Court File No. CV-18-00611217-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

B E T W E E N:

MORNEAU SHEPELL LTD. in its capacity as administrator of
the Sears Canada Inc. Registered Retirement ~~Pension~~ Plan

Plaintiff

- and -

ESL INVESTMENTS INC., ESL PARTNERS, LP, SPE I PARTNERS, LP,
SPE MASTER I, LP, ESL INSTITUTIONAL PARTNERS, LP,
EDWARD S. LAMPERT, WILLIAM HARKER, WILLIAM CROWLEY,
DONALD CAMPBELL ROSS, EPHRAIM J. BIRD, DEBORAH E. ROSATI,
R. RAJA KHANNA, JAMES MCBURNEY ~~and~~ DOUGLAS CAMPBELL
and SEARS HOLDINGS CORPORATION

Defendants

AMENDED STATEMENT OF DEFENCE OF THE DEFENDANTS
WILLIAM HARKER, WILLIAM CROWLEY, DONALD CAMPBELL ROSS,
EPHRAIM J. BIRD, JAMES MCBURNEY, and DOUGLAS CAMPBELL

1. The Defendants William Harker, William Crowley, Donald Campbell Ross, Ephraim J. Bird, James McBurney, and Douglas Campbell deny each and every allegation in the Amended Statement of Claim, except where hereinafter expressly admitted, and deny that the Plaintiff Morneau Shepell Ltd. is entitled to any of the relief sought in the Amended Statement of Claim.

OVERVIEW

2. The Plaintiff seeks to recover approximately $260 million of a $509 million dividend paid to the shareholders of Sears Canada Inc. ("Sears Canada" or the "Company") almost six years ago (the "2013 Dividend") on the theory that Sears Canada had a duty to make certain contributions to the Sears Registered Retirement Plan (the "Plan") at the time in excess of any legal requirements.

3. As sponsor of the Plan, Sears Canada made all of the contributions to the Plan that it was required to make and, as administrator of the Plan, it met all of its statutory and common law duties to the Plan and its members. At all materials times, the Company employed a robust governance process to oversee the Plan and the prudent investment of its assets.

4. When Sears Canada paid the 2013 Dividend, the Plan was healthy. In fact, its position on both a going concern and solvency basis had recently improved and there was no reason to believe that Sears Canada would ultimately fail three and a half years later. Rather, when the board of directors of Sears Canada (the "Board") approved the 2013 Dividend, it intended and expected that the Company would continue in business for the foreseeable future, and that it would continue to sponsor and administer the Plan.

5. Consistent with corporate governance best practices, the Board's decision regarding the use of the significant excess cash involved careful consideration of the financial and operational position of the Company in light of its strategic plan and capital requirements, market conditions, the financial health of the Plan, and the fact that the Company had virtually no debt. Among other things, the Board assessed the results of its strategic plan and the needs of the business based on management's priorities and operating plans, including strategies aimed at long-term growth.

6. Sears Canada was not insolvent or near insolvent when the 2013 Dividend was declared or paid, and it was not rendered insolvent by that payment. On the contrary, following payment of the 2013 Dividend, approximately $513.8 million in cash still remained on Sears Canada's balance sheet, with virtually no debt, and its operations and plans for implementing management's strategic objectives were fully funded. Indeed, Sears Canada remained financially sound for many years after the 2013 Dividend was paid and continued to make all required contributions to the Plan until the commencement Sears Canada commenced proceedings under the *Companies' Creditors Arrangement Act* (the "CCAA").

7. The Plaintiff's assertion that the Board had an obligation – in 2013 – to fund (or set aside money for) the wind up deficit of the Plan, at a point when Sears Canada continued to operate in the normal course and when there was no indication that Sears Canada would, many years later, cease operations or wind up the Plan, is factually baseless and untenable at law.

8. The claim that Harker, Crowley, Ross, McBurney, Campbell (collectively the "Former Directors"), and Bird should now pay $260 million to benefit the pensioners of Sears Canada at the time of its filing for CCAA protection, three and a half years after the 2013 Dividend was approved, should be dismissed.

THE PARTIES

The Former Directors and Bird

9. The Defendant William Harker was a director of Sears Canada from November 2008 to April 2015. Harker was at all material times a highly experienced corporate lawyer, corporate director, and senior manager with significant experience in the retail sector and in investment fund strategy and management.

10. Prior to, and concurrent with part of, his tenure on the Board, Harker held management roles with Sears Holdings Corporation ("Sears Holdings"), including as chief counsel from September 2005, then as general counsel from April 2006 to May 2010, and then as an officer until August 2012, and with ESL Investments Inc. as general counsel from February 2011 to August 2012. Harker also co-founded an investment fund in 2013. He previously practised as a corporate lawyer with the law firm of Wachtell Lipton Rosen & Katz LLP in New York City and has a law degree from the University of Pennsylvania.

11. The Defendant William Crowley was a director of Sears Canada from March 2005 to April 2015, and chair of the Board from December 2006 to April 2015. Crowley was at all material times

a highly experienced executive and corporate director with extensive experience in the management of retail organizations, investment fund strategy and management, and finance.

12. Prior to, and concurrent with part of, his tenure on the Board, Crowley held management roles with Sears Holdings, as executive vice-president, chief financial officer, and chief administrative officer at various times from March 2005 to January 2011, and with ESL Investments Inc., as president and chief operating officer from January 1999 to May 2012. Crowley previously worked as a financial analyst with Merrill Lynch and as a managing director of Goldman Sachs, and co-founded an investment fund in 2013. Crowley has an undergraduate degree and a law degree from Yale University and a master’s degree in philosophy, politics, and economics from the University of Oxford.

13. The Defendant Donald Campbell Ross was a director of Sears Canada from May 2012 to April 2014. Ross was at all material times a highly experienced lawyer with extensive experience in corporate law and corporate governance. From 1988 to August 2013, Ross was a partner at Osler, Hoskin & Harcourt LLP, where he focused on domestic and cross-border mergers and acquisitions and corporate finance, and advised senior management and boards of directors on corporate governance matters. Since September 2013, he has held a senior counsel position with the New York office of Covington & Burling LLP.

14. Ross has been recognized for his work by numerous legal publications and organizations including Chambers Global, the Best Lawyers in Canada, the Lexpert / American Lawyer Guide to the Leading 500 Lawyers in Canada, and the IFLR 1000. He has an undergraduate degree from the University of Toronto, a law degree from Osgoode Hall Law School, and a master’s degree from the London School of Economics. He is a member of Ontario and New York bars. Ross has never held any position at Sears Holdings or ESL Investments Inc.

