CANADA

PROVINCE OF QUEBEC
District of Québec
Division No: 01- Montréal

N^{o} :
C.S.M. **500-11-049210-152**
41-2021835

SUPERIOR COURT

(commercial division)

IN THE MATTER OF THE PLAN OF ARRANGEMENT OF :

LAURA'S SHOPPE (P.V.) INC., a legal person duly incorporated according to Law, having its head office and principal place of business at 4, Granville Street, Hampstead, Quebec, H3X 3B1;

Debtor / Respondent

-and-

SALUS CAPITAL PARTNERS, LLC, a Canadian chartered bank, having its head office at 200 Bay street, 9th floor, South Tower, Toronto, Ontario, M5J 2J5, and a branch at 1, Place Ville-Marie, Montreal, Quebec, H3B 3A9;

Petitioner

-and-

KPMG INC., 600 de Maisonneuve Blvd. West, suite 1500, Montreal, Quebec, H3A 0A3;

Monitor

-and-

THE CADILLAC FAIRVIEW CORPORATION LIMITED, a legal person duly constituted according to law, having a place of business at 1160, avenue des Canadiens-de-Montréal, Province of Quebec, H3B 2S2;

Dip Lender /Mis en Cause

MOTION TO RESCIND OR VARY THE INITIAL ORDER AND OTHER RELIEF
(Art. 2, 20 and 46 of the C.C.P., S.Q.R., c. C-25, section 9 and following of CCAA)

TO ONE OF THE HONOURABLE JUDGES OF THE SUPERIOR COURT, SITTING IN AND FOR THE DISTRICT OF MONTREAL, PETITIONER SALUS CAPITAL PARTNERS, LLC, RESPECTFULLY SUBMITS AS FOLLOWS:

The Current Circumstances

1. On Friday, July 31, 2015 at 4:20 p.m., after having delivered to the Petitioner a consent to the abridgment of the ten-day notice period for enforcement of security under the *Bankruptcy and Insolvency Act* (the "**BIA**") at the Respondent's suggestion, the Respondent filed a Notice of Intention to Make a Proposal pursuant to the BIA;

2. Despite the Petitioner's willingness to work cooperatively with the Respondent to agree on a mutually-acceptable restructuring plan and cash flows, the Petitioner lost confidence in the Respondent's management, in part due to certain misrepresentations made by the Respondent to the Petitioner concerning its true state of affairs and it became apparent to the Petitioner that the value of its collateral was quickly eroding and that the Respondent was unable to put forward a satisfactory plan or cash flows;

3. Accordingly, on Friday, August 7, 2015 at 8:00 p.m., the Petitioner served the Respondent's attorney with a motion in which the Petitioner sought the appointment of a receiver over the Respondent (the "**Receiver Motion**"), with a notice of presentation on Tuesday, August 11, 2015, in commercial chamber room 16.10;

4. In response, on Monday, August 10, 2015 at 10:49 p.m., the Respondent served the Petitioner's attorney with a motion by the Respondent to continue a restructuring process under the CCAA and to obtain an Initial Order thereunder (the "**Restructuring Motion**") and an application for interim financing by way of a priming priority charge (the "**Application**", and together with the Restructuring Motion and the Receiver Motion, the "**Matters**"), both with a notice of presentation for the next day, August 11, 2015, in commercial chamber room 16.10, with the assistance of the proposed court appointed Monitor and its counsel who unfairly disregarded the interests of the Petitioner, one of the Respondents' significant stakeholders;

5. As the legal counsel for the Petitioner in Montreal, Me Claude Paquet, did not have the chance to analyze the Restructuring Motion or Application, nor review with legal counsel of the Petitioner in Toronto or the Petitioner's representatives and advisors, a demand for postponement of two (2) days was formally requested to the Court in order to fully comprehend all the impacts of the Restructuring Motion and the Application and to seek further instructions from Petitioner;

6. The postponement was denied by the Court;

7. On that day, as further discussed below and in support of the alleged urgency of the relief sought by the Respondent, Raymond Massi of Richter Advisory Group Inc. ("**Richter**") testified that the Respondent required immediate access to funds in order to purchase inventory immediately and fund payroll, failing which the Respondent would "very likely [be] forced into liquidation." As also further discussed below, the Respondent did not purchase any of the inventory over the course of the next ten days that it claimed it needed so urgently. A copy of the Transcript of Ray Massi's testimony is attached hereto as **Exhibit R-1**;

8. The Court proceeded with the hearing of the Receiver Motion, the Restructuring Motion and the Application, and rendered judgments on August 11, 2015 bearing file number 500-11-049210-152 (collectively, the "**Judgments**"), which Judgments were eventually written and delivered on August 12, 2015 by the Honourable Marie-Anne Paquette J.S.C., sitting in the commercial division, district of Montreal;

9. The Court granted both the Restructuring Motion and the Application (together, the "**Initial Order**") and dismissed the Receiver Motion;

10. The Petitioner submits that with regard to its position as a senior secured operating lender and knowing that certain facts were either

misrepresented to or not put before the Court, the Judgments have caused and continue to cause the Petitioner the following material prejudice and undue hardship:

(a) a unilateral and substantial modification to its structured asset-based loan credit arrangements which is based on the value of its underlying collateral;

(b) the loss of its Blocked Account Agreements and cash management system (as discussed below) and therefore its ability to manage and monitor its collateral position and the Respondent's unfettered use of the proceeds of the Petitioner's collateral;

(c) a priming DIP charge of $12,000,000;

(d) the KERP (as defined herein) and administration charges which constitute further priming charges;

(e) a stay of all proceedings which prevents the Petitioner from seeking to recover from the Guarantors who are not otherwise subject to the CCAA and who are not, at law, entitled to the benefit of same;

(f) a significant loss of the Petitioner's entitlement to access to information and detailed and timely reporting from the Respondent; and

(g) a loss of payment of interest on the Indebtedness (as defined below);

11. With the benefit of now having the opportunity to present a more complete and accurate record to the Court, it is the Petitioner's submission that the Court is only now properly positioned to assess the merits of the Initial Order;

A. BACKGROUND

The Parties, Credit Agreement and Security

12. The Respondent is a women's clothing retailer operating 162 Laura, Laura Petites, Laura Plus, Melanie Lyne and liquidation stores in nine provinces across Canada;

13. The Respondent is 100% owned by the Guarantor, 9318-5494 Quebec Inc. (the "**Guarantor**"), which was incorporated pursuant to the

Canada Business Corporations Act on December 23, 2010 as "7735235 Canada Inc.", and registered in Quebec on June 10, 2011. 9318-5494 Quebec Inc.'s name was changed from "7735235 Canada Inc." on March 2, 2015;

14. The Petitioner, the Respondent, the Guarantor, Laura's Shoppe Canada Inc. (together with the Guarantor, the "**Guarantors**" and, collectively with the Respondent, the "**Debtors**"), 348271 Canada Inc., (as limited recourse guarantor) and Kalman Fisher (as limited guarantor) are parties to a credit agreement dated April 17, 2013 (the "**Original Credit Agreement**"). The Original Credit Agreement has been amended several times by the Petitioner to address several covenant breaches by the Debtors and to give the Debtors an opportunity to return to profitability, raise additional capital needed for the business and/or to refinance the business with a new lender, as follows:

(a) a Forbearance Agreement dated July 22, 2013, as amended by letter agreements dated August 2, 2013, and August 16, 2013 (collectively, the "**First Forbearance Agreement**");

(b) a Second Forbearance Agreement dated August 30, 2013, as amended by letter agreements dated October 5, 2013, October 19, 2013, October 26, 2013 and November 22, 2013 (collectively, the "**Second Forbearance Agreement**");

(c) a Third Forbearance Agreement dated December 16, 2013 (the "**Third Forbearance Agreement**");

(d) a Fourth Forbearance Agreement dated April 2, 2014 (the "**Fourth Forbearance Agreement**", and together with the First Forbearance Agreement, the Second Forbearance Agreement and the Third Forbearance Agreement, the "**Forbearance Agreements**");

(e) a First Amending Agreement dated August 8, 2014 (the "**First Amending Agreement**"); and

(f) a second Amending Agreement dated February 26, 2015 (the "**Second Amending Agreement**");

15. The Original Credit Agreement, the Forbearance Agreements, the First Amending Agreement and the Second Amending Agreement are collectively hereinafter referred to as the "**Credit Agreement**";

16. Pursuant to the Credit Agreement, Petitioner has supplied the Respondent with:

(a) a revolving asset-based operating facility in the maximum amount of CDN$32,000,000 or its US$ equivalent, subject to sufficient collateral and tied to a borrowing base; and

(b) a CDN$3,000,000 term loan;

