



Bob Aziz  
Executive Vice-President & Chief Legal Counsel

Oxford Properties Group  
Royal Bank Plaza, North Tower  
200 Bay Street, Suite 900  
Toronto, Ontario M5J 2J2

T/ 416 865-8300  
F/ 416 868-0701  
www.oxfordproperties.com

April 2, 2015

BY EMAIL

Ian Putnam  
Executive Vice President  
Chief Corporate Development Officer  
Hudson's Bay Company  
15 West 38th Street, 12 Floor  
New York, NY 10018

- and -

BY REGISTERED MAIL to the addressees in Appendix A.

Dear Ian:

Re: **Hudson Bay Company Leases at Yorkdale Shopping Centre, Scarborough Town Centre and Square One Shopping Centre (the "Leases")**

On behalf of the landlords, Yorkdale Shopping Centre Holdings Inc., Scarborough Town Centre Holdings Inc., and Square One Property Corporation and OMERS Realty Management Corporation (collectively, the "**Landlords**" and individually a "**Landlord**"), respectively, under the Leases, we are responding to your letter dated March 4, 2015 to Michael Kitt requesting the Landlords' consent to the proposed joint venture arrangements between Hudson's Bay Company ("**HBC**") and RioCan Real Estate Investment Trust ("**RioCan**") and the proposed transfer of HBC's leasehold interest under the Leases to the joint venture.

Based on the information concerning the joint venture and the draft documents that you have provided to date, and for the reasons which are discussed in more detail below, and subject to any additional reasons that might become evident following disclosure of all missing, redacted or additional information, our consent is required for your proposed transactions under the terms of each Lease. In accordance with our rights under the Leases, your request for consent is denied. As we have previously advised you, if you proceed to include the Leases in your joint venture transaction without our consent, you will be in default under each Lease and we will exercise our rights and remedies as a result of such default.

Our position on this matter is summarized as follows:

- Your consent request has not been properly made because it lacks full particulars of the proposed transaction.
- Your consent request constitutes a proposed amendment to the Leases, and the

Landlords do not agree to the amendment.

- The proposed transaction offends the underlying premise of each Lease that the leased premises must be held by a retail operator that operates an integrated retail department store. HBC YSS LP is not capable of complying with this obligation and is therefore not eligible to receive an assignment of the Leases.
- While the above considerations are dispositive of the matter, we have gone on to consider the Landlords' respective rights on assignment. The Tenants may not assign the Leases without consent unless an exception is available.
- No exceptions are available, including the exception for affiliated or related companies.
- The Landlords are entitled to withhold their consent unreasonably or arbitrarily.
- Without prejudice to such rights to withhold consent unreasonably or arbitrarily, the Landlords have assessed the proposed transaction, acting reasonably and in good faith, and determined that there are good reasons to withhold consent.

We explain the above position in more detail below. Capitalized terms used and not defined in this letter which are used in the context of a particular Lease have the meanings given to them in such Lease.

## 1. Background

We note by way of background that:

- (a) HBC is the registered and beneficial owner of the leasehold interest and Tenant under the Yorkdale Lease; and
- (b) HBC Can Real Property LP, as represented by its general partner, HBC Can Real Property GP Inc., is the beneficial owner of the leasehold interest and Tenant under each of the Scarborough Town Centre and Square One Leases. HBC holds the registered interest in such Leases as nominee for HBC Can Real Property LP and is the subtenant under such Leases.

We understand that pursuant to your proposed transactions: (i) the beneficial leasehold interest in the Scarborough Town Centre and Square One Leases would initially be assigned to HBC, (ii) HBC would subsequently contribute and assign the beneficial interests in all three Leases to HBC YSS LP, (iii) such leasehold interests would constitute "Partnership Property" to be held by HBC for the benefit of all partners of HBC YSS LP from time to time, (iv) HBC YSS LP would grant a sublease of each of the leased premises under the Leases back to HBC (the "HBC Subleases"), and (v) all of the limited partnership interests in HBC YSS LP would be transferred to RioCan-HBC Limited Partnership ("RioCan-HBC LP").

## 2. Consents Requested

Pursuant to the forms of consent that you provided, you have requested the Landlords' consent to the following transactions:

- "(a) The Tenant's Interest in the HBC Lease may be transferred, assigned and conveyed (through any series of intermediate transfer(s), assignment(s), conveyance(s), disposition(s), or other steps as HBC may determine) and in each case without the consent or approval of the

Landlord to HBC, as general partner of HBC YSS LP, provided that HBC becomes and remains the general partner of HBC YSS LP from and after the closing date of such transactions.

(b) If and so long as HBC holds the Tenant's Interest in the HBC Lease as general partner of HBC YSS LP, any direct or indirect transfer, assignment, conveyance, disposition or financing of any equity shares, units or interests of HBC, HBC YSS LP and HBC YSS Limited Partner (including any change made through the public securities market and any initial public offering of HBC YSS Limited Partner or its direct or indirect parent) will not require the consent of the Landlord.

(c) HBC, as general partner of HBC YSS LP, may grant a sublease of the Leased Premises to HBC (such sublease, the "HBC Sublease") in the form contemplated by the HBC YSS Contribution Agreement."