15. The Defendant Ephraim J. Bird was a director of Sears Canada from May 2006 until November 18, 2013. Bird resigned from the Board prior to the time on November 18, 2013 that the Board approved the 2013 Dividend (for reasons not related to the 2013 Dividend).

16. Bird was the executive vice-president and chief financial officer of Sears Canada from March 2013 to June 2016. He was also the lead director of Sears Canada from May 2007 to March 2013. From 1991 to 2002, Bird was the chief financial officer of ESL Investments Inc. Bird is currently senior vice president and chief financial officer of Sears Hometown and Outlet Stores, Inc. He has an undergraduate degree in accounting from the Hankamer School of Business at Baylor University, a master of business administration degree from the Stanford University Graduate School of Business, and he is licensed as a certified public accountant.

17. The Defendant James McBurney was a director of Sears Canada from April 2010 to April 2015. Prior to joining the Board, McBurney was employed by Goldman Sachs in New York, where he focused on mergers and acquisitions. McBurney currently works as an executive in the technology industry. He has an undergraduate degree from Yale University and a master of business administration degree from the Harvard Business School. McBurney has never held any position with Sears Holdings or ESL Investments Inc.

18. The Defendant Douglas Campbell was a director of Sears Canada from September 2013 to October 2014. In 2011, Campbell joined Sears Canada as an executive vice-president. In 2012, Campbell was promoted to the position of chief operating officer. In September 2013, Campbell succeeded Calvin McDonald as president and chief executive officer of Sears Canada, a position that he held until he resigned in the fall of 2014 for family reasons.

19. Prior to joining Sears Canada, Campbell was a principal at Boston Consulting Group, where he focused on turnaround matters. Campbell is currently a partner with Harvest Partners, LP, a private equity firm focused on leveraged buyout and growth capital investments in

mid-market companies. He has an undergraduate degree in economics from the United States Naval Academy and a master of business administration degree in finance from The Wharton School at the University of Pennsylvania. Campbell has never held any position with Sears Holdings or ESL Investments Inc.

Rosati and Khanna

20. To the best of the Former Directors' and Bird's knowledge, the Defendant Deborah E. Rosati was a director of Sears Canada from April 2007 to August 2018 and the Defendant R. Raja Khanna was a director of Sears Canada from October 2007 to August 2018.

Sears Holdings Corporation

20A. To the best of the Former Directors' and Bird's knowledge, the Defendant Sears Holdings is a corporation incorporated under the laws of Delaware. On October 15, 2018, Sears Holdings filed for protection from its creditors under Chapter 11 of the *United States Bankruptcy Code*.

The ESL Defendants

21. To the best of the Former Directors' and Bird's knowledge, the Defendant ESL Investments Inc. is an investment fund incorporated under the laws of Delaware. The Defendants ESL Partners LP, SPE I Partners, LP, SPE Master I LP, and ESL Institutional Partners, LP were at all material times controlled directly or indirectly by ESL Investments Inc. (these limited partnerships, together with ESL Investments Inc., "ESL").

22. To the best of the Former Directors' and Bird's knowledge, the Defendant Edward S. Lampert is an individual residing in Florida who at all material times was the principal of ESL. Lampert was also, at all material times, the chair and chief executive officer of ESL Investments Inc., the chair of Sears Holdings, and beginning in February 2013 the chief executive officer of Sears Holdings.

23. To the best of the Former Directors' and Bird's knowledge, at all material times, Sears Holdings held a 51% interest in Sears Canada, ESL held a 17.4% interest in Sears Canada, and Lampert held a 10.2% interest in Sears Canada.

The Plaintiff

24. The Plaintiff Morneau Shepell Ltd. was appointed as administrator of the Plan by the Superintendent of Financial Services for Ontario effective October 16, 2017.

THE PENSION BENEFITS REGIME

25. The *Pension Benefits Act,* R.S.O. 1990, c. P.8 and corresponding regulations (collectively, the "Pension Benefits Regime") required Sears Canada, as administrator, to obtain actuarial reports for the Plan at least every three years. Pension plan actuarial reports are subject to detailed requirements under the Pension Benefits Regime, as well as the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) (the "ITA") and actuarial standards set by the Canadian Institute of Actuaries.

26. The actuarial methods and assumptions that may be used in the preparation of actuarial reports are highly regulated and subject to regulatory oversight by the Superintendent of Financial Services (Ontario) and by the Canada Revenue Agency. The actuarial assumptions to be used in actuarial reports change over time and are subject to prevailing interest rates, investment returns, salary increases, mortality, termination rates, and other factors.

27. The Pension Benefits Regime required actuarial reports to contain a number of metrics, including going concern unfunded liability, based on a going concern valuation, and solvency deficiency and solvency ratio (which is the ratio of a plan's solvency assets to its solvency liabilities), based on a solvency valuation.

28. The going concern valuation assesses a plan's financial position on the premise that the plan will continue indefinitely. This valuation determines the actuarial value of the assets, and subtracts the going concern liabilities, resulting in the going concern position. The prior year credit balance is then applied, resulting in the going concern surplus or unfunded liability.

29. In contrast, the solvency valuation assumes that a plan is terminated and wound up on the valuation date, and assesses a plan based on the premise that certain obligations (prescribed in the Pension Benefits Regime) are settled on the valuation date for all members. Estimated wind up expenses as well as solvency liabilities (essentially, payments to plan members) are subtracted from the assets, resulting in the solvency position. Further adjustments (provided for in the Pension Benefits Regime) are made to determine the solvency surplus or deficiency.

30. Actuarial valuation reports also contain a hypothetical wind up valuation and report on whether or not there is a hypothetical wind up deficiency. The hypothetical wind up valuation is not required by the Pension Benefits Regime, but instead by professional standards published by the Canadian Institute of Actuaries. The hypothetical wind up valuation is similar to the solvency valuation, except that it includes all benefits that would be payable under the postulated scenario that would maximize benefits. For example, in valuation reports for the Plan, the hypothetical wind up valuation included inflation indexing, whereas the solvency valuation did not.

31. Valuations of pension plans vary over time based on a number of factors, including:

(a) performance of investments (poor performance will reduce assets, increasing going concern unfunded liabilities and solvency deficiencies; strong performance will increase assets, reducing unfunded liabilities and solvency deficiencies);

(b) interest rates and discount rates (lower interest rates will increase liabilities; higher interest rates will decrease them). Different discount rates are used for going

concern and solvency valuations. The discount rates for solvency valuations fluctuate continuously, such that the solvency position of a pension plan can vary from month to month;

(c) pension benefits paid to plan members; and

(d) actuarial assumptions about mortality (the trend toward longer life expectancies means pensions are paid over a longer period of time, increasing liabilities, thus increasing going concern unfunded liabilities and solvency deficiencies).