(collectively, the "**Credit Facilities**") which Credit Facilities were to be used: (a) to purchase working capital assets in the ordinary course, including inventory and equipment; (b) for capital lease obligations and other capital expenditures; and (c) for general corporate purposes of the Debtors;

17. The Credit Facilities paid out the loans from the Respondent's former asset-based lenders, Bank of Nova Scotia ("**BNS**") and Roynat Inc. ("**Roynat**"). The Respondent also used the Credit Facilities to repay sums owing to HSBC and PNC Capital, primarily in connection with certain leasehold improvement financings. Certain small sums remain outstanding to HSBC. As can be seen, the Petitioner has supported the Respondent and has made numerous accommodations and credit indulgences since almost the beginning of their relationship. The Petitioner continued to support the Respondent for several years until the Respondent chose, as discusses further below, to stop communicating and working with the Petitioner;

18. By a guarantee dated April 17, 2013, the Guarantors guaranteed all present and future obligations of the Respondent to Petitioner (the "**Guarantee**");

19. As security for their obligations to Petitioner, the Debtors provided, among other things:

(a) a Deed of Hypothec and Issue of Bonds dated April 11, 2013 (the "**Hypothec**"), registration in respect of which was made pursuant to the Quebec Register of Personal and Moveable Real Rights (the "**RPMRR**") on that same date by registration number 13-0280666-0001; and

(b) a General Security Agreement dated April 17, 2013 (the "**GSA**"), registration in respect of which was made pursuant to the *Personal Property Security Act* (Ontario) on April 11, 2013 by financing statement no.: 20130411 0905 1590 8557, and pursuant to applicable personal property security legislation in all other Canadian common law Provinces (except Prince Edward Island) on the same date;

20. As at August 27, 2015, the Debtors were indebted to Petitioner for the following amounts pursuant to the Credit Facilities and the Guarantee plus professional fees which continue to accrue of approximately $1MM (collectively, the "**Indebtedness**"):

Revolving Loan	CDN $952,957.59
Principal	US $10,489,931.56
Interest	CDN $16,537.68
	US $84,119.48
Term Loan	
Principal	CDN $2,835,000.00
Interest	CDN $21,262.50
Fees	CDN $243,221.70
	US $3,274,913.00
Total CDN	**$4,068,979.40**
Total USD	**$13,848,964.04**
USD conversion @1.25%	**$17,311.205.05**
Total CDN	**$4,068,979.40**
TOTAL INDEBTEDNESS	**$21,380.184.45**

Asset-Backed Lending and the Importance of Control over Receipts and Reporting

21. The Credit Agreement and the Petitioner's revolving loans to the Respondent are structured as typical asset-based loans ("**ABL**"), which are often provided to financially-distressed companies such as the Respondent. Advances are made based on the amount of available credit which is calculated based on a margining formula and the value of the Respondent's collateral such as its inventory and accounts receivables;

22. Pursuant to this structure, a borrower submits a written request for an advance and an ABL lender makes advances pursuant to such request based on a written borrowing base certificate submitted by an officer of the borrower and the amount of credit available to the borrower taking the value of the collateral and the amount of the outstanding loans into account. In the event that there is insufficient collateral to support the outstanding indebtedness, an advance for any such amount which is not

completely supported by the value of the collateral would not be extended by an ABL lender;

23. Since all outstanding loans and advances are wholly-dependent on the value of the collateral and that such cash receipts represent a loss/replacement of the collateral which supports the indebtedness, ABL loans generally have dominion over a borrower's cash receipts. Such proceeds of collateral are applied to the outstanding obligations on a regular basis and the ABL lender re-advances amounts to its borrower based on the then current calculation of the value of the borrower's collateral/borrowing base and the amount of available credit/availability, if any;

24. In the Respondent's case, since the date of the first advances under the Credit Agreement until the date of the Judgments, the Petitioner had the customary ABL structure of having full cash dominion over all receipts of the Respondent pursuant to, among other things:

(a) a blocked account agreement among the Petitioner, the Respondent and Bank of Nova Scotia ("**BNS**") dated April 16, 2013; and

(b) a blocked account agreement among the Petitioner, the Respondent and Bank of Montreal ("**BMO**") dated April 17, 2013,

(collectively, the "**Blocked Account Agreements**"), copies of which Blocked Account Agreements are attached as **Exhibit R-2**. As described in the below paragraphs and is the customary practice for ABL loans, all of the Respondent's receipts (i.e., proceeds of the Petitioner's collateral) were swept to a collection account designated by the Petitioner, which were applied to the outstanding loans and then re-advance funds to the Respondent on a regular basis in accordance with the Respondent's written borrowing request and the Respondent's certified borrowing base certificate setting out the Petitioner's collateral values/position and available credit, if any;

25. During his examination-in-chief, Raymond Massi of Richter stated that the Petitioner has "stopped funding virtually everything," which overlooks several points, including, without limitation, each of the following, which are addressed in more depth in subsequent paragraphs:

(a) the Respondent not having sufficient credit/availability for its requests for advances;

(b) the Respondent having failed to provide backup documentation for its requests for advances;

(c) the Petitioner having lost all confidence in the borrowing base certificates as submitted by the Respondent and value of its collateral as a result of the Respondent having included inventory in transit for which it did not have title;

(d) the Respondent having not properly disclosed that it was in default of paying rent;

(e) the Respondent having represented for a considerable amount of time that the Petitioner's loans would be refinanced in short order to no avail;

(f) the Respondent refusing to disclose with whom they were in discussions regarding same and the terms thereof;

(g) the Respondent having concealed certain post-dated cheques in breach of the Credit Agreement; and

(h) the Respondent not having provided the Petitioner with an acceptable plan or acceptable cash flows or a systematic refinancing process for the refinancing or its indebtedness to the Petitioner;

26. The simple reality is that despite there not being sufficient borrowing base availability, the Petitioner still continued to support the Respondent and advanced amounts for payroll and August rents to allow additional time for the Respondent to seek a solution acceptable to the Petitioner;

27. In light of the nature of the ABL lending relationship, extensive reporting is an important component of such relationship generally, and the Petitioner-Respondent relationship specifically. A review of Article VI of the Credit Agreement, which Article is 12 pages in length, reflects the extent of such reporting;

28. Article VI of the Credit Agreement also provides the Petitioner, among many other things, with extensive inspection rights, as provided in section 6.10 thereof;

29. As discussed herein, and apart from the first two brief weekly variance reports, and the first updated cash flow, no other reporting or answers to reasonable questions have been delivered to the Petitioner

since August 12, 2015, despite numerous requests for same, nor has the Respondent presented any proposed refinancing process.

History of financial difficulties

30. The Respondent first experienced financial results in the form of net losses for the fiscal years ending February 2, 2013 and February 1, 2014 in the amounts of $17,416,326 and $41,934,215 respectively;

31. These financial losses constituted defaults to the terms of the Credit Agreement. Further defaults occurred in the nature of a breach of the Respondent's fixed charge coverage ratio, due to an adverse variance in disbursements greater than the permitted 15%;

32. In December 2014, the Respondent was again in default of the Credit Agreement as a result of its breach of the $9,400,000 trade accounts payable limit under the Credit Agreement, reporting trade accounts in the amount of $12,200,000;

33. All of these defaults were addressed in forbearance agreements agreed to by the Petitioner; as set out above. Notwithstanding these significant breaches/defaults, the Petitioner continued to work with and support the Respondent;

34. The Respondent reported a short return to profitability in the fiscal year ending January 31, 2015. However, for the five (5) months period ended July 4, 2015, it incurred a net loss of $1,678,029;

35. During the present fiscal year, the Respondent's financial position has again deteriorated significantly;

36. In light of its financial difficulties, the Respondent required additional working capital for its operations, but failed to deliver a binding commitment letter by June 30, 2015 to raise at least $5,000,000 of new additional working capital to continue to operate and as required under the Second Amending Agreement;

37. As further discussed herein, the Respondent only advised the Petitioner on July 17, 2015, that it was in arrears of approximately $5,400,000 of rents to landlords on July 1, 2015 which had already been funded by the Petitioner to the Respondent for the purpose of paying rent;

38. Moreover, the Respondent had represented and certified in its borrowing base certificates during such periods that it was in compliance with all material terms of all leases and it had not been notified of any default. As discussed herein, this constituted a further serious default and

misrepresentation, as notices of default were in fact received from various landlords, which are attached as **Exhibit R-3**;

Initial Restructuring Efforts

39. As set out above, as of July 23, 2015, the Respondent had committed multiple breaches of its obligations under the Credit Agreement, which breaches constituted Events of Default. Accordingly, by letter dated July 23, 2015, the Petitioner's counsel advised the Respondent that it was reserving its rights and remedies under the Credit Agreement and at law with respect to the Events of Default. The Petitioner further requested that the Respondent keep it apprised of its financing and/or refinancing attempts, including by providing the Petitioner with copies of any term sheets and/or discussion papers from any and all new potential lenders;