(emphasis added)

### 3. **Objections to Consent Requested**

The Landlords object to the consent that has been requested on the basis that your request and the form of consent provided do not comply with the Leases for the reasons set out below. In addition, the consent requested does not apply to the assignment of the beneficial interest in each of the Leases to HBC YSS LP which is a fundamental element of your proposed transaction.

#### (a) **Lack of Full Particulars**

Paragraph 1(a) of the form of consent you provided purports to permit the initial transfer of the Leases to HBC as general partner of HBC YSS LP through any series of intermediate steps as HBC may determine and without identifying what those steps are. The HBC YSS Contribution Agreement refers to an "HBC Reorganization" the specifics of which have also not been provided. We are not obliged to, and will not give, consent to unknown transaction steps involving unknown parties. In addition, various provisions of the joint venture documents that you provided for our review have been redacted. We are entitled to be satisfied that the provisions that have been redacted are not relevant to the consent requests and do not impact the Leases.

If you wish to make a proper request for consent, full particulars of the transaction steps and unredacted documents are required. If you have particular sensitivities about the redacted provisions, we would be prepared to consider a mechanism to address your sensitivities while allowing us to be satisfied that the redacted provisions are not relevant to our consideration of your request. An example of such a mechanism would be to allow our external counsel to review the redacted provisions for the purpose of assessing their relevance to the Landlords. They would be authorized to share with us their conclusions as to whether the redacted provisions are relevant to our consideration of your consent request but would not be authorized to disclose the specifics of the redacted provisions to us. If their conclusion is that the redacted provisions are relevant, we would require that you disclose such provisions.

#### (b) **Requested Consent Constitutes an Amendment to the Leases**

Pursuant to Paragraph 1(b) of your form of consent, you requested that we consent to any future changes of ownership of HBC, HBC YSS LP or its limited partner, including pursuant to any proposed initial public offering of securities of HBC YSS LP or either of its partners. This is tantamount to requesting a blanket waiver or amendment to each Lease that eliminates the Landlord's rights to consider and give or withhold its consent to future transactions involving a change of control of the Tenant or whereby the Tenant would cease to be an affiliate of or related

to HBC. We are not obliged to entertain a request for consent that would in effect amend each of the Leases to remove the Landlord's existing rights to consider future changes of ownership or control of the Tenant on a fully informed basis. We will not consent to broad categories of possible future transactions where the parties involved, the effect on the Leases and the implications for our shopping centres cannot be determined.

**4. Assignment Other than to a Retail Operator Offends Underlying Premise of the Leases**

We consider it an important premise underlying each Lease that the leasehold interest in the leased premises is to be held by a retail operator that operates an integrated retail department store in the leased premises as an anchor tenant for the Landlord's shopping centre. In furtherance of this premise, each Lease contains express covenants which require that the Tenant personally operate a retail department store business in the leased premises and carry on such business under the name used by the Tenant at its other comparable department stores.<sup>1</sup> Each Lease also requires that any proposed assignee enter into an agreement in writing with the applicable Landlord whereby the assignee agrees to assume and perform each of the Tenant's covenants and obligations under the Lease. An assignment of the Leases other than to a retail operator offends this key underlying premise. Accordingly, it is our position that the Leases may only be assigned to another retail department store operator that is capable of assuming and performing the Tenant's operating covenants under each Lease. We are not obliged to entertain a request for consent to an assignment of the Leases to an entity that is not capable of assuming and performing such operating covenants as that would effectively be an amendment of the Leases. Absent our agreement to such amendment, an assignment to an entity that cannot satisfy the Tenants' operating covenants would result in a default under the Leases. In this case, HBC YSS LP, as the proposed assignee, is not a retail store operator and is not able to satisfy the Tenant's obligation to operate retail department stores in the leased premises. HBC YSS LP is therefore not eligible to receive an assignment of the Leases.

**5. General Rule Requiring Landlord Consent**

Each Lease contains a general rule which provides that the Tenant may not assign the Lease or sublet the leased premises without the Landlord's prior written consent.<sup>2</sup> Therefore, unless an exception to this general rule is available under a Lease, the consent of the Landlord is required for any assignment of the Lease or sublease of the leased premises. We discuss below the exceptions that, based on our understanding of the proposed transactions, might be available and the reasons for concluding that they are not.

**6. Exception for Assignment to Affiliated/Related Companies**

Although each Lease contains limited exceptions to the requirement for Landlord consent to an assignment of the Lease or sublease of the leased premises, on the facts that you have provided none of those exceptions apply with respect to the proposed assignment of the Leases to HBC YSS LP or the transfer of all of the limited partnership interests in HBC YSS LP to RioCan-HBC LP.

---

<sup>1</sup> Sections 6.00, 21.00(1) and 21.04 of the Yorkdale Lease; Section 4.3 of the Scarborough Town Centre Lease; and Sections 6.00 and 6.02 of the Square One Lease.

<sup>2</sup> Section 21.00 of the Yorkdale Lease, Section 4.1(iv) of the Scarborough Town Centre Lease and Section 21.00 of the Square One Lease.

The Square One Lease contains a specific exception that permits an assignment or sublease to HBC without the Landlord's consent.<sup>3</sup> However, this exception only applies to the proposed initial transfer of the Square One Lease to HBC and the proposed sublease of the premises back to HBC; it does not apply to the proposed transfer of the Lease by HBC to HBC YSS LP pursuant to the Contribution Agreement or the transfer of the limited partnership interests in HBC YSS LP to RioCan-HBC LP.