THE SEARS CANADA REGISTERED RETIREMENT ~~PENSION~~ PLAN

Sears Canada and the Plan

32. Prior to the CCAA proceedings, Sears Canada was a multi-format retailer focused on merchandising and sale of goods and services through its network of approximately 111 full-line department stores and 295 speciality stores, including Sears Home stores and Sears Hometown dealer stores, as well as its direct (catalogue / internet) channel.

33. On June 22, 2017, Sears Canada obtained protection under the CCAA ~~*Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 (the "CCAA")~~. By January 2018, Sears Canada had closed all of the stores that it had operated and had ceased active operations.

34. Prior to the appointment of the Plaintiff as administrator of the Plan, Sears Canada was the sponsor and the administrator of the Plan. The Plan consisted of two components: a defined benefit component and a defined contribution component. On July 1, 2008, the defined benefit component was discontinued and the defined contribution component was added.

35. Sears Canada continued to make all contributions that were due to the Plan as required by the Pension Benefits Regime. Under the defined contribution component, members contributed

between 1% and 7% of their earnings to the Plan, and Sears Canada matched these member contributions at the rate of 50%.[1]

36. The Board, which had oversight responsibilities regarding the administration of the Plan and the investment of its assets, established an investment committee (the "Investment Committee") to oversee investment management of the Plan's assets.

Good Pension Governance Structure

37. The Investment Committee's charter provided that it would have at least five members, at least two of whom would be Board members. Its mandate included the following:

(a) investment policy: the committee was charged with considering and adopting the investment policy recommended by management and an independent consultant, and reviewing it annually;

(b) investment managers: the committee was responsible for considering and approving (or not) recommendations for hiring or terminating investment managers. It was also responsible for monitoring the performance of the investment managers; and

(c) review of financial statements of the Plan.

38. Harker, Crowley, and Bird were members of the Investment Committee from at least November 2010 until May 2014.

39. The Investment Committee was responsible for reviewing the investments of the Plan to ensure compliance with the statement of investment policies and procedures ("SIP&P"). The

[1] The allegations in the Amended Statement of Claim relate solely to the defined benefit component. Unless the context indicates otherwise, the term "Plan" is intended to reference the defined benefit component.

Investment Committee was also required to review the SIP&P at least annually and either confirm it or amend it. The Investment Committee complied these obligations.

40. The SIP&P established an approach to investing which reduced volatility in the portfolio and protected capital for the benefit of Plan members. The risk policy and asset mix policy, contained within the SIP&P, provided for an equity investment allocation of between 25% and 45% and a fixed income investment allocation of 55% and 75%.

41. Sears Canada administered the Plan with the benefit of the advice and input of external financial, legal, and actuarial advisors.

42. In particular, Towers Watson was retained as an investment consultant in respect of the management and ongoing investment strategy for Plan assets. Towers Watson reported to Sears Canada on at least a quarterly basis about the performance of investments held by the Plan. Aon Hewitt ("Aon") was retained as an actuarial consultant and provided advice on the valuation of the Plan assets and prepared the required actuarial reports for the Plan.

43. Additionally, Sears Canada regularly obtained advice from Torys LLP on its legal obligations in relation to the Plan, including advice on funding requirements in accordance with the Pension Benefits Regime.

44. The Investment Committee met regularly, at least quarterly, and reported to the full Board. At its meetings, the Investment Committee received and reviewed reports from Towers Watson on the performance of the Plan's investments, the allocation of invested funds as compared with the investment policy, as well as the asset allocation ranges established in the SIP&P. Towers Watson provided reports comparing the performance of the Plan's investments to market indices and benchmarks, as well as other investment portfolios, where available.

45. The Investment Committee also received and reviewed reports from management on the performance of the Plan. These reports included estimates of the Plan's valuation and funding on both a going concern and a solvency basis.

Actuarial Reports

46. Sears Canada also obtained actuarial valuation reports for the years ending 2007, 2010, 2013, and 2015 from Aon. The key metrics in these reports are as follows:

Key Metric	**2007**	**2010**	**2013**	**2015**
Going concern position	$114,072	$(68,039)	$14,645	$29,936
Going concern surplus/(unfunded liability)	$114,072	$(68,039)	$(355)	$28,876
Solvency position	$7,625	$(205,788)	$(76,405)	$(201,328)
Solvency surplus/(deficiency)	$7,625	$(96,059)	$(27,735)	$(138,575)
Solvency ratio	1.00	0.86	0.95	0.85
All dollar figures expressed in thousands				

47. These metrics show that the Plan, like many other registered pension plans, was impacted by the 2008 and 2009 recession and showed a solvency deficiency in the actuarial valuation report for the year ending in 2010. However, as at December 31, 2013, the Plan had a surplus going concern position and a reduction in its solvency deficiency of over 60%.

48. The actuarial reports prepared by Aon identify the influence of various factors on the Plan's metrics, such as:

(a) most of the decline in the Plan's assets between 2007 and 2010 was attributable to actuarial losses associated with investment return;

(b) the Plan experienced a drop in active membership from 16,013 in 2007 to 10,959 in 2010. The Plan made 4,702 lump sum payouts during that period. This factor had a significant impact on the assets and liabilities in the Plan;

(c) prevailing interest rates had a significant impact on the magnitude of liabilities in the Plan and on the funding of those liabilities. According to the 2010 actuarial report, a 1% decrease in the discount rate would have increased the Plan's accrued liabilities by 12.9% or just under $170 million and would have increased the Plan's solvency liabilities by 11.3% or just over $162 million;

(d) variances in the investment returns on the pension fund from the assumed rate of return had a significant impact on funding obligations. With assets of about $1.25 billion as reported in the 2010 actuarial report, a 1% difference in investment returns would have had an impact of $12.5 million;

(e) actuarial assumptions required to be used had a material impact on the Plan's liabilities. The 2010 actuarial report indicated that the Canadian Institute of Actuaries adopted revised standards for the computation of commuted values, which came into effect in 2011. In addition, the discount rate declined by 0.5% between the 2010 actuarial report and the 2013 actuarial report. The net impact was an increase in going concern liabilities of $68 million; and

(f) similarly, revised mortality tables reflecting longer life expectancies of Canadians increased the Plan's going concern liabilities by $38 million in 2013. The above two changes increased the Plan's going concern liabilities by $106 million, or approximately 9%.