40. In light of the fact that it was finally brought to the Petitioner's attention that the Respondent was in arrears of rent and in default of its lease arrangements, in some cases since February, 2015, that GE Capital and other previously proposed revolving lenders and term lenders that Respondent was in discussions with had advised the Respondent that they were not prepared to refinance the business and that CIBC had made a proposal conditional on due diligence and arranging a $10 million term loan, the Petitioner retained A&M Canada Securities ULC ("**A&M**") on July 24, 2015 to review and assess the Respondent's financial situation, and the Respondent consented to such arrangement;

41. Upon conducting its review, A&M quickly discovered numerous undisclosed outstanding postdated cheques totaling approximately $3,500,000, well in excess of the $2,200,000 limit under the Credit Agreement;

42. The undisclosed postdated cheques were among a large amount of outstanding cheques that the Petitioner was not aware of totalling approximately $8,000,000, an amount that far exceeded the borrowing availability under the loan agreement. These misrepresentations constituted further defaults pursuant to the Credit Agreement;

43. A&M also discovered that the Respondent had included inventory in transit in its borrowing base, even though the Respondent did not have title to such inventory, artificially inflating the value of the Respondent's borrowing base and allowing it to borrow additional funds. These misrepresentations also constituted further defaults under to the Credit Agreement and caused the Petitioner to lose confidence in the

Respondent's reporting to the Petitioner and question what the true state of affairs of the Respondent and the value of the collateral were;

44. The Petitioner and the Debtors, together with their respective legal and financial advisors, met on July 28, 2015. During this meeting, the Respondent initially advised A&M and the Petitioner that all landlords had consented to a deferral of rents for the month of July and that binding documentary evidence of same was in place. However, as discussed below, this was not in fact the case and counsel for the Respondent stated that it was unclear what if any rent deferrals had been agreed to by the Respondent's landlords;

45. During this meeting, the Respondent also advised that, contrary to previous statements made to A&M by the Respondent just the day before upon attendance by A&M at the Respondent's premises with the consent of the Respondent, it now intended to file a notice of intention to make a proposal under the BIA (the "**NOI**") because (a) it was at risk of lease terminations, and (b) the NOI would allow it to disclaim and liquidate existing inventory at approximately 60 stores, a number of which were The Cadillac Fairview Corporation Limited ("**CF**") locations. The Debtors suggested that the Petitioner issue formal demands for repayment from the Respondent just prior to the NOI filing and that the Debtors sign a waiver of the ten-day notice period prescribed by the BIA to abridge the ten-day period. The Respondent advised that it would voluntarily sign the requested waiver as part of its desire to "work with Salus", and in recognition of its appreciation for the support and accommodation that the Petitioner had provided to it for many years and its need for its further support. The Petitioner advised the Respondent that it was prepared to work with and support the Respondent on the condition that the Respondent was transparent, worked collaboratively with it and A&M and presented a credible restructuring plan and cash flows that would not further erode the Petitioner's collateral position. The Respondent further suggested that it would engage Tiger Capital to liquidate stores to generate cash;

46. As discussed at the July 28, 2015 meeting, the Petitioner issued formal demands on July 30, 2015. Each of the Debtors executed the waivers on July 31, 2015 at 12:30;

47. On July 31, 2015, at 16:20, the Respondent filed a notice of intention to make a proposal pursuant to the BIA, and KPMG was appointed as its proposal trustee;

48. On August 4, 2015, the Respondent presented the Petitioner with an eight-week cash flow forecast for the period ending September 26,

2015 and an inventory monetization plan (the "**Richter Plan**") prepared by its advisor, Richter;

49. A&M was engaged to review and assess the cash flows provided as part of the Richter Plan. The cash flows reflected that the Respondent's borrowing availability is in a margin deficiency position within the first five weeks and remains in a margin deficiency for the remainder of the forecast period and therefore the Petitioner's collateral position would be eroded and the Petitioner's position was not sufficiently protected. A&M was of the view that the Richter Plan did not demonstrate a viable restructuring plan. A copy of the analysis and conclusions prepared by A&M (the "**A&M Memo**") is attached as **Exhibit R-4**;

50. In addition, the Petitioner's retail consultants, 360 Merchant Solutions LLC ("**360**"), advised that in the absence of a refinancing solution, every week a liquidation of existing inventory is delayed will likely result in a marked reduction in the desirability of the Respondent's inventory and the disappearance of any competitive advantage as other retailers begin to reduce prices on their merchandise by the end of August further eroding the collateral of the Petitioner;

51. 360 also advised that failure to commence a liquidation sale will result in a significant deterioration of the Petitioner's recovery causing the Petitioner to suffer a significant shortfall. A copy of the analysis and conclusions prepared by 360 (the "**360 Report**") is attached as **Exhibit R-5**;

52. As a result of the conclusions of the A&M Memo and the 360 Report, the Respondent's failure to present a viable plan, cash flows or refinancing commitments, the quickly-eroding inventory values, the Petitioner's overall loss of confidence in the Respondent's management due to its misrepresentations and the fact that time was of the essence, the Petitioner advised the Respondent that it would, as any prudent lender would, be seeking to appoint a receiver and prepare for a liquidation in the event that the Respondent could not find alternative financing or put forward a plan and cash flows that would not further erode the Petitioner's position;

The Respondent Failed to Inform the Petitioner of Restructuring Efforts

53. Prior to the hearing on August 11, 2015, the Respondent advised the Petitioner that it was "engaged in serious discussions" regarding new financing. This had been communicated to the Petitioner many times before over the years since the execution of the First Forbearance Agreement, in each case to no avail. Given the above concerns and time constraints, the Petitioner advised the Respondent that it would continue

to support and fund the Respondent, provided that it could obtain a commitment for new financing before August 14, 2015 and would present the Petitioner with a viable plan supported by appropriate cashflows and security position while working towards a closing of the financing, but that the Petitioner needed to file its Receiver Motion and commence discussions with liquidators as a fall-back plan, as time was of the essence in the event that the Respondent could not present such commitment, plan and cash flows. The Petitioner further advised the Respondent that the Petitioner would be funding payroll, professional fees and other requested amounts subject to receiving copies of invoices and some clarifying information/details regarding whether or not certain amounts were pre- or post-filing amounts, as per e-mail attached as **Exhibit R-6**;

54. In response, the Respondent stated that it thought it would be able to get a commitment before August 14, 2015. Based on discussions with the Respondent, the Petitioner understood that the proposed financing was to be on a term or subordinated basis, since this is the only financing that the Respondent ever discussed with the Petitioner. At no time did the Respondent advise the Petitioner that it would be seeking a priority charge over all the Respondent's collateral in association with the Application, whether from CF or any other party. The Petitioner first became aware of this possibility upon receipt of the Application, immediately before the hearing held August 11, 2015;

55. Furthermore, the Respondent and the proposed Monitor and its counsel, did not provide the Petitioner with any details of the Application, nor did it provide the Petitioner with a proposed term sheet, prior to service of the materials in support of the Application and the Restructuring Motion;

The Initial Hearing Process

56. As no postponement was granted, the Judgments were made based on inaccurate and incomplete information and omissions of facts and without appropriate notice by the Respondent. The Petitioner did not have the chance to contradict the facts combined in the Restructuring Motion and the Application presented by the Respondent. This has caused great prejudice to Petitioner who could not:

(a) analyze the Restructuring Motion and Application;

(b) analyze the exhibits, including, amongst others, the cash flows;

(c) prepare for cross-examinations;

(d) present witnesses to attend on behalf of the Petitioner (from the United States) and A&M (from Toronto);

(e) analyze and comment on the draft Orders;

(f) make evidence of the prejudice caused to the Petitioner and evidence concerning the balance of the convenience;

(g) make submissions as to the appropriateness of the DIP and/or quantum funding required; or

(h) engage in an informed discussion with the Respondent to reach a mutually-acceptable solution;

57. Despite the Petitioner's concerns noted above and the Respondent's inaccurate representations, the Petitioner was still willing to support the Respondent and fund the operations provided that the Petitioner and the Respondent could agree on a cash flow statement that would provide the Petitioner with adequate protection. The Petitioner had already funded the Respondent's August rent roll, and made numerous efforts to reach out to its counsel prior to the August 11 hearing date. Despite the Petitioner's counsels' efforts to open a dialogue with the Respondent, neither the Respondent nor its counsel provided any substantive response. In particular, the Respondent did not give any indication that it intended to bring an application and/or a motion before the court on August 11, 2015, or at all and would not provide any details regarding its refinancing process. Copies of correspondence from the Petitioner's counsel to the Respondent's counsel in this regard are attached as **Exhibit R-7**;