Each Lease also contains a limited exception permitting a transfer of the Lease to an affiliated or related company without the Landlord's consent on the following terms:

- (1) the Yorkdale Lease permits an assignment of the Lease or a sublease of the leased premises to an "Affiliated Corporation", provided that Landlord consent is to be obtained or the Lease is to be reassigned or sublease terminated if the affiliation ceases;<sup>4</sup>
- (2) the Scarborough Town Centre Lease permits an assignment of the Lease or a sublease of the leased premises between "companies which are or are about to become Affiliates of Simpsons, Limited", provided that any such assignment shall have effect only so long as the assignee or subtenant shall remain an Affiliate;<sup>5</sup> and
- (3) the Square One Lease permits an assignment of the Lease or a sublease of the leased premises to "any company which is related to the Tenant (being any company, which is the parent, subsidiary or controlled in common with the Tenant)", but only on condition that such company shall remain related to the Tenant or that upon ceasing to be so related it shall re-assign or surrender its interest in the leased premises to the Tenant.<sup>6</sup>

The substance of the exception is the same in each case: each limits an assignment of the Lease without our consent to a corporation and only if such corporation is affiliated or related with the transferor Tenant, or in the case of the Scarborough Town Centre Lease, with Simpsons, Limited. In this regard, we understand that Simpsons, Limited continues to exist under the name "Snospmis Limited" and that it is a subsidiary of HBC.

These exceptions are not applicable to the proposed assignment of the beneficial interest in the Leases by HBC to HBC YSS LP because: (i) HBC YSS LP is a limited partnership and is not a corporation, and (ii) HBC YSS LP will not remain an affiliate of or related to the existing Tenant under the Yorkdale and Square One Leases or Snospmis Limited in the case of the Scarborough Town Centre Lease. We elaborate on each of these reasons below.

(a) **Exception Requires Assignment to a Corporation**

In your March 4th letter, you state that the Leases will initially be assigned to HBC as general partner of HBC YSS LP and that HBC will remain the sole owner of each Lease as general partner of HBC YSS LP at all times during the term of each Lease, including all extension

---

<sup>3</sup> Section 21.00(1)

<sup>4</sup> Section 21.00

<sup>5</sup> Section 4.1(iv)(a)(1)

<sup>6</sup> Section 21.00(2)

periods. The Contribution Agreement for HBC YSS LP contradicts this statement. Pursuant to that agreement, HBC has agreed to contribute and assign the beneficial interest in each of the Leases to HBC YSS LP and such interest constitutes "Partnership Property" to be held by HBC for the benefit of all partners of the limited partnership. Accordingly, as general partner of HBC YSS LP, HBC will not hold the Leases for its own personal benefit. Notwithstanding that registered legal title to the Leases will be held by HBC, the actual beneficial owner and Tenant under the Leases will in fact be HBC YSS LP. Any other interpretation cannot be supported. In order for HBC YSS LP to derive any value from the Leases, and consequently for RioCan-HBC LP to derive value from the limited partnership interest it would ultimately own in the HBC YSS LP, HBC YSS LP must have beneficial ownership of the Leases. Furthermore, there would be no need for a sublease back to HBC if HBC is both the legal and beneficial owner of the Leases.

The exceptions that permit assignment of the Leases to affiliated or related companies are therefore not applicable at first instance because HBC will not be the beneficial owner of the leasehold interests under the Leases and the actual beneficial owner, HBC YSS LP, is a limited partnership rather than a corporation. Therefore, the Landlords' consent is required for the assignment of each of the Leases by HBC to HBC YSS LP. Indeed, HBC itself must have reached this same conclusion when it sought our consent in December 2013 to assign the Scarborough Town Centre Lease to the current Tenant, HBC Can Real Property LP.

**(b) HBC YSS LP Will Not Remain Affiliated/Related to HBC**

The second reason that HBC YSS LP cannot rely on the affiliated/related company exceptions is because it will not continue to be an "affiliate" of or "related" to HBC within the meaning of those terms in the Leases.

Based on a review of the limited partnership agreement for HBC YSS LP (the "HBC YSS LPA"), the limited partnership agreement for RioCan-HBC LP (the "RioCan-HBC LPA") and the unanimous shareholders agreement (the "RioCan-HBC USA") for RioCan-HBC General Partner Inc. ("RioCan-HBC GP"), HBC YSS LP will not be, or continue to be, an affiliate of or related to HBC for the following reasons:

- (i) Pursuant to the HBC YSS LPA, HBC's authority as general partner to manage the business of HBC YSS LP is restricted with respect to major decisions which must be approved by the limited partners by way of a unanimous "Special Resolution".
- (ii) HBC is specifically prohibited from taking actions with respect to the Leases unless authorized by a Special Resolution of the limited partners. Since the Leases, the related department store buildings and the HBC Subleases will be the only material assets of HBC YSS LP, these provisions significantly restrict HBC's ability to manage and administer the business of the partnership.
- (iii) If HBC defaults as subtenant under the HBC Subleases, HBC must delegate all actions, decisions and other matters relating to the enforcement and exercise of remedies resulting from such default to an arm's length third party property manager acceptable to the limited partners.
- (iv) The limited partners have the right to remove and replace HBC as general partner in the event that HBC becomes insolvent or defaults as general

partner. The power to replace the general partner is an important element of control with respect to a limited partnership. Upon being replaced as general partner, HBC is required to transfer all of the partnership property that it holds – including the Leases – to the replacement general partner. This obligation is not subject to any requirement that Landlord's consent be obtained or that the new general partner be affiliated or related to HBC so as to qualify for the affiliated/related company exception. Accordingly, contrary to statements made in your letter, there is no assurance that HBC will in fact continue to be the general partner of HBC YSS LP or to hold the Leases throughout their respective term or any extension term.