49. The Pension Benefits Regime required Sears Canada, as the sponsor of the Plan, to make “special payments” to liquidate any going concern underfunded liabilities and any solvency deficiencies, over a period of several years. Going concern underfunded liabilities had to be liquidated within fifteen years, while solvency deficiencies had to be liquidated within five years.

50. The Pension Benefits Regime also contained provisions, introduced in 2009 and 2012, that permitted sponsors to elect to defer beginning these payments for twelve months, and to make other elections, including to consolidate a solvency deficiency from a previous report with a solvency deficiency in a new report and establish a new five-year amortization schedule.

51. The 2010, 2013, and 2015 actuarial reports set out the special payments that Sears Canada was required to make. These special payments were the only payments that Sears Canada was required to make after the Plan ceased accruing defined benefit service on July 1, 2008.

52. Sears Canada made all special payments that it was required to make by the Pension Benefits Regime at all relevant times: approximately $29 million in 2012, $44 million in 2013, $20 million in 2015, and $12.6 million in 2016.[2] No contributions were required in 2014.

53. The Pension Benefits Regime does not impose any requirement to liquidate a hypothetical wind up deficiency. Indeed, any eventual wind up deficiency can only be quantified when a plan is actually wound up, since a number of factors will influence the valuation of the assets and liabilities of a plan at the time of wind up.

[2] The 2013 actuarial report calculated the 2016 special payment as $20.2 million. The 2016 special payment was revised in the 2015 actuarial report as $12.6 million.

SEARS CANADA'S TRANSFORMATION PLAN

54. Beginning in 2011, under the guidance of its new CEO Calvin McDonald, Sears Canada undertook a full diagnostic review of all aspects of its business. The purpose of this review, which included an assessment of, among other things, merchandising and marketing, operations and logistics, direct sales (website and catalogue), and the nature and extent of the Company's "retail footprint", was (i) to focus the business on the Company's strengths and (ii) to determine how best to respond to changing market conditions.

55. This review culminated in a three-year strategic plan designed to transform the Company over time by renewing and improving its operational performance and re-focusing its retail business on its traditional core strengths (the "Transformation Plan"). The Transformation Plan acknowledged that Sears Canada had strong performance in suburban and smaller centre / rural markets, had "lost its focus" by pursuing urban markets, and was "stuck" without a relevant value proposition for these three distinct markets: rural, suburban, and urban.

56. The Transformation Plan, which was carefully considered and approved by the Board, was a "compass" for the business transformation, with annual financial and operational plans functioning as "roadmaps" for the implementation of that transformation. The Transformation Plan and annual financial and operational plans included initiatives to improve Sears Canada's operational performance, enhance its core retail business, and unlock value, including through operational changes and capital investment to refresh a number of Sears Canada's stores and thereby improve the performance of the refreshed stores.

57. The Transformation Plan acknowledged the need for Sears Canada to focus on getting the basics of retail right before it could realize any benefit from investing significantly in its retail locations, and provided for a disciplined approach to capital investment. In connection with the store refreshes, management recommended a phased approach, with an initial limited phase of

refreshes, and a demonstrated return on investment prior to any further or Company-wide implementation of store refreshes. The Board authorized the phased approach to capital investment to ensure adequate return for the benefit of the Company.

58. Sears Canada made significant investments in its business as part of the implementation of the Transformation Plan and operating plans in 2012 and 2013. Among other things, it:

(a) invested a total of $165 million in capital expenditures;

(b) invested approximately $40 million completing the refresh or reset of 58 full-line stores, with emphasis on merchandise presentation and standards; and

(c) invested $125 million in various other capital projects, including $8 million in its website, which drove e-commerce growth that exceeded the decline in catalogue.

59. As part of the Transformation Plan, management initiated a thorough assessment of the Company's real estate assets to identify unproductive stores and excess space that, in the context of the strategic review, had higher "real estate value" than "trading value", measured by a multiple of "four-wall" EBITDA.[3] Management called their initiative "Project Matrix".

60. Project Matrix was not initiated, as alleged, because Sears Holdings, ESL and Lampert "had an immediate need for cash" in early 2013. Nor was it devised, as alleged, by Sears Holdings, ESL or Lampert as a "plan to extract cash" from Sears Canada. In fact, the Former Directors and Bird were not aware of any cash liquidity issues or cash constraints for Sears Holdings, ESL or Lampert while they were directors of Sears Canada.

[3] EBITDA refers to earnings before interest, tax, depreciation and amortization. It is a key measure of a company's operating performance and in particular indicates the cash operating profit of a business. It is used by management and investors to assess a company's operational performance by eliminating the effects of financing decisions, accounting decisions, or tax environments.

61. In fact, Project Matrix was initiated by Sears Canada's management in early 2012. It was led by a steering committee composed of senior management from the real estate, legal, and finance departments of Sears Canada, not by the Former Directors and Bird. The assessment undertaken in connection with Project Matrix confirmed that the Company was not optimally positioned with its "real estate footprint", that certain locations (particularly in large urban centres) were more valuable to the Company as real estate assets than as operating stores, and that the divestiture of those assets could "right-size" and re-focus the business by reducing major urban locations.

62. In particular, given economic conditions and the increasingly competitive retail landscape in Canada, management recognized that the sale of store leases for stores that did not generate meaningful operational returns would allow the Company to focus on its core retail business. At the same time, aggressive entry into the Canadian market by American retailers presented a unique and time-limited opportunity to Sears Canada by increasing demand for space that did not fit within the Company's business model.

63. The initiative became a key aspect of the ongoing implementation of the Transformation Plan to refocus operations on Sears Canada's core customer base in suburban, mid-market, and smaller / rural locations, and generate long-term value. Management provided detailed reports to the Board on the results of Project Matrix, including an assessment of each store, with rankings according to their respective real estate values and trading values, measured by a detailed "four-wall" EBITDA assessment, and the proposal to divest unproductive real estate assets to transition the Company to a mid-market retailer without major urban locations.

64. Management identified the top ten stores for which the real estate value far exceeded the trading value. Management presented various scenarios and proposed that Sears Canada

pursue the sale of six to eight of these full-line stores, located in urban markets, and right-size an additional seven or eight full-line stores by subletting excess space in the near term.

65. The Board approved annual financial and operational plans presented by management relating to implementation of the Transformation Plan, which were designed to address changes in retail market conditions and the impact of the various initiatives on the Company's business. In addition to quarterly meetings, the Board met with management every month to review financial and operational performance and each fall, the Board attended a two-day strategic session prior to the review and approval of the annual financial and operational plan.