58. One of the only two communications received from the Respondent's counsel after the service of the Receiver Motion was an email on Saturday, August 8, 2015 from David Stolow, counsel to the Respondent, advising that the Respondent had a number of calls planned for Sunday, August 9, 2015, and that they would be getting back to the Petitioner's counsel on August 10, 2015, and a further email from Me Stolow on Monday, August 10, 2015, requesting a copy of the exhibits referenced in the Receiver Motion. Copies of these emails are attached as **Exhibit R-8**;

59. Following these communications, Montreal counsel to the Petitioner, Me Claude Paquet, left a message for Me Stolow on the morning of August 10, 2015, which call was never returned. The purpose of that call was to discuss the Receiver Motion, set a date for the hearing

and schedule a meeting in Montreal to discuss various issues between the Petitioner and Respondent;

60. As a result of the late hour at which the Application and the Restructuring Motion were served, they were not viewed by Me Paquet until approximately 7:30 on the morning of the hearing. Of further note is the fact that Steve Graff, Toronto counsel to the Petitioner, had a lengthy discussion with Me Fishman, counsel to the proposed Monitor/proposal trustee, on the evening before the hearing, and no mention was made whatsoever of the proposed direction of the Respondent or the impending delivery of the Application or the Restructuring Motion;

61. Due to the foregoing, Petitioner had no opportunity to properly review the material, nor to prepare a response to the Application or the Restructuring Motion. In addition, when the Respondent and the proposal trustee appeared in Court, a total of fifteen people were present for the Respondent. The Petitioner had no notice of the evidence to be provided, nor was it provided with an opportunity to develop a response, have any witnesses testify or undertake any meaningful from of cross-examination;

62. On the morning of August 11, 2015, having just been served with the Restructuring Motion and the Application, the Petitioner requested that the parties agree to postpone the Receiver Motion, the Restructuring Motion and the Application so that they could discuss the terms of continued support by the Petitioner. The Petitioner is informed that, to that end, Ken Rosenstein, Toronto counsel to the Petitioner, advised Me Stolow, Me Fishman, counsel to KPMG, and Raymond Massi of Richter, that the Petitioner was always intending on funding payroll and professional costs and was also prepared to fund other operating expenses, including purchases of fall merchandise, assuming they could reach a reasonable agreement on cash flows and that they would like to meet immediately in Montreal to try to reach an agreement on cash flows and funding requirements to allow the parties to achieve their respective objectives. Me Fishman and Mr. Massi then asked if the Petitioner was prepared to agree at that moment to lift the Cash Management System, thereby giving the Respondent unfettered use of the proceeds of the Petitioner's collateral and fund the Respondent until the end of November. Mr. Rosenstein responded that the parties needed to meet to discuss this and try to come to an agreement, and that the Petitioner's representatives were ready to come to Montreal that afternoon or the following morning. Rather than agreeing to continue the discussion, Me Fishman responded, as a final answer, "have a good day", and passed the phone to Me Stolow, who said that they could not reach an agreement and that they will proceed. The Respondent then immediately proceeded with the hearing;

63. Following the hearing, the Respondent circulated a draft order to the Petitioner's counsel on August 11, 2015 (the "**Original Draft Order**"), which, in addition to the standard provisions of a Restructuring Motion under the CCAA, contained added provisions seeking further relief that had not been in the Respondent's materials. Specifically, and without limitation, the Respondent sought to require the Petitioner to transfer the benefit of the existing Cash Management System, which system is fundamental to the asset-based nature and structure of the loan, to CF to be supervised by CF's financial advisor, PricewaterhouseCoopers Inc. ("**PWC**"), thereby giving the Respondent the use of proceeds of the Petitioner's collateral and having the effect of eroding same if insufficient new assets are not acquired;

64. On August 12, 2015, the parties attended before Honourable Marie-Anne Paquette J.S.C. for the purpose of having the Judgments written and delivered. At that time, the Respondent presented a revised draft Order (the "**Revised Draft Order**") that contained further additional relief that had not been set out in the Original Draft Order. The Revised Draft Order was granted, and provided, amongst other things:

(a) that the stay of proceedings would be extended to parties other than the Respondent, including the Guarantor and Kalman Fisher, who have not made a CCAA filing; and

(b) that a key employee retention plan (the "**KERP**") would be imposed, which would have the benefit of a charge on the Respondent's property up to the aggregate amount of $500,000 in priority to the Respondent's obligations to the Petitioner. The Petitioner has not been provided with a list of beneficiaries of the KERP, but given the fact that the Respondent is a family run business, that many of the key employees are related to Fisher and that Fisher has given a personal guarantee to the Petitioner of the Respondent's debt, the Petitioner's initial view is that the KERP is entirely inappropriate and unnecessary in the circumstances;

B. THE INITIAL ORDER OUGHT TO BE RESCINDED AND/OR VARIED

Viability of the Restructuring and Prejudice to Petitioner

Insufficient Documentation Provided by the Respondent

65. The Respondent's proposed plan of restructuring is set out in the Respondent's Motion and the Application (the "**Restructuring**"). These materials failed to disclose a significant amount of information and/or

documentation required for the Petitioner or any other party to assess the viability of the Restructuring, and its potential prejudice. In particular, the Application did not include:

(a) any analysis supporting the proposal to close 20 stores and negotiate rent reductions on 26 other stores, (the "**Lease Negotiations**");

(b) any evidence to support the savings of $5 million per year to be earned from the Lease Negotiations;

(c) any documentation relating to the proposed temporary and/or permanent layoff of an unidentified number of head office staff;

(d) any details of the proposal to offer a viable financial settlement to the Respondent's unsecured creditors;

(e) any analysis regarding new inventory purchases and product mix;

(f) any analysis of the effect of store closures on sales and purchases of new inventory;

(g) any plan or process to execute a refinancing, equity investment or sale that would typically be expected in the circumstances; and

(h) any pro-forma analysis supporting the restructured entity and the basis on which it could be refinanced;

Analysis of the cash flows

66. The Petitioner is concerned that the DIP Charge in favour of CF gives CF control over the proceedings to the detriment of the interests of the Respondent's other stakeholders, including the Petitioner. CF is one of the Respondent's principal landlords and is owed significant amounts for outstanding rent, plus a deferred long term unsecured debt of $3,500,000, and stands to gain the benefit of not having its store locations disclaimed and receiving rent payments that it otherwise would not have received pursuant to the Richter Plan at the expense and to the prejudice of the Petitioner and other stakeholders including other landlords;

67. The Petitioner is not persuaded that the Restructuring is viable. Among other things, the Respondent has been seeking alternative financing since July 2013 when the Respondent and the Petitioner

entered into the First Forbearance Agreement. Even at this late date, the Respondent has not been able to find a replacement lender and is only able to survive on the basis of short term interim financing that primes the Respondent's existing obligations to Petitioner and expires on November 28, 2015;

68. As set out above, A&M was retained by the Petitioner to provide certain advisory services with respect to the Respondent's loan agreements. Prior to the hearing of the Respondent's Motion and the Application, A&M had reviewed the various restructuring proposals presented by the Respondent, which review and analysis is provided in the A&M Memo;

69. On July 30, 2015, the Respondent provided the Petitioner with a Base Line 13-Week cash flow that was prepared by Richter on the basis that an NOI filling would be made on July 31, 2015, and under the following key assumptions:

- The operations of the Respondent would continue on a going concern basis;
- No store closures or real estate disclaimers, inventory liquidations or other restructuring initiatives would be undertaken;
- Merchandise purchases would continue on a status quo basis, albeit goods would be purchased on 'COD' terms, and no amounts owing to vendors in respect of pre-filing amounts would be paid (other than for critical payments);
- Amounts in respect of 'critical vendor payments' totaling $3 million, as well as other amounts in respect of deposits to service providers were included;
- No amounts in respect of any key employee retention plan ("**KERP**") were included; and
- Funding would continue to be provided by the Petitioner in accordance with its existing credit facilities, and all amounts in respect of interest payments owing under the Petitioner's credit facility would be paid when due;

70. The analysis of A&M (See Exhibit R-4) was that, given the limits imposed by the existing eroding collateral and the Petitioner's credit facility, the Respondent would largely be relying on its ability to:

(a) reduce its operating costs; and

(b) generate cash through the liquidation of existing inventory;

71. Following receipt of the Base Line 13-Week cash flow, A&M received three (3) subsequent cash flow forecasts that were prepared by the Respondent with the assistance of Richter (collectively, the "**Subsequent Cash Flows**"). However, A&M was not allowed any participation in the preparation of the Subsequent Cash Flows nor was it provided any supporting analysis or information regarding the reasonableness of the underlying assumptions;

72. A&M's evaluation of the Subsequent Cash Flows is that the Petitioner's position as the Respondent's senior secured lender is being materially prejudiced because of, among other things:

- Throughout the various periods of the Subsequent Cash Flows, where provided, the Respondent's borrowing availability is either eroding or in deficit; this demonstrates that the Petitioner's security position is eroding even before consideration of the quality of the collateral for which it is relying on, as well as other factors described in more detail in the A&M Memo;

- In particular, under the CCAA 16-Week Cash Flow, the Petitioner's senior secured position has been subordinated to approximately $12.75 million of super priority charges; the Petitioner's position is further eroded by the freezing and compounding of interest payments owing to it in respect of its senior secured debt facilities;

- There is an absence of a reasonable level of critical vendor payments; it is A&M's view that such payments are both necessary and generally required to ensure ongoing merchandise shipments and placement of future orders;

- None of the Subsequent Cash Flows present a restructuring plan which results in the Petitioner being refinanced; in particular, neither the Respondent nor its financial advisor has provided A&M with:

  (a) Any information in support of the longer term viability of the Respondent; such information would include (at a minimum) pro-forma financial forecasts that extend

out beyond the periods covered by the Subsequent Cash Flows;

(b) Any information in support of a plan or a process to refinance the obligations to the Petitioner or to support the notion that the business of the Respondent is re-financeable upon completion of a restructuring proceeding;

(c) A plan to address the more than $5.5 million of potential estate cure costs, including unpaid rent, which will need to be addressed in some manner for the Respondent to restructure and/or refinance the Petitioner; and

(d) Any details regarding go-forward assumptions around working capital requirements post restructuring; it is unlikely that the Respondent will be able to obtain trade terms from its vendors for a period of time (typically 3 to 6 months) following the completion of the restructuring and accordingly, the Respondent's working capital requirements will be higher than normal; in order for the Respondent to continue to operate on a going concern basis, it will require a large amount of financing, significantly more than just amounts owing in connection with the Indebtedness and the DIP Facility;

- Compared to the Base Line 13-Week Cash Flow, the Subsequent Cash Flows present materially less merchandise purchases, and accordingly, lower inventory levels; furthermore, among the Subsequent Cash Flows, merchandise purchases and inventory levels range materially; these variances remain unexplained; no detailed analysis has been provided with respect to target inventory levels and merchandise mix to substantiate any of the forecast purchasing and inventory levels, as well as forecast gross margin levels;

- Compared to the Base Line 13-Week Cash Flow, the Subsequent Cash Flows appear to anticipate store closures and a material reduction in inventory levels; further analysis is required to understand how the Respondent intends to

negotiate with its vendors to reduce purchase quantities or delay the delivery of existing purchase orders; and

- In the absence of further information, it is impossible to adequately or accurately assess the reasonableness of these forecasts; Petitioner notes that the CCAA 16-Week Cash Flow, in particular, is not supported by written assumptions;

73. In addition to the cash flow forecasts, the Respondent's Application included an analysis of the Estimated Net Realization Value ("**ENRV**") of the Respondent's assets for the 16 week period ending November 28, 2015, in relation to which Petitioner notes that:

- The ENRV is (i) based on unsubstantiated assumptions; (ii) subject to a high level of execution and operational risk; (iii) missing, among other things, and at a minimum, the potential cure costs in excess of $5.5 million related to unpaid rents and critical vendor payments that would be required under the circumstances; and (iv) missing various costs and fees forming part of the Petitioner's indebtedness relating to foreign exchange losses, termination fees and professional fees which continue to accrue in an amount in excess of 4.5 million;

- If these amounts were to be correctly included in the ENRV analysis, the Petitioner's security position would be negative at all points during the CCAA 16-Week Cash Flow;

- The Inventory Net Orderly Liquidation Value (the "**NOLV**") is based on an inventory appraisal issued by Tiger Valuation on July 24, 2015, but based on inventory balances as at May 30, 2015. While the NOLV estimates range from 94.4% to 101.1%, no information or evidence has been provided to substantiate the accuracy of this range and it is presumably based on outdated information and is significantly lower at this point in time;

- Assumptions around the equity value in the Respondent's real estate leases, in the range of $1.4 million, are based on a letter supplied to the Respondent by Oberfeld Snowcap, without any description or explanation around the analysis performed or the qualifications of the individuals who performed the valuation. The estimate does not include

information related to the material amounts of unpaid rent from June and July in excess of $5.5 million and other cure costs that may be required to assign the leases and realize any equity value;

- The schedule estimates that the Petitioner's security position turns positive at November 28, 2015 ($1.3 million) primarily due to the positive net cash flow of $7.5 million during the last three weeks of the CCAA 16-Week Cash Flow. The increase in positive net cash flow in the last three weeks is presumably based upon underlying assumptions which have not been provided to A&M and accordingly, A&M cannot assess the reasonableness or accuracy of such assumptions;

- The schedule assumes that the Petitioner would be able to recover $3 million from a personal collateralized guarantee provided by Fisher. No information has been provided to A&M to assess the reasonableness or accuracy of such assumptions, and this is a further inaccurate representation since no collateral security has been granted by Fisher;

- The ENRV does not provide for certain fees owing to Salus pursuant to the Credit Facility including termination fees, collateral monitoring and fees, and foreign exchange translation losses, as well as professional fees and other expenses which continue to accrue and should be included in such analysis; and

  After accounting for the items noted above, the Petitioner's net realization position, as presented in the ENRV, would be materially impacted such that the Petitioner's position would range between negative $11.7 million and negative $18.1 million during the 16-week period (before accounting for the $3 million personal guarantee).

Misrepresentations in the Application

The Petitioner is not winding-down its operations

74. Notwithstanding the Respondent's inaccurate assertions, the Petitioner is not engaged in its own liquidation process, as evidenced by, among other things, the Petitioner having just entered into the Second Amending Agreement with the Respondent on February 26, 2015, and the Petitioner having funded the Respondent's rent roll for August 2015;

Unfounded allegations of impropriety against the Petitioner

75. In all its dealings with the Respondent, the Petitioner has conducted itself as a normal, reasonable and prudent lender. Reference in this regard is made to the affidavit sworn in support of the Receiver Motion (the "**Affidavit**");

76. The Petitioner continued to fund and revolve the Respondent's loans in accordance with the Credit Agreement up until Thursday, July 30, 2015. Thereafter, it continued to fund the Respondent on a written request basis for advances based on the aforementioned ABL structure and borrowing base availability. During this period, and notwithstanding that there was insufficient availability, the Petitioner still advanced approximately $5,500,000 to satisfy the Respondent's August rent, which represents a significant proportion of the funds presently outstanding to the Petitioner;

77. Through July 28, 2015, the Petitioner intended to continue working with the Respondent to support its restructuring plan, and to continue to fund the Respondent, including advancing funds to purchase fall merchandise. However, the Petitioner's support in this regard was dependent upon receiving cash flows that could demonstrate that, under the Respondent's proposed restructuring plan, the Petitioner would receive adequate protection and its collateral position and/or refinancing plan would not be eroded;

78. At a meeting held on July 28, 2015, the Petitioner advised the Respondent that the Petitioner was prepared to support the Respondent on the conditions set out in the above paragraph. The Respondent also suggested that it waive the ten-day notice period provided for in the BIA. The Respondent was not "induced" to sign the waiver – it did so voluntarily as part of its desire to "work with Salus" and continue to access the Petitioner's capital;

79. As described at length above, when the Respondent provided the Petitioner with the cash flow projections prepared by Richter, these cash flows did not provide the Petitioner with any comfort that its position would be sufficiently protected. As a result of the foregoing, the Respondent did not meet the conditions required for the Petitioner's continued support, and the Petitioner therefore advised the Respondent that it would be preparing a motion to appoint a receiver in the event that the Respondent could not present a viable plan and cash flows and/or refinance within a reasonable amount of time given the seasonality of the business and the eroding value of the collateral;

80. Although the Application is highly critical of the Petitioner for allegedly "pressuring" the Respondent to agree to "an imminent liquidation of its Stores", the Application fails to disclose that it was the Respondent itself that had proposed an immediate store-wide liquidation of existing inventory to generate cash and close certain locations. The Respondent made this proposal during its initial restructuring discussions with the Petitioner on or about July 28, 2015. At that time, the Petitioner considered liquidation to be a back-up plan in the event that the Respondent could not find alternative financing or provide a restructuring plan and cash flows that were acceptable to the Petitioner;

81. Contrary to what is indicated in the Application, the Petitioner did not ask the Respondent to take possession of inventory without paying for it. As described in the Affidavit, the Respondent had included certain inventory in its borrowing base certificates where that inventory did not belong to the Respondent, or the Respondent did not yet have possession of it, notwithstanding that it made a written request to the Petitioner for an advance on the revolver to pay the broker who was in possession of the goods. This serious misrepresentation was one of the reasons why the Petitioner was not prepared to continue to fund the Respondent without better and more reliable information about the Respondent's inventory and the collateral. This misrepresentation also further explains the Petitioner's loss of confidence in the Respondent and its management;