- (v) Based on the foregoing, the limited partners of HBC YSS LP will exercise control of the partnership, effectively overriding HBC's authority and power as general partner.
- (vi) RioCan-HBC GP's authority as general partner of RioCan-HBC LP is also restricted with respect to major decisions which must be approved by way of a unanimous "Special Resolution" of HBC and RioCan as limited partners.
- (vii) Each of HBC and RioCan will appoint two of four directors of RioCan-HBC GP.
- (viii) Pursuant to the RioCan-HBC USA, RioCan-HBC GP is specifically prohibited from making any decision on behalf of RioCan-HBC LP in its capacity as the limited partner of HBC YSS LP unless at least one director nominated by each of HBC and RioCan approves the matter. As a result, HBC acting alone will not have the exclusive authority to make decisions relating to HBC YSS LP or the Leases. Most or all significant decisions in respect of the Leases will require the approval of RioCan and RioCan will have an effective veto over any such decisions.
- (ix) Decisions with respect to investment guidelines, operating budgets, development and leasing budgets and business plans for RioCan-HBC LP's partnership property – including its interest in HBC YSS LP- will require the joint approval of representatives of both HBC and RioCan. These portfolio level management decisions will impact the management of HBC YSS LP and the administration of the Leases.
- (x) When making decisions for HBC YSS LP in respect of the Leases, the commercial reality is that, regardless of what authority is given to HBC to manage HBC YSS LP under the terms of the HBC YSS LPA, HBC and RioCan will make joint decisions regarding HBC YSS LP and the Leases in exactly the same way as they do for RioCan-HBC LP. By virtue of its joint ownership and decision-making power in RioCan-HBC LP, RioCan will exert substantial influence over HBC's decisions as general partner of HBC YSS LP. Indeed, HBC emphasized the importance of this joint

decision making in its presentation to investors when the transactions were announced.<sup>7</sup>

For the foregoing reasons, when the limited partnership interests in HBC YSS LP are assigned to RioCan-HBC LP, HBC will cease to exercise exclusive control over each of HBC YSS LP, RioCan-HBC GP, and RioCan-HBC LP. As a result, HBC YSS LP will cease to be an affiliate of or related to HBC for the purposes of each of the Leases and the affiliate/related company exception will not apply.

Furthermore, when the limited partnership interests in HBC YSS LP are transferred to RioCan-HBC LP, RioCan will acquire an indirect undivided beneficial co-ownership interest in the Leases as a limited partner of RioCan-HBC LP in its capacity as the limited partner of HBC YSS LP. The indirect assignment of such interest to RioCan is not permitted pursuant to the Leases without Landlord consent.

#### 7. Consent May be Unreasonably/Arbitrarily Withheld

Each of the Leases provides that the Landlord may unreasonably or arbitrarily withhold its consent to a proposed assignment or sublease that is not permitted pursuant to a specific exception on the following terms:

(a) In the Yorkdale Lease:

- (i) the Landlord shall not unreasonably withhold its consent if the proposed transferee is: (A) creditworthy, (B) a suitable replacement tenant, or (C) sufficiently experienced and competent in operating a business of the type required to be operated in the Tenant Department Store;<sup>8</sup> and
- (ii) the Landlord may unreasonably withhold its consent if the proposed transferee has not agreed with the Landlord in writing on a form acceptable to the Landlord to assume and perform each of the Tenant's covenants, obligations and agreements in the Lease or if the requirements of Section 21.00, including the requirement that the ownership of the Tenant Department Store and the leasehold interest in the Lease co-exist in the same entity, have not been satisfied.<sup>9</sup>

In the Landlord's view, including for the reasons set forth in the following section of this letter, the requirements for this exception have not been met and the Landlord is therefore entitled to unreasonably withhold its consent.

- (b) The Scarborough Town Centre Lease provides that the Landlord's consent may be unreasonably withheld where:

---

<sup>7</sup> Hudson's Bay Company Investor Presentation, "JV Transactions to Unlock Real Estate Value and Drive Long-Term Growth", February 25, 2015, page 6.

<sup>8</sup> Section 21.00

<sup>9</sup> Section 21.02



- (i) the Landlord has not received full particulars relevant to the proposed assignment and the identity, reputation, experience and financial position of the proposed assignee; and
- (ii) having received such particulars, the Landlord, acting reasonably and in good faith, is not fully satisfied that: (A) the proposed assignee (1) is of good reputation in the industry, (2) has substantial and successful experience in the operation of integrated retail department stores, and (3) is in a financial position such there is no reasonable grounds to foresee that all of the obligations of the Tenant under the Lease will not be fully performed and satisfied by the assignee during the balance of the term, and (B) the introduction of such assignee as an occupant of the premises will not be adverse in any significant respect to the foreseeable best interest of the shopping centre.<sup>10</sup>

In the Landlord's view, including for the reasons set forth in the following section of this letter, these requirements have been met and the Landlord is therefore entitled to unreasonably withhold its consent.

