

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

E.O.D. AUG 03 2003

In Re:

Case No. 02-B02474

KMART CORPORATION, et al.,

IN PROCEEDINGS UNDER CHAPTER 11
(Jointly Administered)

Reorganized Debtors.

Chief Judge Susan Pierson Sonderby
UNITED STATES BANKRUPTCY JUDGE

**FOURTH INTERIM AND FINAL APPLICATION FOR ALLOWANCE OF
COMPENSATION AND REIMBURSEMENT OF EXPENSES INCURRED BY
PRICEWATERHOUSECOOPERS LLP AS FINANCIAL, AUDIT, AUDIT-RELATED AND
TAX ADVISORS TO THE REORGANIZED DEBTORS FOR THE PERIOD
JANUARY 22, 2002 THROUGH MAY 6, 2003**

PricewaterhouseCoopers LLP, (hereinafter referred to as "PwC" or the "Applicant") moves pursuant to Sections 330 and 331 of Title 11 of the United States Bankruptcy Code (the "Bankruptcy Code"), Rule 2016 of the Federal Rules of Bankruptcy Procedure, and the Administrative Order establishing Procedures for Interim Compensation and Reimbursement of Expenses of Professionals, dated January 25, 2002 (the "Administrative Order"), for an Order awarding reasonable final compensation for professional services rendered as Financial, Audit, Audit-Related and Tax Advisors to the Reorganized Debtors in the amount of \$11,984,452.80 together with reimbursement for actual and necessary expenses in the amount of \$1,131,957.45, for the period of January 22, 2002 through May 6, 2003 (the "Final Application Period"). Inclusive in this amount is \$1,190,314.30 and \$8,522.51, which represent compensation for professional services rendered and reimbursement for actual and necessary professional expenses, respectively, during the period of January 1, 2003 through May 6, 2003 (the "Fourth Application Period"). In support of this application, PwC represents as follows:

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NORTHERN DISTRICT OF ILLINOIS

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KENNETH S. GARDNER, CLERK
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OVERVIEW

1. This Chapter 11 case commenced with the filing by the Reorganized Debtors of a Voluntary Petition for Relief under Chapter 11 of the Bankruptcy Code on January 22, 2002 in the United States Bankruptcy Court, Northern District of Illinois, Eastern Division (the "Court").

2. The Court authorized the employment of PricewaterhouseCoopers LLP as Financial Advisors for the Reorganized Debtors and Reorganized Debtors-In-Possession under Sections 327(e) and 1107 of the Bankruptcy Code by the Final Order entered on February 13, 2002 (the "PwC Retention Order"). The Court also authorized the Reorganized Debtors to employ PwC to provide audit, audit-related and tax services by the Final Order Pursuant to 11 U.S.C. §§ 105(a), 327(a) and 331 Authorizing Retention of Professionals Utilized by the Reorganized Debtors in the Ordinary Course of Business (the "Ordinary Course Professionals Final Order") entered on February 13, 2002.

3. PwC sold its Business Recovery Services practice, related assets and receivables (the "BRS Practice") to FTI Consulting, Inc. ("FTI") on August 30, 2002 (the "Closing Date"). In light of the BRS Practice and FTI's ongoing role as Financial Advisors to the Official Committee of Institutional Creditors in this proceeding, PwC concluded its work (the "BRS Services") for the Reorganized Debtors as of the Closing Date.

4. The Reorganized Debtors filed the Supplemental Application Pursuant to Fed. R. Bankr. P. 2014(a) For Order Under Sections 327(a) and 328(a) of The Bankruptcy Code Authorizing the Reorganized Debtors to Amend the Scope of Employment and Retention of PricewaterhouseCoopers LLP to include the provision of Audit, Audit-Related and Tax Services (the "Supplemental PwC Retention Application") on September 11, 2002 to amend the PwC Retention Order to: (a) include audit, audit-related and tax services previously authorized by the Court per the Ordinary Course Professionals Final Order; and (b) to reiterate authorization for PwC to provide non-audit services such as bankruptcy tax and other financial advisory services to the Reorganized Debtors, all of which are not included in the BRS Services. The Supplemental PwC

Retention Application was approved by Court Order on September 24, 2002 (the "Amended PwC Retention Order").

5. Included in the \$1,190,314.30 fee amount requested for the Fourth Application Period is \$93,683.43 that represents the 10% professional fee hold-back² referenced in the Administrative Order for the period January 1, 2003 through May 6, 2003. The Applicant seeks interim and final allowance and payment of the fees and expenses in total, including the 10% hold-back on professional fees. The Court granted interim approval of the First Interim Fee Application and the hold-back amount from that period was subsequently paid by the Reorganized Debtors. The Court also granted interim approval of the Second Interim Fee Application, but directed that the hold-back amount for this period would be paid at the end of this Chapter 11 case subject to Court approval of the Final Fee Application. A hearing has not yet been held for the Third Interim Fee Application and the hold-back amount from this period remains outstanding.

6. As of the date hereof, pursuant to the Administrative Order, the Reorganized Debtors have paid PwC in respect of the Fourth Application Period \$824,832.35 for professional fees and \$1,523.50 for expenses, as detailed in Exhibit A2. For the Final Application Period, the Reorganized Debtors have paid PwC \$11,335,519.73 for fees and \$1,125,086.39 for expenses as detailed in Exhibit A1. Amounts not yet paid total \$655,804.13 (professional fees of \$648,933.07 and expenses of \$6,871.06). Prior to the Petition Date, PwC received a retainer from the Reorganized Debtors in the amount of \$1,000,000. This retainer was returned to the Reorganized Debtors on November 13, 2002.