The Respondent's additional misrepresentations and omissions

82. The Application omits the following points:

(a) The Respondent continually represented in its daily borrowing requests to the Petitioner that all the Respondent's July rents were current, only to later acknowledge that it was in arrears of approximately $5.4 million for July rents (plus certain arrears going back as far as February) and had received copies of 42 notices of rent default for 46 separate locations totalling over $2.6 million;

(b) The Respondent subsequently asserted that it had reached agreement with the landlords for substantially all the Respondent's stores for the deferral of July rents for a period of time, when the documentary evidence provided to support its claims of rent deferral clearly indicated that in no case had a binding agreement been reached with any of the landlords, let alone substantially all of them;

(c) The Respondent did not disclose approximately $8.0 million of issued cheques from the Petitioner, including post-dated cheques, cheques on hand and cheques in circulation, which amount far exceeded the Respondent's borrowing availability with the Petitioner at that time, and which was only discovered once A&M was given access to monitor and review the Respondent's records;

(d) In addressing the projected cash flows associated with the Restructuring, the Application states that the "inventory analysis shows that the quality of the [Respondent]'s inventory would improve dramatically by the end of September 2015 if operations were continued and fall 2015 goods were purchased and received," but fails to disclose that the negative availability position starting at week five of the Respondent's own cash flows would preclude the Respondent from purchasing and receiving such inventory; and

(e) The Respondent did not fully disclose to the Petitioner its refinancing efforts and would not disclose to whom it was speaking in such regard;

83. The presentation of the eight-week cash-flow projection in the Application is misleading because:

(a) It states that the Respondent "could continue operating until the end of August 2015 with positive availability," without disclosing that the borrowing base is then projected to be in a negative availability position until the end of the projection period in September;

(b) It fails to disclose that the negative availability peaks at approximately $2.9 million;

(c) It fails to provide any forecast information beyond September 26, thereby precluding a thorough assessment on the anticipated longer-term results of the Restructuring;

(d) Certain material assumptions are missing from the cash-flow analysis, including certain professional fees, critical vendor payments and other disbursements that would significantly increase the shortfall;

(e) It fails to provide any quantitative support whatsoever for the assumption that the Petitioner's security position from October

to December would improve, or that the Respondent's financial health would improve during such period;

(f) It fails to show the impact of store closures on sales and the Respondent's ability to procure an acceptable inventory mix; and

(g) There is no ascertainable plan or process to determine when, or if, the Respondent would be in a position to refinance the Indebtedness;

84. Also, whereas the Richter Plan proposed the closure of 59 stores, the Application failed to address why only 20 stores would be closed pursuant to the Restructuring. It appears from the Application that several of the CF-owned locations were amongst those removed from the "closure" list.

Restructuring to-date

85. The Weekly Variance Report dated August 21, 2015, but relating to the first week of the Restructuring (the "**WV Report**"), ended August 15, 2015, provides that the new cash management system was not set up by August 21, 2015, even though the Petitioner relinquished all control over the old cash management system on August 12, 2015, as per the terms of the Initial Order. The WV Report does not disclose the reason for the delay, shows that almost its entire positive cash variance is as a result of the reversal of cash sweeps and that the inventory that the Respondent purportedly immediately required was not purchased. A copy of the WV Report is attached as **Exhibit R-9**;

86. The Petitioner has requested further information/clarity, but KPMG and its counsel refuses to provide any further reporting or information regarding the operation of the Respondent and/or its restructuring efforts or refinancing process to the Petitioner. This is reflective of a general lack of objectivity and a failure to act in the interest of all the Respondent's stakeholders. A copy of certain correspondence in this regard is attached as **Exhibit R-10**;

87. Despite the significant emphasis placed on reporting throughout the Petitioner's relationship with the Respondent, as documented in the various iterations of the Credit Agreement, the WV Report constitutes the entirety of all the reporting that the Petitioner has received since the commencement of the Respondent's CCAA proceedings;

88. During his examination-in-chief on August 11, 2015 in support of the Respondent's request to deny the Petitioner a two-day postponement

of the hearing of the Respondent's Motion and the Application, Raymond Massi of Richter's gave testimony concerning the Respondent's lack of financing and said that "[i]f that continues for another week and we don't do purchases next week [i.e., the week of August 17, 2015], it is very likely that the company will effectively be forced into liquidation, because it can never get out of the cycle of catching up with the purchases." A copy of the transcript of Mr. Massi's testimony is already attached as Exhibit R-1;

89. Even though the Petitioner immediately relinquished control over the Blocked Account Agreements ("**BAA**")/cash management system and even though Mr. Massi testified that the Respondent needed to purchase inventory immediately, the Respondent did not purchase any inventory in the first ten days after the granting of the Initial Order. This demonstrates that the balance of convenience was with the Petitioner – the Respondent's actions indicate that it would not have been prejudiced had the hearing been postponed notwithstanding the misrepresentations made to the Court, in sharp contrast to the prejudice that the Petitioner has suffered and continues to suffer by having its position subverted and its potential deficiency further augmented;

Inability to refinance and inappropriateness of the DIP financing

90. The fact that the Respondent has been in a precarious financial situation is the reason why it has been unable to refinance the Indebtedness despite numerous attempts. Of note, the Respondent's negotiations with GE and its proposed term lender failed just prior to the filing of the NOI, and CIBC's non-binding proposal was subject to due diligence and the arrangement of $10 million of term debt which never materialized;

91. The Respondent did not have a *prima facie* right to approval of the DIP Charge or a transition from the BIA to the CCAA, and it was for the Respondent to establish, which, with respect, it did not do satisfactorily, that the Court should exercise its discretion to grant such relief in the circumstances of this case (see *Enterprise Capital Management Inc. v. Semi-Tech Corp.* (1999), 10 C.B.R. (4th) 133 at para. 20 (S.C.J. [Commercial List]) and *Re Conporec inc.*, 2008 QCCS 4813 at para. 55, leave to appeal refused, 2008 QCCA 2222);

92. In *Conporec*, *supra*, Parent J.S.C. held at para. 55(1) that [emphasis added]:

> **Allowing a DIP financing or creating a priority charge is an extraordinary measure that should be used sparingly and only in clear cases**;

93. Section 11.2 of the CCAA expressly provides that, in deciding whether to approve a DIP Charge, the Court is to consider, in addition to the recommendations of the court officer, each of the following factors:

(a) the period during which the Respondent is expected to be subject to CCAA proceedings;

(b) how the Respondent's business and financial affairs are to be managed during these proceedings;

(c) whether the Respondent's management has the confidence of its major creditors;

(d) whether the loan underlying the DIP Charge would enhance the prospects of a viable proposal, compromise or arrangement, as applicable;

(e) the nature of the Respondent's property; and

(f) whether any creditor would be materially prejudiced by the DIP Charge;

94. With respect to the last point, section 11.2 of the CCAA now clearly states that the Respondent must advise the "secured creditors who are likely to be affected by the security or charge" prior to obtaining interim financing with super priority. This statutory provision codified the existing case law, which confirms that a super priority cannot be granted by the Court if the creditors affected by such super priorities are not notified and given the opportunity to make representations;

95. In *Royal Oak Mines Inc.* (1999), 6 C.B.R. (4th) 314 (Ont. Court, General Division), Blair J. wrote at para. 24 [emphasis added]:

> It follows from what I have said that, in my opinion, extraordinary relief such as DIP financing with super priority status should be kept, in Initial Orders, to what is reasonably necessary to meet the debtor company's urgent needs over the sorting-out period. Such measures involve what may be a significant re-ordering of priorities from those in place before the application is made, not in the sense of altering the existing priorities as between the various secured creditors but in the sense of placing encumbrances ahead of those presently in existence. Such changes should not be imported lightly, if at all, into the creditors mix; **and affected parties are entitled to a reasonable opportunity to think about their potential impact, and to consider such things as whether or not the CCAA approach to the insolvency is the appropriate one in the circumstances as opposed, for instance, to a receivership or bankruptcy – and whether or not, or to what extent, they are**

> **prepared to have their positions affected by DIP or super priority financing**. As Mr. Dunphy noted, in the context of this case, the object should be to "keep the lights [of the company] on" and enable it to keep up with appropriate preventative maintenance measures, but the Initial Order itself should approach that objective in a judicious and cautions matter;

96. In *Boutiques San Francisco Inc. (Re)*, [2003] Q.J. No. 18940 (QL), Gascon J. wrote at para. 32 [emphasis added]:

> The Court agrees with Professor Janis Sarra of the Faculty of Law of the University of British Columbia that five principles should govern a court in considering applications for [priority charges for the directors and officers indemnification and for the monitor and counsel fees]:
>
> > **- There should be adequate notice to creditors so that they be heard on the issue. It should only be considered on an *ex parte* basis for what is required to keep the debtor's "lights on" pending notice to all and every interested parties.**
> >
> > **- There should be sufficient disclosure for the benefit of all creditors of what is likely to be the impact of these priority charges on their claims and securities.**
> >
> > (...);