- (c) The Square One Lease provides an unqualified right for the Landlord to withhold its consent.<sup>11</sup>

While each Landlord is entitled to act unreasonably or arbitrarily in withholding its consent to the assignment of the applicable Leases to HBC YSS LP or to the future changes of ownership of HBC YSS LP or its partners which you have requested, we have assessed your proposed transactions, acting reasonably and in good faith, and determined that there are good reasons to withhold our consent. These reasons are summarized in the following section of this letter.

#### 8. Landlords' Reasons for Withholding Consent

Without prejudice to each Landlord's right to withhold its consent unreasonably or arbitrarily, the Landlords are withholding their consent for the following reasons:

- (a) **Change of Tenant from an Operator of an Anchor Tenant Retail Department Store to a Real Estate Business**

Your proposed transaction involves the assignment of the Leases from an entity that is in the business of operating anchor tenant retail department stores to an entity that will operate a real estate business in competition with each of the Landlords and on the Landlords' own property. This proposed change would fundamentally alter the nature of the relationship between each Landlord and its Tenant under the Leases to the prejudice of the Landlords.

#### *Different Business Objectives Drive Different Decision-Making*

HBC, as a retail department store operator, seeks to maximize sales while minimizing costs, including rent. HBC has stated that its goals are to continue to grow sales and to realize significant operating margin improvements by increasing gross profits and managing operating

---

<sup>10</sup> Section 4.1(iv)(b)

<sup>11</sup> Section 21.00

expenses.<sup>12</sup> These business objectives are aligned with those of the Landlords in that both the Tenant and the Landlords are seeking to increase traffic through the shopping centres and drive retail sales. This alignment is important to the Landlords as it informs the conduct of the Tenant, including in the Tenant's exercise of rights afforded to it as an anchor tenant under the Leases and in making decisions with respect to any proposed amendment of the Leases. For example, in exercising its anchor tenant's right to approve a lease for a new store, each Landlord can expect that HBC, as a retail store operator, will approve a new store that is expected to increase traffic both to the shopping centre and to its store.

This may be contrasted with a REIT (such as RioCan) or other entity (such as RioCan-HBC LP or HBC YSS LP) that operates a real estate business and seeks to maximize long term rental income. RioCan, for example, has stated that its goals are to create stable and growing cash flows from its property portfolio in order to deliver stable and reliable cash distributions to its unitholders that increase over the long term.<sup>13</sup> These business objectives are competitive with those of the Landlords. In the new store example discussed above, if the Tenant under the Lease were a REIT or other real estate business, the Tenant can be expected to weigh the benefit of the new store as a tenant of the shopping centre against the benefit of the new store as its own tenant or sub-tenant and potentially compete with the Landlord for the new store in the same shopping centre or in another property owned by it. Instead of being aligned with the shopping centre Landlord, the anchor tenant is now a competitor of the Landlord in the operation of its real estate business. This is prejudicial to the Landlord's commercial interests.

Another example of these different business objectives driving different decision-making is with respect to the allocation of capital. A retail department store operator can be expected to prioritize investments that increase sales and/or decrease costs. Such investments regularly include investments in their stores - an outcome which is aligned with the business objectives of the Landlords. A REIT or other real estate owner, however, can be expected to prioritize investments that increase long term rental income. In the case of the RioCan-HBC joint venture, it can be expected to prioritize investments in additional properties rather than in existing stores like the ones in question from which the joint venture will already be receiving above-market rents.

*Different Types of Agreements between Landlords and Anchor Tenants versus  
Agreements between Adjacent Property Owners*

The above commercial reality is reflected in the differences between leases that are entered into between landlords and true anchor tenants as compared to reciprocal operating agreements that are made between property owners that each own adjacent properties and who agree to operate such properties as an integrated shopping centre for their mutual benefit. In an anchor tenant lease where the interests of the Landlord and the tenant are aligned and the tenant's behavior is predictable based on its operation of a retail business, the tenant is given rights to approve the Landlord's operating rules and regulations, signage policies, merchandising and leasing activities and expansions or alterations to the shopping centre. On the other hand, an operating agreement between the owners of neighbouring real estate businesses contains reciprocal covenants designed to ensure the joint but independent operation of their respective properties. The rights given to HBC as anchor tenant under the Leases limit the Landlords' freedom of action in order to preserve and enhance HBC's retail business in its department stores, which in turn benefits the Landlord. It would be unusual to give such rights to the owner of a

---

<sup>12</sup> Hudson's Bay Company, MD&A released December 9, 2014.

<sup>13</sup> RioCan Real Estate Investment Trust, MD&A released February 13, 2015.

neighbouring real estate business in an operating agreement. The assignment of the Leases to HBC YSS LP will be prejudicial to the Landlords because it will extend such anchor tenant rights to HBC YSS LP and indirectly to RioCan-HBC LP as the operators of a real estate business that competes with the Landlords.