SUMMARY OF SERVICES RENDERED BY APPLICANT

7. The First Amended Joint Plan of Reorganization of Kmart Corporation and Its Affiliated Reorganized Debtors and Reorganized Debtors-In-Possession (the "Plan") was confirmed by the Court on April 23, 2003. The Reorganized Debtors emerged from Chapter 11 Bankruptcy

² The Fee Statement submitted for the February 1, 2003 through February 28, 2003 period was paid at 100% of professional fees (vs. 90% of professional fees). This incremental amount, or \$25,348.00, has been applied as a credit to amounts owing for the period of April 1, 2003 through May 6, 2003 Fee Application.

protection on May 6, 2003, the Effective Date of the Plan. Throughout the case, PwC served critical roles as Audit, Audit-Related, Tax and Financial Advisors to the Reorganized Debtors and performed valuable services that assisted the Reorganized Debtors to restructure and emerge from Bankruptcy in a timely manner. Summary descriptions of the services provided by category during the Final Application Period are provided below.

Code 1010 - Short-term Cash Flows

During the First Interim Application Period, PwC assisted the Reorganized Debtors in developing a 13-week cash flow analysis used to monitor and project the Reorganized Debtors' short-term cash flow position during this critical period of the bankruptcy. PwC assisted the Reorganized Debtors in all aspects of this analysis, including: (a) developing a process to maintain, update, and extend the 13-week cash flow report on a weekly basis; (b) interviewing the Reorganized Debtors' personnel to evaluate assumptions used to forecast cash receipts and disbursements; (c) reviewing documentation and performing various analyses; (d) outlining a process to gather actual cash flow data on a weekly basis for comparison to the 13-week cash flow projections; and (e) preparing budget-to-actual comparisons of historical weekly cash flows. Through these efforts, the Reorganized Debtors were able to more accurately project anticipated cash inflows and needs, ensure its Debtor-in-Possession facility was of proper size and manage its disbursements process.

Code 1025 - Bankruptcy Reporting Requirements

During the First and Second Interim Application Periods, PwC held discussions with Reorganized Debtors' personnel and the U.S. Trustee in regards to monthly operating report requirements, statements and schedules requirements, and other data requested by the U.S. Trustee, which included Reorganized Debtors' insurance certifications and consolidated tax returns. In addition, PwC assisted the Reorganized Debtors to gather legal entity data for the purposes of calculating the quarterly fee to be paid to the U.S. Trustee's Office.

Code 1031/VRCC - Vendor Relations Call Center

During the First Interim Application Period, the Vendor Relations Call Center (the "VRCC") was a critical component of the Reorganized Debtors' vendor communications and management strategy in the immediate post-petition operating environment. PwC assisted the Reorganized Debtors to field and respond to over 16,000 vendor calls on topics including general bankruptcy questions, potential applicability of First Day Orders and timeliness of post-petition payments. PwC also assisted the Reorganized Debtors to handle vendor requests regarding modification of post-petition trade terms. The VRCC also assisted the Reorganized Debtors to process and document approximately 1000 trade term changes and to ensure that these changes were reflected in the Reorganized Debtors' accounts payable system in a timely manner. Other activities of PwC in this category included: (a) customizing a proprietary call and response tracking database to the Reorganized Debtors' specifications; (b) creating pre-defined and ad-hoc reports to manage the VRCC on a daily basis; and (c) interacting with Debtor business and functional groups to resolve vendor issues such as trade term requests, shipping interruptions, and merchandise returns, in a timely manner. These efforts required PwC to work closely with the Reorganized Debtors' external and internal counsel, and its merchandising, logistics and accounting operations groups. Through these efforts, the Reorganized Debtors were able to respond quickly to vendor concerns and ensure merchandise shipments with minimal disruption. These efforts also helped the Reorganized Debtors to maintain liquidity in the immediate post-petition period, as the Reorganized Debtors were successful in managing aggregate trade terms. To maximize the efficient administration of the estate, PwC trained and utilized several Debtor vendor management employees to work alongside its professionals in the VRCC. This approach allowed for call center responsibilities to be transferred to the Reorganized Debtors' staff as the demands of the initial period of the bankruptcy subsided and call volume was reduced.

Code 1050 - Reclamation Claims Administration

During the First and Second Interim Application Periods, PwC was instrumental to the Reorganized Debtors' ability to meet the Court deadline of March 25, 2002 to respond to vendors with its initial reclamation analysis. To meet this deadline, which was sixty (60) days after the Petition Date, PwC: (a) coordinated with the Reorganized Debtors and Reorganized Debtors' Counsel to define the process for responding to vendor reclamation claims; (b) reviewed and documented over 2,500 vendor reclamation claims with an aggregate value of \$1.069 billion; (c) analyzed all received reclamation claims to determine the face value of non-duplicate claim amounts, an analysis that included the review of over 300,000 invoices; (d) coordinated with the Reorganized Debtors and Reorganized Debtors' Counsel to design the vendor reconciliation report to be mailed to claimants; (e) coordinated with the Reorganized Debtors' Accounts Payable and Information Technology departments to define, construct, and test the reclamation database used in the claims reconciliation process; (f) conducted training and provided assistance to the Reorganized Debtors' Accounts Payable personnel involved in the claims reconciliation process; (g) reviewed Debtor-generated reclamation statements for logic, format, and other changes during the multi-phase reconciliation process; and (h) coordinated with the Reorganized Debtors and Reorganized Debtors' Counsel to define the process for responding to "special situation" vendor reclamation claims such as vendors with insufficient information, vendors with debit balances, vendors paid pursuant to first day orders, and vendors requiring manual reconciliation. This analysis culminated with the mailing of approximately 600 vendor response letters on March 25, 2002 to approximately 530 unique vendors with an aggregate claim amount of approximately \$94 million. PwC also coordinated with the Reorganized Debtors and Reorganized Debtors' Counsel to respond to 21 vendors that submitted reclamation claims past the deadline, with an aggregate amount of \$3.7 million.

