, including addressing questions or concerns of parties who contacted the Monitor on the toll-free number or email account established by the Monitor;
- monitoring the receipts, disbursements, purchase commitments and arrangements for deposits with certain suppliers and creditors of the Applicants, including tracking outstanding balances and commitments due to critical service providers;

- assisting the Applicants in assessing certain components of the Orderly Wind-down, including the disclaimer of contracts and agreements, employee reductions and other matters;
- developing and updating, on a daily basis, the “Daily Management Dashboard” to assist the Applicants in managing the Orderly Wind-down;
- corresponding with and tracking claims transfers and assignments received from purchasers of creditor claims;
- in its capacity as Administrator of the Employee Trust, communications with and among Employee Representative Counsel, Monitor counsel, Applicants’ counsel and the Trustee regarding the Employee Trust, and facilitating the opening of the Employee Trust Account and transfer of funds; and
- posting non-confidential materials filed with the Court to the website established by the Monitor for the CCAA Proceedings.

**9.0 MONITOR'S RECOMMENDATION**

9.1 For the reasons set out in this Second Report, the Monitor is of the view that: (a) the relief requested by the Applicants is reasonable and respectfully recommends that this Court make the Orders granting the relief requested by the Applicants; and (b) the PFAC Motion should be dismissed.

All of which is respectfully submitted to this Court this 7<sup>th</sup> day of February, 2015.

**Alvarez & Marsal Canada Inc., in its capacity  
as Monitor of Target Canada Co., and  
the other Applicants listed on Appendix "A"**

Per:



Name: Douglas R. McIntosh  
Title: President

Per:



Name: Alan J. Hutchens  
Title: Senior Vice President

IN THE MATTER OF A PLAN OR COMPROMISE OR ARRANGEMENT OF TARGET CANADA CO.,  
TARGET CANADA HEALTH CO., TARGET CANADA MOBILE GP CO., TARGET CANADA PHARMACY  
(BC) CORP., TARGET CANADA PHARMACY (ONTARIO) CORP. TARGET CANADA PHARMACY CORP.,  
TARGET CANADA PHARMACY (SK) CORP., AND TARGET CANADA PROPERTY LLC.

Court File No.: CV-15-10832-00CL

**ONTARIO**

**SUPERIOR COURT OF JUSTICE  
COMMERCIAL LIST**

Proceeding commenced at Toronto

**SECOND REPORT OF THE MONITOR**

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**IN THE MATTER OF A PLAN OR COMPROMISE OR ARRANGEMENT OF TARGET CANADA CO.,  
TARGET CANADA HEALTH CO., TARGET CANADA MOBILE GP CO., TARGET CANADA PHARMACY  
(BC) CORP., TARGET CANADA PHARMACY (ONTARIO) CORP. TARGET CANADA PHARMACY  
CORP., TARGET CANADA PHARMACY (SK) CORP., AND TARGET CANADA PROPERTY LLC.**

Court File No.: CV-15-10832-00CL

**ONTARIO  
SUPERIOR COURT OF JUSTICE  
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**THIRD REPORT OF THE MONITOR**

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