In addition, the introduction of a REIT or other real estate owner as Tenant is prejudicial to the Landlords because the Tenant has access to confidential information concerning each Landlord's real estate business and plans for the shopping centre by virtue of the rights which the Tenant has pursuant to the Leases to approve such matters as expansion or redevelopment plans, merchandising or leasing plans and new leases to other major department stores. By way of example, imagine a scenario in which the Landlords are planning an expansion of Square One Shopping Centre to accommodate a tenant that is planning to move from Oakville Place, a mall that will be co-owned by RioCan and RioCan-HBC LP, or another mall in the RioCan portfolio. If that expansion requires the consent of HBC YSS LP under its Lease, upon becoming aware of the plans of the tenant to move and the detrimental effect the loss of that tenant would have on Oakville Place or such other mall, RioCan-HBC LP and/or RioCan would have every incentive to block the expansion, notwithstanding that the addition of the tenant to Square One Shopping Centre might be very beneficial to the operations of HBC at Square One Shopping Centre.

This tension is heightened in the context of the proposed RioCan-HBC joint venture given that RioCan is one of the Landlords' most formidable competitors. RioCan is Canada's largest REIT with a total capitalization of approximately \$15.1 billion as at December 31, 2014. It owns and manages Canada's largest portfolio of shopping centres with ownership interests in a portfolio of 340 retail properties containing more than 79 million square feet.

#### *Conclusion*

The assignment of the Leases to HBC YSS LP and the subsequent transfer of the limited partnership interests to RioCan-HBC LP, coupled with the joint decision-making regime under the joint venture documents, will change the Tenant into the operator of a real estate business. This will significantly alter the Tenant's approach to management and operation of its anchor department store and decisions to be made under or in respect of its Lease in a manner that will be prejudicial to the commercial interests of each of the Landlords and their respective properties.

#### **(b) RioCan Will Not Be Solely a Passive Investor**

In your letter you state that RioCan-HBC LP will be solely a passive, non-operating investor in HBC YSS LP. This is not supportable. Pursuant to the HBC YSS LPA, the RioCan-HBC LPA and the RioCan-HBC USA, RioCan's participation is required for any material decisions relating to the Leases. The joint venture structure introduces RioCan into a shared decision making role with HBC in respect of the Leases - either explicitly pursuant to the foregoing agreements or by virtue of the commercial reality of the joint venture arrangements (as discussed under Subsection 6(b) above). This adds an additional and complicating dimension to any negotiation between each Landlord and its Tenant. Issue resolution can now be expected to involve additional requirements of RioCan that are unrelated to the landlord/tenant relationship between the Landlord and HBC as operator of an anchor tenant retail department store. This is also prejudicial to the Landlord's commercial interests.

#### **(c) Transactions Not Consistent with the Purpose or Spirit of the Covenant Against Assignment**

As noted in Section **Error! Reference source not found.** above, we consider it an important

premise underlying each Lease that the leasehold interest in the premises is to be held by a retail operator that operates an integrated retail department store in the leased premises as an anchor tenant for the Landlord's shopping centre. This is the basis on which the Landlords agreed to lease premises to HBC in the first place and the reason why covenants against assignment without the Landlord's consent were included in each of the Leases. The covenants against assignment without Landlord consent were intended to ensure that the leased premises continue to be occupied and operated as an anchor tenant retail store by a qualified and experienced operator of integrated retail department stores.

In its structuring of the transactions, HBC has attempted to disguise the true nature of the joint venture arrangements in an effort to comply literally with exceptions that allow assignments to corporate affiliates of a retail operator without Landlord consent. In doing so, HBC hopes to achieve a transfer of the Leases to an entirely different type of tenant than is otherwise permitted. This is artificial and is contrary to both the purpose and spirit of the covenants against assignment without Landlord consent. HBC is effectively asking the Landlords to replace the existing contractual arrangements created by the Leases with alternative arrangements that are more advantageous to HBC and RioCan and their future plans. The Landlords would be prejudiced by such proposed arrangements because they would lose existing rights which they have over changes of ownership of the Tenant and would have no control over whether their objective to have the leased premises continue to be operated by a qualified and experienced retail department store operator would be met in the future.

**(d) HBC YSS LP is Less Creditworthy as Tenant**

As a tenant with only three properties and no business operations, HBC YSS LP will be less creditworthy than the current Tenants under the Leases. The substance of the transaction is to leave the Landlords with HBC as the same *de facto* Tenant (albeit now as subtenant in all cases) but with HBC YSS LP as the new party against whom the Landlords will have direct claims and remedies as Tenant. As a result, the Landlords will be left with less effective remedies and poorer recovery prospects in the event of a Tenant default or insolvency. This reality, together with the weakened financial position of HBC (as discussed in Subsection 8(e) below) and the complexity of the proposed structure, will also adversely affect each Landlord's ability to obtain third party financing on its property.

**(e) Transactions Weaken HBC's Financial Position**

The proposed transactions materially weaken the profitability of the three subject stores by increasing operating expenses for rent under the new HBC Subleases and expected consequential increases in real property taxes. This increases each Landlord's financial exposure to the applicable stores, including by reducing HBC's ability to invest in the stores. Under the Leases, HBC pays rent at rates below those charged to other shopping centre retail tenants. Lower rents enhance HBC's profitability and its ability to invest in the stores which in turn is beneficial to the shopping centres and each Landlord's business. The proposed transactions will eliminate this material benefit to the Landlords by diminishing HBC's ability to invest in the subject stores.