PwC also assisted the Reorganized Debtors by staffing a Reclamation Call Center to respond to vendor inquires. Per Court Order, vendors could dispute the Reorganized Debtors' reclamation response letters for a period of sixty days (the "Dispute Period") following March 25, 2002 (the dispatch date of the Reorganized Debtors' initial reclamation responses). This Dispute Period was followed by a period during which the Reorganized Debtors could respond to vendor disputes (the

“Dispute Response Period”). During these periods, PwC: (a) created and customized the reclamation call center database to track vendor inquiries, status of claims, and ultimate resolution; (b) researched vendor questions regarding reclamation statements and individually disputed invoices stemming from approximately 860 vendor inquiries, including necessary reconciliation of additional detail provided and coordination with the Reorganized Debtors’ Accounting Operations Department to update the accounts payable system as necessary; and (c) assisted the Reorganized Debtors in reaching agreement with vendors as to their potential reclamation claims and coordinated with Reorganized Debtors’ legal department to send amended reclamation letters to these vendors. In total, approximately 504 vendor agreements were reached during the First and Second Interim Application Period, with the Reorganized Debtors’ estimated reclamation exposure increasing to approximately \$118 million as a result of the corrections / updates made to the Reorganized Debtors’ accounts payable system during the Dispute and Dispute Response Periods. As of August 31, 2002, approximately sixteen reclamation disputes remained, with potential additional exposure of \$10.9 million. Supporting detail for these remaining disputes and all agreements was transitioned to the Reorganized Debtors’ restructuring advisors in late August 2002.

Code 1055 - Perishable Agricultural Commodities Act of 1930 (PACA) Claims Administration

During the First and Second Interim Application Periods, PwC coordinated with Reorganized Debtors and Reorganized Debtors’ Counsel to design an approach to evaluate potential PACA claims by assisting the Reorganized Debtors to quantify potential exposure of approximately \$10-14 million and to begin a detailed evaluation of vendor invoices in this potential exposure group to assess actual exposure. As of August 31, 2002, 25 PACA claim agreements were reached with an estimated reclamation exposure of \$925,000 out of a submitted amount in excess of \$3.8 million.

Code 1065 - First Day Orders – Definition and Operational Compliance

During the First and Second Interim Application Periods, PwC assisted the Reorganized Debtors in the segregation of the pre and post petition operating environments. PwC also coordinated with the Reorganized Debtors and the Reorganized Debtors’ Counsel to administer and track pre-petition

payments made pursuant to the First Day Orders granted by the Court. PwC: (a) worked with the Reorganized Debtors' Accounts Payable and Information Technology personnel to define and implement a process for separating and segregating approximately 2 million invoices between pre and post-petition payables; (b) worked with the Company to generate representative lists of vendor groups defined in the First Day Orders as requested by the Court; (c) interacted with various business groups to define and refine estimates of pre-petition payables for vendors covered in the First Day Orders as required by the Debtor-in-Possession lenders; and (d) assisted the Reorganized Debtors and Reorganized Debtors' Counsel to define and implement an internal approval process for payment of pre-petition amounts pursuant to First Day Orders. As of the Second Interim Application Period, PwC had assisted the Reorganized Debtors with approximately 3,800 individual requests. In addition, PwC assisted the Reorganized Debtors to calculate pre-petition balances for certain consignment vendors with valid filed UCC-1 statements and to analyze pre-petition returns by vendor to identify situations where a portion of the returns could be allocated to post-petition (situations where the returns were greater than the pre-petition balance). PwC's efforts in this category allowed the Reorganized Debtors to transition to a post-petition operating environment with maximum efficiency.

Code 1070 - Debtor-In-Possession Financing

During the First Interim Application Period, PwC assisted the Reorganized Debtors in responding to various due diligence requests from lenders related to the Debtor-in-Possession Facility and assisted the Reorganized Debtors with negotiating the Debtor-in-Possession financing agreement, including financial covenants, reporting requirements, and the borrowing base calculations. Further, PwC reviewed and assisted in the development of the Reorganized Debtors' confidential information memorandum and the presentation for the syndication of its Debtor-in-Possession Facility. PwC also participated in various presentations with potential lenders and rating agencies. The result of these efforts was the successful closing of a \$2 billion Debtor-In-Possession Financing Credit Facility, approved by the Court on March 6, 2002.

Code 1130 - Meeting with the Unsecured Creditors' Committee and/or their Advisors

During the First and Second Interim Application Periods, PwC expended time in meetings with the Unsecured Trade and Finance Creditors' Committees, the Committees' legal counsel and financial advisors. PwC assisted the Reorganized Debtors in the preparation of numerous presentations to the Committees, including the preparation of the Statements and Schedules presentation and the Section 341 Meeting presentation. PwC responded to various information requests from the Unsecured Trade and Finance Creditors' Committees' financial advisors on topics including First Day Order compliance, reclamation procedures and statistics and Statements and Schedules analysis. PwC's efforts assisted the Reorganized Debtors to keep the Committees and their representatives informed of new developments in the case and helped to maintain an effective working relationship.

Code 1140 - Post-Petition Business Operations

During the First and Second Interim Application Periods, PwC assisted the Reorganized Debtors to operate effectively in a post-petition business environment. PwC worked with the Reorganized Debtors to address vendor issues regarding timing of post-petition payments and participated in Accounts Payable operational meetings to address vendor and internal accounts payable issues on a timely basis. PwC also worked with the Reorganized Debtors to define a tracking process for payments to Ordinary Course Professionals as defined by Court Order, which was transitioned to the Reorganized Debtors restructuring advisors in late June 2002. PwC also completed an evaluation of the Kmart Vendor Response Center ("VRC"). PwC's effort in this regard included: (a) interviewing Kmart personnel in various functional areas, including accounts payable, return logistics and vendor management; (b) analyzing types of calls received by VRC, call capacity and methods of communication with key functional Kmart areas of inquiry resolution; and (c) preparing a summary presentation with key conclusions, action items, and items for further investigation.