97. It is a well-known principle that an interim financing must be limited to what is required "*to keep the debtor's lights on*". In the present instance it cannot be argued that the interim financing of $10,000,000, which would provide funds to the Respondent for approximately four (4) months, is what was required to "keep the Debtor's lights on". Such relief was disproportionate and preferential to CF, which, as of this date, has only provided a small amount for payroll and for the purchase of goods;

98. In light of the facts presented by Respondent, the Court immediately allowed the total interim financing when all the while the Petitioner was ready to bridge at least a two day period to allow for postponement to prepare and expose all the facts;

99. The facts informing factors (a)-(e) discussed above have been examined at length in this motion, but can be summarized as follows:

(a) The Petitioner was and continues to be materially prejudiced by even the shortest of CCAA proceedings. In the absence of the DIP Charge and the stay of proceedings imposed by the transition to the CCAA, the Petitioner was expected to recover close to 100% of the Indebtedness if a liquidation

sale had commenced immediately. The delay in liquidation has put the Petitioner at risk of suffering a significant shortfall. Every week a liquidation is delayed results in a marked reduction in the desirability of the spring/summer inventory and the disappearance of the Respondent's present competitive advantage in holding an immediate liquidation sale, as retailers have reduced prices of their spring/summer merchandise during the second half of August;

(b)-(c) The Petitioner was and continues to be materially prejudiced by a management team in which it has no confidence. The Petitioner has lost all confidence in the Respondent's existing management team, but the relief granted allows the Respondent's business and financial affairs to continue to be managed by the Respondent's current directors and officers. Contrary to the assertions that the Petitioner is "deceitful" and that the Respondent's directors and officers "are honest and experiences [sic] retailers," it is the Respondent that has failed to fulfill its covenants to its lender for two years (and to its prior lenders beforehand), that made material misrepresentations regarding its financial status, including its borrowing base certificates, its position with its landlords, the amount of post-dated cheques outstanding and the value of its inventory. These misstatements go to the heart of the Petitioner's relationship with the Respondent and to the core of the loss of confidence; and

(d) The Petitioner was and continues to be materially prejudiced by CCAA proceedings that do not present a viable solution or even a refinancing process. Other than the suggestion from Mr. Massi of Richter that the relief was necessary to ensure that inventory would be purchased within two days to keep the business afloat, which inventory purchase the Respondent then failed to implement during the next *ten days*, the Respondent provided little to no support for its bold statement that the continuation under the CCAA and the DIP Charge were necessary to make a viable proposal to its creditors. In fact, no proposal has been presented nor is one even likely imminent at this stage;

Inappropriateness of the relief generally, given the lack of notice

100. In a subsequent decision in the *Royal Oak Mines* case discussed above, and writing generally with respect to initial CCAA applications, Farley J. wrote in 7 C.B.R. (4th) 293 at para. 5(7) that [emphasis added]:

I appreciate that everyone is under immense pressure and have concerns in a CCAA application. However, **as much advance notice as possible should be given to all interested parties**. It may be helpful to provide the service list with an initial letter or draft notice of motion which would clearly set out the nature of the relief sought and the general grounds (with reasonable elaboration) with the formal material following in due course. **At a minimum, absent an emergency, there should be enough time to digest the material, consult with one's client and discuss the matter with those allied in interest and also helpfully with those opposed in interest so as to see if a compromise can be negotiated. Responding material may require further time before the hearing actually takes place. I am not talking of a leisurely process over weeks here; but I am talking of the necessary few days in which the dedicated practitioners in this field have traditionally responded**. Frequently those who do not have familiarity with real time litigation have difficulty appreciating that, in order to preserve value for everyone involved, Herculean tasks have to be successfully completed in head spinning short times. All the same **everyone is entitled the opportunity to advance their interests**. This too is a balancing question;

101. In the present case, there was no "emergency" entitling the Respondent to deprive the Petitioner of meaningful notice to digest the matter and file responding material. Although the Respondent represented to the Court that a two-day postponement would have precluded it from purchasing the necessary fall inventory to avoid a liquidation, the Respondent then allowed *ten days* to elapse, and had still not purchased the requisite fall inventory;

102. Having avoided a two-day postponement, it is the Respondent that took a "leisurely process over weeks" of which Farley J. was critical, and such behaviour should not be condoned;

Extending the stay to the Guarantors was inappropriate

103. Quite apart from the notice issue, this Court did not have jurisdiction to extend the CCAA stay of proceedings to the Guarantors, which stay can only be provided within the limits of subsections 11.02(1) and 11.02(2) of the CCAA (respectively, for stays requested on, and subsequent to, an initial application). Section 11.04 of the CCAA explicitly provides [emphasis added]:

No order made under section 11.02 [i.e., the stay provisions in subsections (1) and (2)] has affect on any action, suit or proceeding against a person, other than the company in respect of whom the order is made, **who is obligated under a letter of credit or guarantee in relation to the company**;

104. Subsection 11.02(4) further provides that the Court does not have any residual discretion outside section 11.02 to grant a stay in favour of a guarantor [emphasis added]:

> **Orders doing anything referred to in subsection (1) or (2) may only be made under this section**;

105. It has long been the case – even well-before the above statutory enactments – that a stay under the CCAA was not available for guarantors. For example, in *Browne v. Southern Canada Power Co.* (1941), 23 C.B.R. 131 (Quebec King's Bench, Appeal Side), Walsh J. held that [emphasis added]:

> *The Companies' Creditors Arrangement Act*, however, intervened in the case of the City Gas Company to grant the company favoured treatment; **this Act does not extend its favours to others, who had guaranteed the debt**;

106. Moreover, even if the Court had the jurisdiction to expand the stay to encompass the Guarantors, which the Petitioner submits is not the case, the Respondent did not request or provide support for such expanded stay in any of its materials prior to tabling the Revised Draft Order, and there was accordingly no evidence before the Court upon which an expanded stay could have been considered on the basis that it is somehow important for the reorganization process;

Granting the KERP charge was inappropriate

107. While the CCAA is silent with respect to the granting of KERP charges, Newbould J. held in *Re Grant Forest Products Inc.* 2009, 57 C.B.R. (5th) 128 (Ont. S.C.J. [Commercial List]) that the Courts will consider several factors in determining whether to grant a KERP and a KERP charge, including:

(a) Whether the Employees to which the KERP applies would consider other employment options if the KERP agreement were not secured by the KERP charge (*Grant Forest*, *supra*, at para. 8)

(b) Whether the continued employment of the employees to which the KERP applies is important for the stability of the business and to enhance the effectiveness of the marketing process (*Grant Forest*, *supra*, at para. 11);

(c) The employees' history with and knowledge of the debtor (*Grant Forest*, *supra*, at para. 12);

(d) Whether the agreement and charge were approved by the board of directors, including the independent directors (*Grant Forest*, *supra*, at para. 18); and

(e) Whether the KERP agreement and charge are supported or contested to by the secured creditors of the debtor or the Monitor (*Grant Forest*, *supra*, at paras. 19-20).

108. The Court was not given the opportunity to evaluate the above factors, and the Petitioner similarly was not afforded such opportunity, as the Respondent did not request or provide support for the KERP in any of its materials prior to tabling the Revised Draft Order;

109. To determine whether the KERP is appropriate, information relating thereto needs to be disclosed to the Court, the Petitioner and other parties, on a sealed basis if necessary, in order to inform the above factors;

110. To the extent that the Respondent's KERP is meant to apply to shareholders and/or family members (which cannot be ascertained without the filing and release of information), it is submitted that such an arrangement would not be appropriate. As the ultimate purpose of a KERP is, not surprisingly, to retain key personnel for the duration of the restructuring process (see factor (a) above, and *Grant Forest*, *supra*, at para. 14), consideration should be given as to not only how integral an employee is to the company's performance, but also the likelihood of departure in the absence of the KERP. Accordingly, it would not be appropriate for a KERP to include employees who are unlikely to look for other work because they already have a vested interest in the continued viability of the Respondent, such as family members and shareholders.