REAL ESTATE DIVESTITURES

66. Project Matrix culminated in Sears Canada entering into four transactions in 2013 for the sale or redevelopment of certain store locations. Management led the negotiations for each transaction with assistance from external advisors and input from various Board members. The Board was specifically aware of the assistance provided by members of the Board and Jeffrey Stollenwerck, an executive with Sears Holdings, who had relevant expertise and relationships with Sears Canada's and other retail landlords. Sears Holdings, ESL, and Lampert did not direct the negotiating strategy in connection with these transactions.

67. Management recommended each transaction to the Board following comprehensive review and consideration and provided detailed presentations to the Board with its recommendations, which included an assessment of the transaction, an evaluation of store performance versus real estate value, accounting implications of a sale, and the impact of the proposed sale on operational and financial performance, EBITDA, and the balance sheet. Each of

the four transactions was carefully reviewed and unanimously approved by the Board as being in the best interests of Sears Canada.[4]

The Oxford Transaction

68. Sears Canada entered into a transaction with Oxford Properties Group ("Oxford") for the sale of leases for Yorkdale and Square One for total consideration of $191 million and a $1 million payment by Oxford in exchange for an option to purchase the Scarborough Town Centre lease for $53 million.

69. The transaction was not initiated by the Company. Rather, it was initiated by a proposal from Oxford and negotiations were led by Sears Canada's management with input as necessary from external advisors and various Board members.

70. Management had ranked the three stores in the Oxford transaction in the top ten stores with real estate value exceeding trading value, and the divestiture of these assets was consistent with the Company's plan to right-size and re-focus its business. The consideration of $191 million represented a value of more than 21 times the four-wall trading EBITDA for Yorkdale and the Square One locations, 10.6 times the four-wall trading EBITDA for Scarborough Town Centre, and greatly exceeded management's estimate of real estate value by approximately $55 million.

The Concord Transaction

71. Sears Canada entered into a transaction with Concord Kingsway Project Limited Partnership ("Concord") for the sale of a 50% beneficial interest in its property in Burnaby, British Columbia – except for the new Sears Canada store site – and the creation of a co-ownership joint venture for the redevelopment of a mixed-use residential office and retail shopping centre. The total consideration proposed was approximately $140 million.

[4] In light of a potential conflict related to outside business activities not related to Sears Canada, Harker and Crowley recused themselves from the review and approval of the Concord transaction, described below.

72. Management recommended partnering with Concord over two other candidates that had been considered on the basis that Concord proposed the most favourable structure, was one of Canada's largest mixed-use developers, and offered the highest net present value.

The Cadillac Fairview Transaction

73. Sears Canada entered into a transaction with Cadillac Fairview Corporation Limited ("Cadillac Fairview") for the sale of leases for five stores: the Toronto Eaton Centre, Sherway Gardens, Markville Shopping Centre, Masonville Place, and Richmond Centre. The total consideration proposed was $400 million.

74. The transaction was not initiated by the Company. Rather, it was initiated by a proposal from Cadillac Fairview and negotiations were led by Sears Canada's management with input as necessary from external advisors and various Board members.

75. Management had ranked the five stores in the Cadillac Fairview transaction in the top seventeen stores with real estate value exceeding trading value, with three being in the top ten. The divestiture of these assets was consistent with the Company's plan to right-size and re-focus its business. The consideration of $400 million represented a value of more than 26.1 times the four-wall trading EBITDA and greatly exceeded management's estimate of real estate value by approximately $158 million.

The Montez Transaction

76. Sears Canada entered into a transaction with Montez Income Properties ("Montez") for the sale of Sears Canada's 50% joint venture interest with Westcliff Group of Companies in eight shopping centres in Quebec for consideration of approximately $315 million.

77. Management advised the Board that this amount represented fair market value for these non-core real estate assets. The transaction allowed the Company to refocus is business by

exiting the joint venture arrangement while continuing to operate full-line stores in the eight shopping centres, with the leases being revised to account for Sears Canada being a tenant and not a landlord.

78. When announcing the transaction with Montez, the Company explained that "unlocking the value of assets is a lever we use as a way to help create total value. The joint venture assets we are selling to Montez impact neither our store operations nor our ability to serve customers. As such, our primary focus in creating long-term value remains on the basics of the business and continuing to become more relevant with Canadians coast to coast."

The Board Rejected Transactions Inconsistent with the Transformation Plan

79. Transactions proposed by management that were inconsistent with the Transformation Plan were not authorized by the Board. In particular, in late 2013 management proposed a transaction with Ivanhoe Cambridge to sell five store leases and its 15% joint venture interest in a shopping centre in Quebec. As with all potential real estate divestitures presented by management, the Board conducted a thorough review and consideration of this transaction to determine whether it was consistent with Sears Canada's strategy and long-term interests.

80. After careful consideration, the Board decided that the proposed transaction was not consistent with the objectives of the Transformation Plan, including the right-sizing of the retail footprint, since most of these locations were too valuable as operating stores to be divested. Accordingly, the Board declined to authorize management to pursue the proposed transaction.

All Transactions Were Driven by the Transformation Plan

81. These transactions did not represent a sale of the Company's "crown jewels", as alleged. In fact, the opposite is true. All of these transactions related to store locations where value as real estate assets far exceeded their trading value as operating stores. The sale of these assets was consistent with the Transformation Plan – the strategy approved by the Board to right-size the

Company's full-line store network and refocus Sears Canada's retail operations on its core customer base in suburban and smaller / rural locations while growing that business.

82. The Former Directors and Bird deny that any of these transactions was entered into for an improper purpose and deny that the divestment of these real estate assets in 2013 had any negative short term or long term impact on the Company, or in the alternative, could be foreseen to have a long-term negative impact.

83. In fact, these transactions were expected to generate positive results. In September 2013, management presented the 2014 financial and operating plan, with a focus on improving earnings through further cost savings, right-sizing, and targeted capital expenditures. The plan outlined various financial and operational improvements from the implementation of the Transformation Plan in the first half of 2013, including improvements in EBITDA of approximately $19 million (on a comparable basis) and in gross margin rate of approximately 66 basis points year over year.

84. The plan outlined a path, in light of retail market conditions, to achieve EBITDA ranging from 3.9% to 5% of total revenue with more moderate sales growth and projected cost savings initiatives totalling approximately $200 million in various areas of the business, including logistics and cost of goods sold over the next three years. It also incorporated the impact of the divestiture of full-line locations as part of the Company's continued right-sizing. Through the continued implementation of these initiatives, Sears Canada's EBITDA was projected to be $196 million by 2016 rather than the projected negative $105 million without such initiatives.