Code 1200 - Statements and Schedules

During the First and Second Interim Application Periods, PwC assisted the Reorganized Debtors to file 11 sets of Statements of Financial Affairs ("SOFAs") and Schedules of Assets and Liabilities

("SOALs"), covering all 38 filing entities, with the Court on April 15, 2002. This combined submission contained approximately 10,000 pages and required close coordination between PwC, the Reorganized Debtors' external counsel and the Reorganized Debtors' General Counsel, Tax and Financial Reporting departments. The Reorganized Debtors' Schedules and Statements required significant effort due to the sheer magnitude of the data involved and because the Reorganized Debtors do not prepare, other than annually for tax purposes, separate, stand-alone accounting records in their general ledger for certain legal entities. During the course of the Schedules and Statements documentation process, PwC: (a) participated in organizational meetings with the General Counsel's Office, Tax and Financial Reporting to highlight the process and timeline for filing the Schedules and Statements; (b) gathered data from various functional and business groups, including approximately 15,000 executory contracts from real estate, merchandising, information technology and other departments, over 20,000 litigation cases and individual claimant demands, and approximately 100,000 pre-petition payable balances; (c) coordinated with the Tax and Financial Reporting groups to define and execute the process for extracting specific asset data and directly attributable liability data from the Consolidated Schedules for the legal entities to be scheduled separately; (d) developed a process to gather and reconcile information to the Reorganized Debtors' trial balance and to the Tax-Group-generated balance sheets to ensure completeness of information scheduled; (e) conducted multiple status meetings, conference calls with the Reorganized Debtors and Reorganized Debtors' counsel to raise or resolve issues related to the collection of data for statements and schedules on a timely basis; (f) coordinated multiple rounds of Schedules and Statements review by Kmart analysts and management, including generation of executive summary packets and establishment of Schedules and Statements review rooms in New York, Detroit, and Chicago; (g) worked with Reorganized Debtors and Reorganized Debtors' Counsel to draft the Global Notes for the Statements and Schedules for all scheduled entities, integral parts of the ultimate submission to the Court; and (h) coordinated with a third-party printer to arrange for draft rounds and final versions of documents submitted to the Court on April 15, 2002. PwC also worked with Reorganized Debtors and Noticing Agent to define data warehousing formats to facilitate transfer of liability data used for the claims noticing process. PwC also assisted

the Reorganized Debtors to define a process for responding to vendor requests for clarification of the contingent classification of certain pre-petition payables listed in the Reorganized Debtors' Schedules and Statements. PwC's efforts were instrumental to the Reorganized Debtors fulfilling the requirement for full and complete disclosure of its financial position as of the Petition Date.

Code 1220 - Bankruptcy-related Tax Issues

During the First, Second, Third and Fourth Application Periods, PwC provided federal state tax consulting services that enabled the Reorganized Debtors' internal tax department (the "Reorganized Debtors" Tax Group") and counsel to (i) quantify its tax attributes, (ii) evaluate various alternatives in order to maximize the preservation of its tax attributes and minimize the tax costs of the restructuring (iii) project future tax costs and (iv) and create an organizational structure that optimizes future tax savings upon emergence from bankruptcy.

Initially, PwC assisted the Reorganized Debtors' Tax Group to gain an understanding of the potential federal and state tax issues and consequences that potentially could result from the conduct of the Chapter 11 case and the Reorganized Debtors' restructuring, including the impact of a change in the equity ownership of the Reorganized Debtors', the tax consequences of cancellation of debt ("COD") income and its impact on the Debtors' tax attributes, and the deductibility of bankruptcy-related fees and expenses.

PwC reviewed and analyzed the previous changes in the equity ownership of the Reorganized Debtors in order to determine whether an "ownership change" had occurred or would be likely to occur before emerging from bankruptcy. (Under Section 382 of the Internal Revenue Code of 1986, as amended, such an ownership change could have a significant adverse effect on the Reorganized Debtors' valuable net operating losses.) This involved a detailed analysis of the trades of all direct and indirect five-percent shareholders during the prior three-year period. In this context, PwC also conferred with tax and bankruptcy counsel regarding the merits of attempting to impose trading restrictions on the interests and claims against the Reorganized Debtors in order to avoid an

ownership change prior to emergence from bankruptcy and to preserve the ability to make potentially favorable tax elections.

In October 2002, PwC was requested to: (i) undertake an analysis of the impact of the proposed reorganization on the Reorganized Debtors' tax attributes, (ii) assist the Reorganized Debtors' valuation experts in determining the projected post-emergence tax costs and (iii) identify and evaluate alternative structures and elections that might minimize the tax impact of the reorganization. Thus, during the Third and Fourth Application Periods, PwC worked with the Reorganized Debtors' Tax Group to create a dynamic and sophisticated model that estimated the Reorganized Debtors' potential cash tax liability over the next five and ten years under various assumptions, elections and alternatives.

In order to develop this model, PwC worked closely with the Reorganized Debtors' Tax Group to identify and verify the facts that were needed to assess the impact of the COD income, including tax basis, credits and net operating loss carryovers attributable to each legal entity. Based on the information provided, the model was used to compare results under several alternative scenarios and elections, including, for example, an election to terminate accounting for inventory on the "last-in, first-out" method, and various assumptions regarding "net unrealized built-in loss" calculations. In addition, the model analyzed changes to several base assumptions, including changes to the assumptions in the equity value of the Reorganized Debtors and the amount of COD income, to highlight the various tax savings that could potentially be generated. This resulted in over nine variations of the model to be produced, each with over 10 scenarios. After analyzing the information provided by the model, PwC, along with the Reorganized Debtors' Tax Group and tax counsel, developed the organizational structure that is reflected in the Plan. As part of this exercise, PwC worked with the valuation team of Miller Buckfire Lewis LLP to provide estimates of future cash tax liabilities for input into the valuation model.

The federal tax model was then used as a platform to analyze the state tax consequences of the COD

income in several of the Reorganized Debtors' larger states. In addition to adapting the model to take into account the various rules for each state, the model also considered the tax consequences of other variables, including state tax limitations imposed as a result of a change of ownership, and amendments to inter-company debt. The results from the state tax model were instrumental in determining the elements of the restructured organization. Moreover, PwC, along with the Reorganized Debtors' Tax Group evaluated several state tax strategies in order to minimize the Reorganized Debtors' future tax liabilities, which are also reflected in the Reorganized Debtors' current organization structure.