111. Moreover, to the extent that the continued employment of the employees to which the KERP applies may be important for the credibility of any eventual marketing process (see factor (b) above), Newbould J. further distinguishes why family members and shareholders should be treated differently from independent employees, noting in *Grant Forest* at para. 16 [emphasis added]:

> **One can readily understand that a prospective bidder in the marketing process that is now underway might want to hear from an experienced executive of the company who is not a shareholder and thus not conflicted**. Mr. Dunphy on behalf of the Monitor submitted that Mr. Lynch is the only senior executive independent of the shareholders and that it is the Monitor's view that **an unconflicted non-family executive is critical to the marketing process. The KERP agreement providing Mr. Lynch with a substantial termination payment in the event that the business is sold can be viewed as adding to his**

independence insofar as his dealing with respective bidders are concerned;

Conclusion

112. In the totality of the circumstances discussed above, including, without limitation, the absence of a prior notice and the lack of full disclosure to the Court, the Petitioner and the other interested parties, the Respondent's Motion and the Application are equivalent to an *ex parte* hearing which justifies the Petitioner's request for the relief requested herein;

113. The Respondent has not presented any realistic plan or proposed refinancing process that has caused and continues to cause serious concerns to the Petitioner; and

114. It is urgent that this motion be heard within the shortest possible delay, as the Respondent is expected to borrow further from the Interim Lender and therefore further negatively affect Petitioner's position;

115. The present motion is well founded in facts and in law;

WHEREFORE THE PETITIONER PRAYS THIS COURT TO:

GRANT the present Motion;

ABRIDGE the delays for service, filing and presentation of this Motion and further **DECLARE** that the Petitioner is relieved of any other requirements for service of the Motion;

DECLARE that any further sums to be borrowed by Respondent as of the day herein **September 3, 2015** from the Interim Lender shall be secured by a charge which shall rank after the security granted by the Respondent to Petitioner;

In the alternative, **AMEND** paragraphs 19 through 26 of the Initial Order to replace the Interim Lender with the Petitioner as the interim lender;

RESCIND paragraphs 33 to 38 of the Initial Order so that the Cash Management System which existed between Respondent and Petitioner, before the Initial Order, be returned to Petitioner and be under the control and supervision of Petitioner;

In the alternative, **AMEND** paragraphs 33 to 38 of the Initial Order to provide that Alvarez & Marsal shall control the Cash Management System and provide a weekly report to Petitioner and this Court regarding same;

LIFT the stay of proceedings against the Guarantors with regards to paragraphs 8, 10, 12, and 13 of the Initial Order;

DECLARE that the KERP Charge shall rank after the security granted by the Respondent to Petitioner;

RESCIND the confidentiality and sealing relief provided by paragraph 57 of the Initial Order,

AMEND the Initial Order to require immediately that the Respondent pay interest to the Petitioner on the Indebtedness.

AMEND paragraph 70 of the Initial Order to provide the Petitioner with weekly detailed reporting as follows:

a) a weekly report to Petitioner and the Court regarding the progress on a refinancing, including details of potential lenders, term sheets and timelines to completion;

b) a rolling 13 week projected cash-flow statement to and including the period ending November 28, 2015, and to allow Alvarez & Marsal to participate in the preparation of such cash flow projection and to provide input in the development of all underlying assumptions;

c) weekly reporting on inventory purchases (including trade terms, discounts received, name of vendor, quantities ordered and received, total cost of each order, and to which season the goods relate);

d) a weekly borrowing base certificate and backup documentation;

e) reasonable access to Respondent's management along with responses to any reasonable inquiries made by the Petitioner or its advisors;

f) a weekly flash sales report by store, together with inventory aging performance reports and goods in transit reports;

g) a weekly report detailing the aging of all payables; and

h) a weekly report detailing:

(i) all payments made in respect of pre-filing obligations, if any;

(ii) planned store closures and the status or liquidation sales thereat; and

(iii) an update on any and all lease negotiations, including location, timeline, status (revised lease terms).

ORDER Respondent to prepare and submit to this Court for approval a formal financing solicitation process to be supervised by the Monitor in a form acceptable to Petitioner and Cadillac Fairview;

THE WHOLE with costs;

MONTREAL, September 3, 2015

BCF LLP

BCF LLP
ATTORNEYS FOR PETITIONER
SALUS CAPITAL PARTNERS, LLC

<u>**AFFIDAVIT**</u>

I, the undersigned, **KYLE C. SHONAK**, residing and domiciled for the purpose of the present statement at 197 First Avenue, Suite 250, Needham, MA 02494, USA, make oath and declare that:

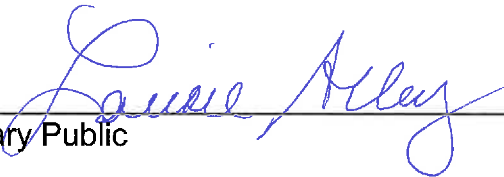
1- I am the Co-President of Salus Capital Partners, LLC;

2- All the facts alleged in the present Motion to rescind the initial order and other relief are true;

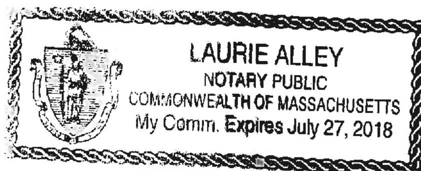
AND I HAVE SIGNED

____
KYLE C. SHONAK

Solemnly affirmed before me, at Needham MA
on September 3 2015



____
Notary Public


LAURIE ALLEY
NOTARY PUBLIC
COMMONWEALTH OF MASSACHUSETTS
My Comm. Expires July 27, 2018

NOTICE OF PRESENTATION

TO: SERVICE LIST

TAKE NOTICE that Petitioner's **MOTION TO RESCIND OR VARY THE INITIAL ORDER AND OTHER RELIEF** will be presented for adjudication before the Honourable Marie-Anne Paquette, J.S.C., sitting in the Commercial Division of the Superior Court of Quebec, in and for the district of Montreal, on **September 11, 2015, at 9:00 a.m.,** or as soon as counsel may be heard, in a room to be announced, at the Montreal Courthouse, 1 Notre-Dame Street East, Montreal.

DO GOVERN YOURSELVES ACCORDINGLY.

MONTRÉAL, September 3, 2015

BCF LLP

BCF LLP
ATTORNEYS FOR PETITIONER
SALUS CAPITAL PARTNERS, LLC

CANADA

PROVINCE OF QUEBEC
District of Québec
Division No: 01- Montréal

N^{o} :
C.S.M. **500-11-049210-152**
41-2021835

SUPERIOR COURT

(commercial division)

IN THE MATTER OF THE PLAN OF ARRANGEMENT OF :

LAURA'S SHOPPE (P.V.) INC., a legal person duly incorporated according to Law, having its head office and principal place of business at 4, Granville Street, Hampstead, Quebec, H3X 3B1;

Debtor / Respondent

-and-

SALUS CAPITAL PARTNERS, LLC, a Canadian chartered bank, having its head office at 200 Bay street, 9th floor, South Tower, Toronto, Ontario, M5J 2J5, and a branch at 1, Place Ville-Marie, Montreal, Quebec, H3B 3A9;

Petitioner

-and-

KPMG INC., 600 de Maisonneuve Blvd. West, suite 1500, Montreal, Quebec, H3A 0A3;

Monitor

-and-

THE CADILLAC FAIRVIEW CORPORATION LIMITED, a legal person duly constituted according to law, having a place of business at 1160, avenue des Canadiens-de-Montréal, Province of Quebec, H3B 2S2;

Dip Lender /Mis en Cause

7465542.4
7465542.6

LIST OF EXHIBITS

EXHIBIT R-1: Transcript of Ray Massi's testimony;

EXHIBIT R-2: Blocked Account Agreements;

EXHIBIT R-3: Notices of default received from various landlords;

EXHIBIT R-4: Copy of the analysis and conclusions prepared by A&M;

EXHIBIT R-5: Copy of the analysis and conclusions prepared by 360;

EXHIBIT R-6: E-mail;

EXHIBIT R-7: Copies of correspondence from the Petitioner's counsel to the Respondent's counsel;

EXHIBIT R-8: Email dated Saturday, August 8, 2015 from David Stolow, counsel to the Respondent, and further email from Me Stolow dated Monday, August 10, 2015;

EXHIBIT R-9: Copy of the WV Report;

EXHIBIT R-10: Copy of certain correspondence;

MONTRÉAL, September 3, 2015

BCF LLP

BCF LLP
ATTORNEYS FOR PETITIONER
SALUS CAPITAL PARTNERS, LLC

23750409.3

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7465542.6

No.: 500-11-049210-152

SUPERIOR COURT
District of Montreal
(commercial division)

LAURA'S SHOPPE (P.V.) INC.

Debtor / Respondent

-and-

SALUS CAPITAL PARTNERS, LLC

Petitioner

-and-

KPMG INC.

Monitor

-and-

THE CADILLAC FAIRVIEW CORPORATION LIMITED

Mis en cause

MOTION TO RESCIND OR VARY THE INITIAL ORDER AND OTHER RELIEF, NOTICE OF PRESENTATION, LIST OF EXHIBITS AND EXHIBITS R-1 TO R-10

ORIGINAL

Me Bertrand Giroux

Our file: 036481-0002

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