In addition, HBC proposes to amend its leases for premises at other properties owned by the joint venture to increase the rents paid for extended terms. This further burdens the company. As a result of the proposed transactions, HBC will have significantly higher operating expenses and therefore less ability to withstand adverse fluctuations in sales and revenues. The analysis of CIBC is instructive in this regard: *"The Canadian side of the deal sees HBC paying net rents of about \$26/sq. ft. to a JV where it controls 80% of the entity. Sales per sq. ft. across HBC's Canadian stores are probably about \$140/sq. ft., and the 10 prime properties vended into this*

deal probably average \$180/sq. ft. A GROC (gross rent to occupancy cost) of 14% (implying net rent of over 20% of sales) is far beyond what most landlords would consider safe and reasonable."<sup>14</sup> With a higher percentage of sales revenue being paid in rent, HBC will have less revenue available to invest in inventory, marketing, employees and stores. Indeed, HBC's own figures show that the increased gross rents are not fully offset by partnership distributions from RioCan-HBC LP resulting in a negative cash flow impact.<sup>15</sup>

Notwithstanding HBC expects to account for the JV using the equity method, the proposed transactions will also increase HBC's total leverage taking into account both HBC's direct debt obligations (including capitalized operating lease obligations) and its share of debt incurred or assumed by RioCan-HBC LP. Both equity research analysts, including CIBC, and credit research analysts, including S&P, have identified the negative impact of incremental debt and/or rent on the financial position of HBC.<sup>16</sup>

Finally, HBC's stated plans for rapid expansion of the RioCan-HBC LP platform<sup>17</sup> could put increased pressure on HBC's financial position over time.

These considerations have the potential to be material in adversely affecting HBC and increase the likelihood over time, as its ownership stake in RioCan-HBC LP is reduced through the stated intention to take that vehicle public, that it will not be able to meet its obligations including as subtenant under the Leases and to its lenders in the future. Further, since HBC is the general partner of HBC YSS LP, there is an increased risk that HBC YSS LP will default on its obligations as Tenant under the Leases. Finally, to the extent that HBC remains liable to the Landlords as an original Tenant, prior assignee or guarantor under the Leases, the Landlords' ability to recover direct claims from HBC as a result of a default by HBC YSS LP will be adversely affected.

**(f) Consequences of HBC Becoming Bankrupt or Insolvent**

The proposed sublease structure will be prejudicial to the Landlords in the event that HBC becomes bankrupt or insolvent, including because (i) the Landlords will not have a direct claim against HBC as subtenant in the event that the HBC Subleases are terminated or disclaimed, nor would they have a seat at the table in any insolvency proceedings, which they would currently have, as a creditor of HBC, (ii) HBC YSS LP will cease to be managed by HBC as general partner under the terms of the HBC YSS LPA and RioCan will effectively then have the ability to appoint a new general partner and control the Tenant, (iii) HBC YSS LP under the direction of a new general partner and in its role as a real estate firm will have the right to bring a direct claim against HBC as subtenant and may have a priority interest in respect of any disposition of the HBC Subleases in any insolvency or CCAA proceedings or court supervised process for the sale of the HBC Subleases, (iv) the HBC Subleases create the potential for significant competing

<sup>14</sup> CIBC World Markets - Institutional Equity Research - Earnings Update, "*Hudson's Bay Company – Friendly Partners*", February 25, 2015, pages 5-6

<sup>15</sup> Hudson's Bay Company Investor Presentation, "*JV Transactions to Unlock Real Estate Value and Drive Long-Term Growth*", February 25, 2015, pages 15- 16

<sup>16</sup> CIBC World Markets - Institutional Equity Research - Earnings Update, "*Hudson's Bay Company – Friendly Partners*", February 25, 2015; Standard & Poor's Rating Services Ratings Direct "*Bulletin: Hudson's Bay Co. Ratings Unaffected by Plans to Monetize Real Estate Portfolio*", March 3, 2015.

<sup>17</sup> Hudson's Bay Company Investor Presentation, "*JV Transactions to Unlock Real Estate Value and Drive Long-Term Growth*", February 25, 2015, page 7.

inter-company liabilities between HBC YSS LP or RioCan-HBC LP and HBC that could overwhelm claims of other unsecured creditors, including the Landlords (as has been the case in the Target CCAA proceedings), and (iv) any negotiated deal to buy back the Leases or HBC Subleases would be more complicated since it would require negotiations among HBC and HBC YSS LP and therefore also RioCan, the interests of each of whom would need to be addressed and accommodated in any transaction. In fact, the proposed structure is designed to give RioCan a right to acquire the Leases in the event of an HBC insolvency in priority to the rights that the Landlords currently have to do so, a fact that was noted by CIBC World Markets in its analysis of the proposed transaction.<sup>18</sup>

**(g) Landlords Deprived of Distress Remedy**

The HBC Subleases will deprive the Landlord of its rights of distress since distraint rights are effectively limited to property of the Tenant. Most of the inventory and other personal property on the leased premises at present is owned by HBC. However, after the transaction, all such property will be owned by HBC as subtenant and HBC YSS LP as new Tenant will have little or no personal property on the premises against which the Landlord may exercise distress rights.