During the Third and Fourth Application Periods, PwC assisted the Reorganized Debtors' Tax Group in responding to inquiries from the tax advisors to the creditor committees regarding the Reorganized Debtors' current tax attributes, the likely impact of the COD income on such attributes, and other tax inquiries. PwC also assisted the Reorganized Debtors' Tax Group in addressing several state tax audits that were commenced as a result of the bankruptcy. PwC assisted in evaluating the merits of the audits and proposed overall guidelines for addressing the audits in an expedited fashion. In addition to audits, PwC worked with the Reorganized Debtors' Tax Group to understand the claims reconciliation process and assist in developing an approach to reconciling the several thousands of tax claims that were filed prior to emergence from bankruptcy.

In order to assist the Reorganized Debtors' Tax Group's preparation of its tax provision for its tax year ending January 31, 2002, PwC reviewed the Reorganized Debtors' bankruptcy related costs and worked with the Reorganized Debtors' Tax Group to create guidelines for estimating future deductibility of bankruptcy related costs.

Code 1221 – Federal Tax Consulting

During the Third Interim Application Period, PwC analyzed, researched and consulted with the Reorganized Debtors on various tax carryback claims by reviewing the Reorganized Debtors' calculations and providing guidance on filing procedures. PwC assisted the Reorganized Debtors in

analyzing its 10-year carryback tax claim for specified liability losses. The carryback resulted in a \$14 million tax refund claim with the Internal Revenue Service, which Kmart has received in its entirety. PwC also assisted the Reorganized Debtors in analyzing its Form 1139 carryback claim for \$12 million related to alternative minimum taxes, of which \$12 million has been refunded to Kmart as a result of the Job Creation and Worker Assistance Act of 2002. PwC also provided research and consultation to the Reorganized Debtors on potential deductions that may be available as a result of newly issued regulations relating to losses realized on sales of subsidiaries in prior years.

Code 1223 – State Tax Consulting

During the Third and Fourth Application Periods, PwC reviewed and certified the Reorganized Debtors' 2001 Puerto Rico income tax and property tax returns. PwC assisted in the renewal of the Alcoholic Beverage and Jewelry Licenses with the Puerto Rico Treasury Department by participating in various meetings to gain an understanding of the necessary procedures to transfer the renewal of the licenses to the Reorganized Debtors. PwC also assisted the Reorganized Debtors in obtaining a renewal of their Prepaid Importer Number and facilitated the cancellation of various debts that appeared in the Certificate of Debts issued by the Puerto Rico Treasury Department. PwC provided state tax restructuring services to effectively manage state income and franchise taxes, employment taxes, and abandoned and unclaimed property liabilities. PwC provided project management, and technical support in designing and implementing the various state components of the restructure entity.

Code 1224 – Expatriate Tax Consulting

During the Third and Fourth Application Periods, PwC met with the Reorganized Debtors' payroll department, international service program coordinators and expatriate assignees to discuss the status of 2001 tax returns, tax equalization policies, estimated tax payments and tax notices. PwC worked with the Reorganized Debtors' payroll department and program coordinators to determine appropriate marginal tax rates for withholding. PwC determined which assignee would remain on

hypothetical withholdings versus using actual withholding rates. PwC coordinated with the Reorganized Debtors' payroll department, program coordinators and assignees on issues related to severance payments and related compensation matters as well as other year-end compensation planning. PwC coordinated and met with the Reorganized Debtors' international service program coordinators to discuss the 2002 assignee authorized listings, tax equalization policies, and year-end compensation analysis. Additionally, PwC worked with Reorganized Debtors' payroll department to analyze compensation breakdowns and to consider tax gross-ups when necessary. PwC provided assistance with respect to responding to and addressing tax notices.

Code 1225 – Full Service Personal Financial Planning

During the Third Interim Application Period, PwC participated in meetings and discussions with the Reorganized Debtors regarding the conclusion of personal financial planning services.

Code 1240 – Debtor-in-Possession Financial Model and Plan

During the First Interim Application Period, PwC's assistance to the Reorganized Debtors regarding the financial model was critical to sizing and securing its Debtor-in-Possession Financing. In this category, PwC: (a) assisted the Reorganized Debtors in analyzing its financial model projections and key assumptions; (b) interviewed Debtor personnel to assess the reasonableness of the assumptions included in the financial model; (c) consulted with the Reorganized Debtors' finance personnel on potential modifications and improvements to the Reorganized Debtors' existing financial model; and (d) worked with Reorganized Debtors' finance personnel to analyze the impact of various sensitized assumptions on the financial model.

Code 1250 - Vendor Allowance Investigation

During the Second, Third and Fourth Application Periods, PwC participated in meetings with Reorganized Debtors' counsel and Counsel's forensic accounting advisors, Chicago Partners, related to the completion of its investigation of certain vendor related allowances. PwC participated in interviews of certain current and former employees of the Reorganized Debtors who were

involved in obtaining vendor allowances and/or recording vendor allowance amounts (merchandising, finance, and accounting individuals) to gain an understanding of their roles and responsibilities, the Reorganized Debtors' policies and procedures related to vendor allowances and to develop a framework for the alleged violations. As a result of these meetings, PwC reviewed the analysis prepared by Chicago Partners to ascertain the magnitude of questionable allowance reporting and to assess the reasonableness of its conclusions related to the reporting of vendor allowances. PwC also attended a meeting of the Reorganized Debtors' Audit Committee to discuss such issues. The issues related to these vendor allowances were also being evaluated by the Securities Exchange Commission (SEC). PwC provided the SEC with supplemental data and memos to assist in its review of certain vendor related allowances.

The scope of PwC's analysis was ultimately expanded to include the review of certain incremental vendor allowances. PwC participated in meetings with the Reorganized Debtors, Chicago Partners and Reorganized Debtors' counsel, Skadden Arps, to review and analyze these issues. The results of this subsequent review were included in the Reorganized Debtors' filings with the SEC.