APPROVAL OF THE 2013 DIVIDEND

85. The four real estate transactions resulted in total cash consideration of $906 million, and management anticipated that Sears Canada would have cash on hand of approximately $1 billion at the end of fiscal year 2013. As a result, the Board determined in early November 2013 to consider the use of the proceeds, which would include consideration of the financial and

operational position of the Company, as well as future needs of the business, as Sears Canada implemented its strategic plan, at the Board meeting scheduled for November 18 and 19, 2013.

86. The process undertaken by the Board leading up to the approval of the 2013 Dividend was robust and consistent with good corporate governance practices. The approval of the 2013 Dividend by the Board was an exercise of informed business judgment.

The Board Was Aware of the Requirements for Declaring Extraordinary Dividends

87. Approximately one year earlier, on December 12, 2012, in the midst of implementing the Transformation Plan, Sears Canada declared an extraordinary dividend of $102 million (the “2012 Dividend”). Prior to the declaration of the 2012 Dividend, Sears Canada had anticipated cash and cash equivalents of approximately $400 million. As of year-end 2012, after paying the 2012 Dividend, Sears Canada had approximately $240 million in cash and cash equivalents.

88. Prior to approving the 2012 Dividend, the Board received a presentation which included an analysis of the impact of a dividend on the Company’s financial position, including its liquidity position, cash, EBITDA and total debt, the anticipated cash requirements for operations, and a sensitivity assessment. This presentation reviewed the Board’s governance considerations, and summarized the statutory solvency and process requirements under the *Canada Business Corporations Act*, R.S.C. 1985, c. C-44 (the “CBCA”).

89. The Board also received confirmation from the chief financial officer, following consultation with the Company’s auditor, Deloitte, that statutory solvency requirements were met, and was provided with an officer’s certificate certifying that, among other things, there were no reasonable grounds for believing that Sears Canada was, or would be after the payment of the 2012 Dividend, unable to pay its liabilities as they became due.

90. In light of the Board's ongoing dialogue and consideration of the Company's business and operations throughout 2012, including at numerous Board meetings and otherwise, much of the information contained within this presentation was already known to the Board when the presentation was provided.

91. The process undertaken by management and the Board leading up to the declaration of the 2012 Dividend was robust and consistent with corporate best practices. The decision to declare the 2012 Dividend was an exercise of informed business judgment by the Board acting in the best interests of Sears Canada.

The Board Was Fully Informed and Engaged

92. The Board was provided with the information necessary for the consideration of a dividend in 2013, and the decision by the Board to approve the 2013 Dividend was informed by the analyses, presentations, and discussions that occurred during the November 18, 2013 meetings and the informal and formal meetings of the Board and the audit committee of the Board (the "Audit Committee"), which took place leading up to those meetings, and in the course of extensive dialogue among members of the Board.

93. In particular, in advance of the declaration of the 2013 Dividend, the Audit Committee, composed entirely of independent directors, met on February 26, March 14, May 21, August 20, and November 18, 2013. Additionally, in advance of the declaration of the 2013 Dividend, the Board met on January 30, March 14, April 24, April 25, April 29, May 21, June 13, July 16, September 4, September 5, September 23, October 11, October 28, and November 18, 2013.

94. Aside from formal meetings, members of the Board were in frequent contact not only around the scheduled meetings but also on an as-needed basis, and at least once per month. The Board was also informed by the analyses and discussions that occurred at such meetings in

advance of the Company declaring the 2013 Dividend and their experience and knowledge regarding practices and processes relating to a decision to declare a dividend.

95. In 2013, the Board received, among other things:

(a) annual operating plans which included detailed cash flow analyses, operating cash requirements, and capital expenditures relating to the ongoing business and the implementation of the Transformation Plan;

(b) regular updates on the financial and operational position of the Company, the status of the implementation of the Transformation Plan – including capital needs required to drive long-term growth in a manner consistent with this strategy, cash flow analyses and cash requirements, debt, and the status of pension funding, including at quarterly Board meetings and on monthly financial update calls; and

(c) regular updates on the implementation of Project Matrix, the divestiture of real estate assets, including at quarterly board meetings, at special purpose board meetings, by e-mail, and at informal Board meetings.

96. In light of the significant amount of information provided to the Board by management, in the summer of 2013 the Board was aware of the cash needs and operational requirements of the Company. In particular, from ongoing monthly and, at times, weekly discussions with management, the Board was aware that all transformation and operating plan projects were adequately funded and that no additional capital could be usefully deployed to enhance these projects and drive long-term growth for the Company.

97. In the summer of 2013, the Board was also aware, from reports provided by management and Towers Watson, that:

(a) the Plan had achieved investment gains of $134.3 million in 2012, which more than offset payments made to retirees, resulting in a net gain of $46.1 million;

(b) the Plan balance had increased by $32.1 million on a net basis in the first quarter after taking into account income, contributions and withdrawals, and pension payments. Overall, the Plan achieved a 4.57% return in that quarter; and

(c) the year-to-date return to June 30, 2013 was 5.61% and that there had been a net decrease in Plan assets of $12.2 million during the second quarter of 2013.

98. In September, October, and early November 2013, over multiple meetings of the Board, management provided analyses and other details relating to the business and operations of the Company, cash flows, and pending real estate transactions, all of which were discussed and considered by the Board. The financial performance updates in respect of the implementation of the Transformation Plan and annual operating plan provided by management to the Board in that period advised that the Company's EBITDA was improving as compared to the prior year as follows:

(a) regarding the September 2013 financial results, that EBITDA had improved by $2 million compared to September 2012;

(b) regarding the October 2013 financial results, that EBITDA had improved by $5.6 million compared to October 2012; and

(c) regarding the third quarter 2013 financial results, that EBITDA had improved by $11.7 million compared to October 2012 on a year-to-date basis and by $19.6 million on a comparable year-to-date basis.

99. As part of the preparation for the Board meeting scheduled for November 18 and 19, 2013, management prepared *pro forma* balance sheet, income statement, and cash flow analyses for the remainder of 2013 and 2014 and analyzed the impact of potential dividend scenarios. Based on these analyses, management determined that the difference between Sears Canada's cash-on-hand and cash needs to implement its strategic plan resulted in significant excess cash and would allow for a dividend of between $7 and $8 per share, assuming no debt.