**(h) Property Tax Consequences**

The transactions will have adverse property tax consequences for the Landlord and other tenants in the three affected shopping malls. By inflating the income derived from the HBC stores through increased sublease rent, the transactions will result in increased property assessments and increased property taxes for the HBC stores. The property assessments and realty taxes for the Landlords' shopping malls will be influenced by the increase in value for the HBC stores and will likely also increase with the result that the other tenants of the shopping malls will also pay a higher share of property taxes. This is prejudicial to the Landlords' business at the affected shopping malls because those malls will be at a competitive disadvantage to other properties where tenants do not face corresponding tax increases. The Landlord may also bear the cost of increased taxes directly in the case of leases under which the tenant's liability for property taxes is capped.

**(i) Confusion in Market Place**

The announcement of the proposed transaction has created considerable confusion among the Landlords' employees, tenants, lenders and investors, many of whom have come to believe that RioCan has acquired an ownership interest in Yorkdale Shopping Centre, Scarborough Town Centre and Square One Shopping Centre.<sup>19</sup> Comments by representatives of RioCan-HBC LP have only served to fuel this confusion. The following comment of Edward Sonshine, the Chief Executive Officer of RioCan is one example: *"These two significant retail entities, with an incredible amount of collective retail real estate and development experience and expertise, will seek ways to improve upon and, in some cases redevelop, some of Canada's most*

---

<sup>18</sup> See for example the analyst report asserting as follows: "One can see what RioCan likes about this deal. For very little contribution – a couple of weak properties, and a minor cash commitment – it gets a call option on several premium properties if anything goes wrong." CIBC World Markets - Institutional Equity Research - Earnings Update, "Hudson's Bay Company – Friendly Partners", February 25, 2015, page 6.

<sup>19</sup> See *supra*, note 18.

*prominent urban retail locations into landmark mixed-use urban developments.*<sup>20</sup> This confusion is prejudicial to the Landlords in carrying on their business and in competing with RioCan.

(j) **Failure of HBC YSS LP to Assume Leases**

Each Lease contains a requirement that an assignee enter into an agreement in writing with the applicable Landlord whereby the assignee agrees to assume and perform each of the covenants and obligations of the Tenant under the Lease. You have not given any assurance or confirmation that HBC YSS LP as assignee of the Leases will enter into such assumption agreements. We assume that this is because HBC YSS LP is not in a position perform the operating covenants included in such covenants and obligations. See the discussion of this point in Section **Error! Reference source not found.** above.

(k) **Future Amendment of Joint Venture Agreements and HBC Subleases**

HBC and RioCan may agree to amend any of the joint venture agreements or the HBC Subleases at any time in the future in a manner that would exacerbate the concerns that we have expressed above. For example, the parties may amend the provisions of the HBC YSS LPA or the RioCan-HBC USA to require RioCan's approval of additional decisions under or with respect to the Leases. The parties could also amend the HBC Subleases to further increase the sublease rents, which would be beneficial to the real estate business of HBC YSS LP and RioCan-HBC LP, but would increase the financial burden on HBC and the adverse implications for the Landlords.

9. **Proposed Resolution**

You have asserted that the Landlords' consent is not required. We disagree. We understand that your proposed transaction is scheduled to close on or about June 30, 2015. We previously recommended that you exclude our properties from such transaction. Given that we are not consenting to the proposed assignment of the Leases, we reiterate that recommendation.

Alternatively, if you wish to seek judicial resolution of the apparent disagreement by bringing an application for declaratory relief from the court, we are prepared to co-operate with the hearing of an application for such relief on an expedited basis. In our view such application would be appropriately brought on the Commercial List.

---

<sup>20</sup> Edward Sonshine, Chief Executive Officer of RioCan REIT quoted in press release dated February 25, 2015 issued by Hudson's Bay Company available at <http://www.businesswire.com/news/home/20150225005434/en/Hudson%E2%80%99s-Bay-Company-RioCan-Real-Estate-Investment#.VRIdBbFzbc>

We assume that you have been keeping RioCan fully apprised of our exchange of correspondence concerning this matter. We encourage you to share this letter with them so that they understand our position and the reasons why we are withholding consent.

Yours truly,

A handwritten signature in black ink, appearing to read "Robert M. Aziz", written over a circular stamp or mark.

Robert M. Aziz  
Executive Vice President and Chief Legal  
Counsel,  
Oxford Properties Group



APPENDIX A

Hudson's Bay Company  
698 Lawrence Avenue West, 3rd floor  
Toronto, Ontario  
M6A 3A5  
Attention: Senior Vice- President, Real Estate and Development

Hudson's Bay Company  
401 Bay Street  
Suite 600  
Toronto, Ontario  
M5H 2Y4  
Attention: Senior Vice-President, Real Estate and Development

HBC Can Real Property GP Inc.  
-and -  
HBC Can Real Property LP  
698 Lawrence Avenue West, 3rd floor  
Toronto, Ontario  
M6A 3A5  
Attention: Senior Vice- President, Real Estate and Development

HBC Can Real Property GP Inc.  
-and -  
HBC Can Real Property LP  
401 Bay Street  
Suite 600  
Toronto, Ontario  
M5H 2Y4  
Attention: Senior Vice-President, Real Estate and Development