Code 1260 - Case Administration

PwC expended time in the overall project planning, budgeting, and staffing of this engagement. In addition, PwC conducted periodic meetings with personnel involved in the Reorganized Debtors' reorganization, such as the Reorganized Debtors' counsel and the Reorganized Debtors' restructuring advisors, to ensure clear communication on key activities and issues arising in the case. These necessary meetings have helped to maximize the efficient administration of the estate and helped to avoid duplication of effort by professionals involved in the case.

Code 1310 - Court Attendance

During the First Interim Application Period PwC attended Bankruptcy Court hearings (e.g., First Day hearing and hearing to approve the Debtor-In-Possession Financing Credit Facility) to provide

expert witness testimony, if necessary, and informational support to the Reorganized Debtors and Reorganized Debtors' counsel as needed.

Code 1350 - Fee Application and Fee Statement

Throughout the case, PwC expended paraprofessional and professional resources required for timely filing of monthly fee statements in accordance with the Administrative Order Pursuant to 11 U.S.C. Sections 105(a) and 331 Establishing Procedures For Interim Compensation and Reimbursement of Expenses of Professionals dated January 25, 2002.

Code 1480 - Preparation of Work papers and Files

Throughout the case, PwC expended time maintaining the organization of work papers and files used to perform services for the Reorganized Debtors.

Code 1490 - Relationship Check and Application for Retention

During the First Interim Application Period, PwC worked with the U.S. Trustee and Reorganized Debtors' Counsel to draft the PwC Retention Order, which was approved by the Court on February 13, 2002. PwC expended effort to submit a Supplemental Affidavit to the Bankruptcy Court on February 28, 2002 disclosing PwC's known relationships with significant interested parties in this Chapter 11 case.

During the Second and Third Application Periods and at the request of the U.S. Trustee, the Statutory Committees and the Reorganized Debtors' Audit Committee, PwC worked with the Reorganized Debtors and the Reorganized Debtors' counsel to draft and submit a Supplemental Application Pursuant to Fed. R. Bankr. P. 2014(a) For Order Under Sections 327(a) and 328(a) of The Bankruptcy Code Authorizing the Reorganized Debtors to Amend the Scope of Employment and Retention of PricewaterhouseCoopers LLP to include the provision of Audit, Audit-Related and Tax Services. This Supplemental PwC Retention Application was approved by Court Order on September 24, 2002.

Code 1510 – Travel

Throughout the case, PwC expended time in non-working travel time, charged to the Reorganized Debtors, limited to 50% of actual flight time and other actual travel time to client site.

Code 1700 – PeopleSoft General Ledger System

During the Third Interim Application Period, PwC performed a preliminary security and controls assessment of the Reorganized Debtors' new PeopleSoft General Ledger System. PwC reviewed the system controls to assess whether critical tasks were being addressed, including: project management, staffing and organization, review of test plans and selected results and a review of organizational change management activities. PwC reviewed data migration plans, tests, and results to ensure that legacy data was accurately and completely converted to the new system.

PwC also reviewed the PeopleSoft application, interface, and infrastructure controls to assess whether the software was meeting the Reorganized Debtors' business needs and management's expectations, and that it provided reasonable assurance that transactions flowing through the system were complete, accurate, timely, authorized and secure. PwC focused the review on embedded and configurable controls, process controls and technical infrastructure controls.

Code 2000 – Fees Not Billed

Over the course of the case, PwC expended hours in non-working travel time, charged to the Reorganized Debtors, limited to 50% of actual flight time and other actual travel time to client site. The remaining 50% of actual flight time and other actual travel time, which is not charged to the Reorganized Debtors is captured in this code. Additionally, time or expenses incurred that PwC believes to be valuable to the efficient and effective execution of its responsibilities, but recognizes that the direct benefit may be less than obvious are captured in this code as well. During the Third Interim Fee Period, these amounts were captured explicitly within this task code. For all other Application Periods, these amounts are at the aggregate level.

Audit Services

On September 24th, 2002 the United States Bankruptcy Court for the Northern District of Illinois Eastern Division approved a Supplemental Application to amend the previously-approved scope of the employment and retention of PricewaterhouseCoopers (PwC) to include audit and audit related services as set forth in the executed 2002 engagement letter which was included as an exhibit to the Supplemental Application. In addition to the services outlined in the 2002 engagement letter, PricewaterhouseCoopers was also approved to provide additional audit related services that had been deemed appropriate by the Reorganized Debtors and were subject to review by the United States Trustee, the Statutory Committees and the Reorganized Debtors' Audit Committee prior to payment of any related invoices. Under the terms of The Supplemental PwC Retention Application, Audit professionals were exempt from detailed time reporting requirements. Instead, they needed to provide only summary documentation of the work performed, which was to include hours incurred by professional level and a description of tasks that were completed by the audit group during each applicable time period. These summaries were submitted to the Reorganized Debtors, the United States Trustee, the Statutory Committees and the Reorganized Debtors' Audit Committee.

Audit of 2002 Financial Statements

PwC provided the following services related to completing the audit of the 2002 financial statements.

- Assessed changes in the Reorganized Debtors' business objectives in order to determine the impact on overall audit strategy
- Documented and tested the Reorganized Debtors' accounting systems, computer environment, general computer controls and management monitoring controls
- Reviewed relevant accounting, auditing and regulatory standards to assist in the resolution of business and accounting issues
- Prepared/updated tailored audit tests for all audit areas and significant transactions

- Executed and documented audit tests as they related to the audits of Kmart Corporation, the Kmart Corporation Retirement Savings Plans and Kmart Corporation Puerto Rico Division
- Reviewed audit work performed to support audit decisions in significant judgment areas
- Reviewed financial statement information to ensure conformity with Generally Accepted Accounting Principles

PwC was paid \$1,900,000 in professional fees and \$100,000 for out-of-pocket expenses and internal charges related to these services.