100. The Board had previously agreed to consider the appropriate use of excess cash at its meeting in November. In advance of that Board meeting, the Board received and reviewed voluminous materials. In particular, the materials provided to the Board in advance of the Audit Committee meeting, which was attended by the entire Board, included:

(a) the draft third quarter results, MD&A and draft press release, as well as an analysis prepared by management relating to the Company's financial performance, factors relating to the retail sector, and accounting implications of divestiture of real estate assets;

(b) an analysis prepared by Deloitte relating to third quarter 2013 results; and

(c) an analysis regarding pending litigation.

101. In addition, the materials provided to the Board in advance of the Board meeting included

(a) an analysis outlining management's immediate priorities, including:

(i) building a long-term growth strategy by focusing on sustainable growth on a smaller asset base; and

(ii) generating cash from investing activities to create value and fund growth by selling assets deemed to be non-core;

(b) an analysis of asset valuation, which confirmed that there was a substantial core business remaining after the real estate divestitures;

(c) an analysis of operating efficiency, which included a plan to drive excess cost out of the business, allowing Sears Canada to meet 70% of its $200 million savings target in 2014 and an update on a "90 Day Program", advising that top opportunities were being pursued that would yield $106 million in annual savings;

(d) an analysis of merchandising value, which included a category performance review, strategies to address gaps in operational performance and strategies to re-build Sears Canada's value proposition with the goal of clearly and consistently standing for something in the minds of Canadian consumers; and

(e) a financial analysis prepared by the CFO together with the Company's 2014 Financial Plan, which provided management's view of the Company's financial position and cash needs for 2014.

102. The Investment Committee met on November 14, 2013. At this meeting it received presentations prepared by Towers Watson and management relating to the Plan, which were relayed to the Board at the meeting, and confirmed that:

(a) the Plan had continued to improve. Returns were above benchmarks, at 8.3% year-to-date (to September 30) and 2.54% for the third quarter. The overall balance in the Plan had increased on a net basis by $10.2 million in that quarter;

(b) improvements from the Plan's position as at December 31, 2012 were predicted. On a going concern basis, the Plan was forecasted to achieve a surplus of $77 million, up from a deficit of $15 million in 2012. The Plan's solvency was forecasted to improve more than 50%, from a deficiency of $376 million in 2012 to a deficiency

of $162 million at the end of 2013. As set out above, the Plan beat the solvency forecast in 2013; and

(c) Sears Canada might not have to make any special payments to the Plan for the December 2013 valuation: “Funding would no longer by required for Dec. 31, 2013 valuation if interest rates were to increase approx 100-125bps and assets earn 5.5% per annum for 2013”.

Declaration of 2013 Dividend: Exercise of Business Judgment

103. On November 18 and 19, 2013, the Board met to review and consider a number of items, including the possible declaration of a dividend. This meeting was held in New York, consistent with the Board’s practice to have periodic meetings in both Toronto and New York.

104. The Board did not decide to authorize the 2013 Dividend at a “short pre-dinner discussion on November 18, 2013”, or without receiving any financial analyses or information from management, as alleged. In fact, in advance of the Board meeting, on November 18, 2013, the Audit Committee met to consider a number of matters. All of the members of the Audit Committee were independent directors. Consistent with past practice, all of the Board members attended the Audit Committee meeting. The Company’s auditor, Deloitte, also participated in the meeting and an in camera session with the committee members.

105. The presentation provided by management at this meeting indicated that the Company’s balance sheet and liquidity position remained strong, with significant cash on hand and no draw downs on the credit facility. The presentation also indicated that Sears Canada had approximately $1.66 billion in current assets, and provided information on real estate transactions completed, including the Oxford, Concord, Montez, and Cadillac Fairview transactions.

106. Additionally, Deloitte delivered a report on November 18, 2013 which noted that it had discussed a number of matters with management, including pending litigation, changes to pension discount rates and the required reserve, and the recent real estate transactions completed by the Company.

107. The real estate divestiture transactions, cash position, capital requirements and funding for turnaround projects, long-term growth, and possibility of declaring a dividend, including the potential amount of the dividend, were discussed by management and the Board during the Audit Committee meeting, with the benefit of the information provided to the Board in advance of and at the Audit Committee meeting.

108. The Board then discussed the potential dividend during the Board meeting held on November 18, 2013, following the Audit Committee meeting. At the Board meeting, the Board, among other things:

(a) received and considered a detailed presentation on management's priorities and asset valuation, including strategies aimed at long-term growth for the Company – all of which were fully funded;

(b) received a sensitivity analysis with respect to the payment of a potential dividend, and discussed and considered the timing and quantum of a dividend in light of the Company's operational and cash position, and the cash that would remain following payment, including in the event that:

(i) the Montez transaction entered into by Sears Canada, which was expected to close in January 2014, did not close; or

(ii) projected revenues and earnings were not achieved;

(c) received and considered a detailed presentation from the CFO regarding the financial and operational position of the Company, future cash requirements, cash flow and liquidity, and the impact of the payment of a dividend of $5 per share on the Company's financial and liquidity position in 2013 and 2014;

(d) received and considered a presentation from the chair of the Investment Committee regarding the Plan; and

(e) received confirmation from management, following consultation with Deloitte, that the statutory solvency requirements were met and received a certificate of solvency from the CFO prior to approving the 2013 Dividend.

109. All but two of the directors, Campbell and Ron Weissman, were members of the Board when Sears Canada had declared an extraordinary dividend less than one year earlier, after receiving legal advice about their duties in relation to declaring dividends. The Board, which was composed of highly skilled and experienced corporate directors with expertise in retail, finance, accounting, and law, had significant and specific experience relating to these duties. In addition, the Board had the benefit of the participation of both the general counsel and the assistant general counsel at the Audit Committee and Board meetings.

110. The two directors who were not members of the Board when it approved the 2012 Dividend were, like the other directors, satisfied that the 2013 Dividend was in the best interest of Sears Canada on the basis of the information provided to them in advance of and at the Audit Committee and Board meetings, their discussions with other members of the Board, and the information presented to the Board by management on November 18, 2013.

111. None of the Former Directors or Bird had a material relationship with Sears Holdings, ESL, or Lampert which could reasonably have been expected to interfere with their independent

judgment in supporting the 2013 Dividend. At all material times, and in particular on November 18, 2013, the Former Directors and Bird were not conflicted and exercised their independent judgment with a view to the best interests of Sears Canada in voting to approve the 2013 Dividend.[5] Historic relationships between some of the Former Directors or Bird and Sears Holdings, ESL, and Lampert specifically did not motivate any decisions whatsoever in which they participated as directors of Sears Canada.