Store Closing Charge

During the first quarter of 2002, the Reorganized Debtors recorded a restructuring charge related to the closing of 283 stores and acceleration of markdowns on approximately 107,000 categories of inventory items that would no longer be sold by the Company. As the services required to complete the audit testing of this restructuring charge were not contemplated under the terms of the 2002 engagement letter, PwC was paid \$65,000 for the incremental hours incurred related to this project. The services provided by PwC in connection with our review of these activities included the following:

- Participated in multiple meetings with various representatives of the Reorganized Debtors to gain an understanding of the key estimates used and methodologies employed by management in deriving this charge
- Designed tailored audit steps in order to test the various components of the restructuring charge
- Executed and documented audit tests in order to assess both the reasonableness of management's estimates and the accuracy of the Reorganized Debtors' analyses
- Reviewed audit work performed to support audit decisions in significant judgment areas
- Reviewed proposed financial statement presentation and disclosure in the first quarter Form 10-Q to ensure conformity with Generally Accepted Accounting Principles

Restatement of Prior Period Financial Statements

During the fourth quarter of 2002, the Reorganized Debtors elected to restate its 2001 Form 10-K, 1st Quarter 2002 Form 10-Q and 2nd Quarter 2002 Form 10-Q. As the process of restating previously-issued financial statements required PwC to attest to the accuracy of the amended filings with the SEC, extensive participation of PwC audit professionals was required in order to reissue our audit opinion. As the services provided in connection with the Reorganized Debtors' restatement efforts were not included in the provisions of the 2002 audit engagement letter, PwC was paid an additional \$410,000 for the incremental hours incurred related to the associated restatement projects. The services provided by PwC audit professionals as part of the Reorganized Debtors' restatement efforts included the following:

- Participated in multiple meetings with members of management, the Audit Committee, the Securities and Exchange Commission and Reorganized Debtors' Counsel, Skadden, Arps, Slate, Meagher & Flom (SEC counsel), to evaluate the various restatement issues and assess the impact on prior period financial statements.
- Designed tailored audit steps in order to test the various restatement entries that were identified during the current year and verify the accuracy of each of the restatement issues
- Executed and documented audit tests in order to assess both the reasonableness of management's estimates and the accuracy of Company prepared analyses
- Participated in approximately 30 interviews of certain current and former Kmart employees (merchandising, finance and accounting individuals) who were involved in either executing or recording specific vendor allowances transactions, in order to obtain an understanding of the scope and magnitude of the transactions and the nature of the employees involvement
- Reviewed audit work performed to support audit decisions in significant judgment areas
- Reviewed multiple drafts of financial statement presentation and disclosure in the amended Forms 10-Q and amended Form 10-K to ensure conformity with Generally Accepted Accounting Principles

8. In addition to the description of services provided, Applicant's time records are summarized in Exhibits B, C and D. Applicant's records show a total of 35,315.1 hours related to non-audit services rendered, from the date of employment in the case, of which 3,120.8 hours relate to non-audit services rendered in the Fourth Application Period. Additionally, a total of 13,223.9 hours relate to audit services rendered from the date of employment in the case. Each non-audit professional's time is summarized by every one-tenth of an hour of work performed except for time directly related to the Vendor Relations Call Center, which is summarized with hours incurred by staff and with descriptions of the categories of tasks completed as permitted in the PwC Retention Order. Detail descriptions for the Fourth Application Period are included in the monthly fee statement excerpts attached as Exhibits H - K for the Court. Exhibits B1 through B3 provide summaries of fees by professional and Exhibit C provides summaries of hours spent and time charged for each activity category. Exhibit D summarizes the services rendered by PwC during the Fourth Application Period by professional and project category. The effective hourly average rate, incurred by PwC since the date of employment in this case for non-audit services, including hours worked but not charged to the Reorganized Debtors, is approximately \$272.10. The effective hourly average rate for audit services is approximately \$179.60.

9. Exhibit E provides summaries of actual and necessary expenses incurred by expense category. Exhibit F provides summaries of actual and necessary expenses incurred by professional. Detail descriptions for the Fourth Application Period are included in the monthly fee statement excerpts, attached as Exhibits H - K for the Court.

10. PwC carefully reviewed all of its time records and has elected to make certain voluntary reductions to the fees it is requesting. These reductions resulted from eliminating time incurred that PwC believes to be valuable to the efficient and effective execution of its responsibilities, but recognizes that the direct benefit may be less than obvious. For this reason, and in a good faith effort to insure that PwC's compensation request represents proper value, PwC eliminated these fees and expenses from its request. Such voluntary reductions for non-audit services, since the date of employment in this case, total approximately 2,435.7 hours, resulting in \$692,963.80 of professional fees, of which a voluntary reduction of 133.8 hours resulting in

\$33,371.40 of professional fees relates to the Fourth Application Period. Voluntary reductions for audit services total approximately 7,055.9 hours, resulting in \$2,716,882.00 of professional fees. The reductions are permanent, with prejudice, and indicate our best effort to ensure that our fees represent appropriate value.

RELIEF REQUESTED

11. Section 330 of the Bankruptcy Code, as amended by the Bankruptcy Reform Act of 1994, governs compensation of professionals in a bankruptcy case and empowers the Court to award reasonable compensation for actual and necessary services and reimbursement for actual and necessary expenses. The time and fees incurred by PwC in rendering professional services on behalf of the Reorganized Debtors should be considered in light of: (a) the novelty and complexity of issues presented and the amounts and results achieved; (b) the time and labor required; (c) the skills required to properly perform the financial advisory services; (d) the customary fee to a client for the services rendered outside of bankruptcy; (e) the time constraints imposed by the urgency of the case; (f) the experience, reputation and ability of the professionals rendering services; (g) the efficient administration of the estate; and (h) the avoidance of duplicate fees or compensation for non-legal services. PwC believes that the consideration of these criteria more than justifies the compensation requested.

a. *Novelty and complexity of issues presented and the amounts and results achieved* – This case involved multi-faceted questions, complex legal structures of the Reorganized Debtors and voluminous amounts of data. Overall, PwC asserts that the professional services provided were invaluable to the emergence from bankruptcy.

b. *Time and labor required* – The time and labor expended by PwC has been commensurate with the size and complexity of the case. PwC made a dedicated effort to avoid duplication of effort and to leverage staff appropriately. The complex issues of the case required staff professionals to conference and collaborate at certain times to ensure the efficient allocation of resources and to plan strategies effectively. While essential to the effective administration of the

engagement, to the extent possible these conferences were kept to a minimum. PwC kept management informed of its activities and did not commence any work or analysis without the consent, knowledge and approval of the Reorganized Debtors' management team.

c. *Skills required to properly perform the financial advisory services* - PwC was instrumental in providing facts and reporting results that enabled the Reorganized Debtors to make informed decisions on complex issues. The specialized and complex nature of these issues require professionals with demonstrated skill and experience to appropriately address the issues, and to provide relevant expert testimony if necessary. As such, PwC was required to utilize certain professionals with substantial experience and expertise for the work associated with this assignment. PwC has spent considerable time and resources over the past several years in developing and refining its reorganization experience, and the professionals who have worked on this case have demonstrated the skill required to provide the services necessary to assist the Reorganized Debtors throughout this proceeding.

d. *Customary fee to a client for the services rendered outside of bankruptcy* - The compensation requested in this Final Application reflects the usual and customary fees charged by PwC for similar services in this marketplace. The hourly fees charged to clients are dependent upon the experience of the individuals assigned to the engagement. The fees requested herein are not in excess of those charged to our non-bankruptcy clients. Upon PwC's knowledge and belief, the rates sought for approval herein are commensurate or below the usual and customary rates charged for services performed by comparable experts in bankruptcy cases. PwC's fees for performing services on behalf of the Reorganized Debtors in this case are fixed at PwC's standard hourly rates and are not contingent on the results achieved. However, PwC's fees are contingent upon approval of the Court.

e. *Time constraints imposed by the urgency of the case* - The case moved rapidly, and at times required substantial effort by PwC in completing work to meet specific deadlines.

f. *Experience, reputation and ability of the professionals rendering services-*

The Reorganized Debtors selected PwC due to the experience and expertise of its professionals both in bankruptcy proceedings and for its particular industry knowledge. The combination of PwC's industry expertise and bankruptcy experience enabled the Reorganized Debtors to make informed decisions during the proceedings. Over the past several years, PwC has been involved in numerous bankruptcy cases and, as a result, has many professionals and support staff who are extremely knowledgeable with respect to the specialized work and analyses required in a Chapter 11 proceeding.

g. *Efficient administration of the estate* - The services in this case were

rendered, whenever possible, by those professionals with the lowest billing rates and the degree of experience and specialization needed to perform the services required efficiently and properly. In addition, PwC sought Reorganized Debtors' personnel to assist with services whenever possible. For example, to maximize the administration of the estate, PwC trained and utilized several Reorganized Debtors' vendor management personnel to work alongside the professionals in the Vendor Relations Call Center during the First Interim Application Period. During the Second Interim Application Period, PwC transitioned certain activities such as the tracking of pre-petition payments to Alix Partners, the Reorganized Debtors' restructuring advisors, for ultimate transfer to Reorganized Debtors personnel.

h. *The avoidance of duplicate fees or compensation for non-legal services* - To

the best of PwC's knowledge and belief, there has been no duplication of professional services rendered between PwC and any other professionals of the Bankruptcy estate.

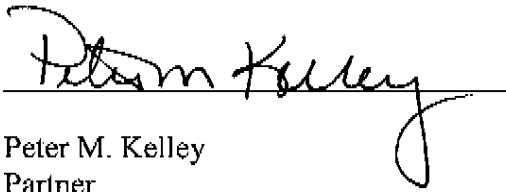
12. As noted above, PwC sold the BRS Practice to FTI as of August 30, 2002. FTI, as successor to the BRS Practice, is entitled to all payments to be made by the Reorganized Debtors to PwC for any outstanding receivables related to BRS services. Other than as described above, no agreement or understanding exists between PwC and any other person for the sharing or division of compensation to be received by them for services rendered in or in connection with this case; and the Applicant has not shared in the compensation of any other person in connection with this case.

13. PwC respectfully requests to be reimbursed for the costs associated with the preparation and submission of its Fourth and Final Application in an amount equal to \$45,000. To date, PwC has incurred approximately \$89,053.50 of fees and \$6,129.56 of expenses relating to the preparation and submission of the Fourth and Final Application, of which PwC has agreed to take a voluntary reduction of \$50,183.06. Time detail relating to this activity is attached as Exhibit L. In addition, PwC estimates that it will incur approximately \$5,000 of additional fees relating to this matter, including appearances in the Bankruptcy Court relating to the Fourth and Final Application.

14. I have read this application and to the best of my knowledge, information and belief formed after reasonable inquiry, certify that it complies with the requirements of such applications and that the fees and disbursements sought are billed at rates in accordance with practices customarily employed by PricewaterhouseCoopers.

WHEREFORE, PricewaterhouseCoopers LLP respectfully requests this Court to: (i) approve its Fourth Application for compensation for the period from January 1, 2003 through May 6, 2003 in full in the amount of \$1,190,314.30 and reimbursement expenses in the amount of \$8,522.10; (ii) approve the Final Application for compensation for the period from January 22, 2002 through May 6, 2003 in full in the amount of \$11,984,452.80 and reimbursement of necessary out-of-pocket expenses in the amount of \$1,131,957.45; (iii) authorize the Reorganized Debtors to pay PwC \$655,804.13 for services rendered and expenses incurred, but not yet paid (reflecting the 10% hold-back on professional fees for the Second through Fourth Fee Application Periods and certain fees and expenses for the Fourth Application Period); (iv) authorize payment in the amount of \$45,000 for services rendered in connection with the preparation and submission of the Fourth Interim and Final Application, as well as future services to be rendered in connection therewith; and (v) grant such other and further relief as the Court deems just and proper.

PRICEWATERHOUSECOOPERS LLP

A handwritten signature in cursive script, reading "Peter M. Kelley", is positioned above a horizontal line. The signature is written in black ink and is the primary visual element of the top-left section of the page.

Peter M. Kelley

Partner

PricewaterhouseCoopers LLP

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