112. Additionally, and in any event, the interests of all shareholders with respect to the Company's declaration of the 2013 Dividend were aligned, all shareholders were treated the same, and Sears Holdings, ESL and Lampert had the strongest interest in (and investment in) the ongoing financial and operational success of Sears Canada.

113. The 2013 Dividend was not driven or dictated by Sears Holdings, Lampert or ESL, or their need for funds. The Former Directors and Bird specifically deny the allegations that they approved or acquiesced in approving the 2013 Dividend or that Sears Canada paid the 2013 Dividend fraudulently and dishonestly for the purpose of benefiting Sears Holdings, Lampert and ESL in alleged disregard of the interests of the Plan or its beneficiaries.

114. Indeed, none of the decisions regarding Project Matrix, the divestiture of real estate assets, any other aspect of the Company's financial and operational plans, or the 2013 Dividend were in any way directed by or related to the financial needs of Sears Holdings, ESL or Lampert. There was no "plan to extract cash from Sears Canada" through the sale of real estate assets devised by Sears Holdings, ESL or Lampert, or at all. Even if there were such a plan, which is denied, the Former Directors and Bird were not generally or specifically aware of it, and they were certainly not participants.

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[5] Although Harker and Crowley were not considered to be independent under National Instrument 52-110, which relates to independence for the purpose of audit committee membership only, they were not members of the Audit Committee.

115. Rather, the process undertaken by management and the Board leading up to the declaration of the 2013 Dividend was robust and consistent with corporate best practices. Moreover, the decision was an exercise of informed business judgment by the Board acting in the best interests of Sears Canada, with knowledge that the Plan was in surplus on a going concern basis, that its solvency position had improved, and that the Company was intended to remain a going concern indefinitely.

116. On December 6, 2013, the 2013 Dividend was paid *pro rata* to Sears Canada's shareholders. Sears Canada was not insolvent or near insolvent when the 2013 Dividend was declared or paid and was not rendered insolvent by that payment. On the contrary, following that payment, approximately $513.8 million in cash still remained on Sears Canada's balance sheet, with virtually no debt, and its operations and plans for the future remained fully funded.

No Dividend in 2014: Exercise of Business Judgment

117. In March 2014, the Board considered the Company's cash position following the completion of the Montez transaction and the possibility of a further dividend. In particular, the Board reviewed two further dividend scenarios presented by management, valued at $1.50 per share and $2.50 per share, respectively.

118. At that time, the Board received a detailed presentation from management regarding the financial and operating results for the fourth quarter of 2013, the drivers for such results, and various initiatives being undertaken by management to improve performance.

119. Consistent with its approach to the consideration of the 2012 Dividend and the 2013 Dividend, the Board undertook a comprehensive review and consideration of the financial position and the potential impact of various dividend scenarios.

120. Ultimately, the Board decided not to declare a dividend. This decision was not the result of concerns about Sears Canada's long-term viability. Rather, the Board decided not to declare a dividend in early 2014 in light of Sears Canada's unexpected poor performance in the fourth quarter of 2013 and its resulting cash position, which was lower than expected.

121. As with the decision to declare the 2013 Dividend, the decision not to declare a dividend in 2014 was an exercise of informed business judgment by the Board acting in the best interests of Sears Canada.

THE PLAN'S STATUS AFTER THE DIVIDEND

122. After the 2013 Dividend was paid, Sears Canada continued to operate as a going concern and continued to meet its obligations to the Plan.

123. In fact, the funded status of the Plan continued to improve into 2014. For example, the Investment Committee met on February 25, 2014 and then on May 20, 2014. The information presented at these meetings indicated that the position of the Plan continued to improve. In the first quarter of 2014, the fund balance in the Plan had increased by a net $8.6 million.

124. The actuarial report provided to Sears Canada by Aon in June 2014 (which related to the Plan as at December 31, 2013) showed a positive going concern position of $14.6 million and a reduction in its solvency deficiency of over 60%, to $138.6 million. The Plan's solvency ratio was 0.95, well above the threshold set in the Pension Benefits Regime for identifying plans with solvency issues.

SUBSEQUENT EVENTS

125. Following the approval and payment of the 2013 Dividend, Sears Canada continued to obtain and rely on financial, strategic, and other advice from third party professionals and continued to carry on business in the normal course for three and a half years – until at least June

21, 2017. During that time, management and other employees of Sears Canada operated stores, sold goods, undertook marketing efforts, implemented new initiatives, and made strategic, business, financial, operational and other decisions.

126. However, after the Former Directors and Bird left Sears Canada, the Canadian retail market faced increasingly significant and unpredictable changes and stresses which posed new challenges for the continued successful operation of retailers, including Sears Canada. These events affected all segments of the retail market in Canada, including apparel, house wares, kitchen wares, office supplies, electronics, furnishings, toys, department stores, and jewellery. Numerous prominent retailers operating in Canada became insolvent, ceased operations, restructured, or reduced their footprint in the period immediately preceding Sears Canada's application for CCAA protection.

127. After payment of the 2013 Dividend, while the Former Directors remained on the Board and Bird remained an officer, Sears Canada's Board and management worked to implement strategies in the best interests of Sears Canada and the Company's share price and financial position remained strong. In 2014, the Company's shares traded as high as $17.12 per share and not lower than $8.56 per share.

128. However, after the Former Directors ceased to hold positions on the Board and Bird left the Company, new management ushered in and oversaw significant shifts in the Company's strategic direction, including with a plan known as "Sears 2.0". In 2016, the Company's shares never traded higher than $7 per share (lower than the low in 2014) and the average trading price was only $3.68 per share. By early 2017, Sears Canada was in a difficult financial position.

129. As late as January 28, 2017, Sears Canada operated 95 full-line department stores, 830 catalogue and on-line merchandise pick-up locations, and 14 outlet stores. At that time, it had current assets of over $1 billion, of which $235.8 million was cash, with shareholder equity in the

amount of $222.2 million. However, Sears Canada suffered a sudden, significant, and unexpected decline in early and mid-2017. In that period, cash on hand had fallen to $125.3 million and inventory on hand had increased to $648.1 million from $598.5 million. In addition, as of April 2017, the Company had incurred debt of $125 million under a term loan. By June 5, 2017 it had incurred additional debt of $33 million under a revolving credit facility.

130. Upon filing for CCAA protection, Sears Canada confirmed that the decline in financial performance was the result of market factors causing the decline of other retailers, as well as, among other things:

(a) unsustainable fixed costs from an overly broad retail footprint;

(b) the decline of the catalogue business and lower than expected conversion of catalogue customers to online customers; and

(c) the inability to secure an agreement for the management of credit and financial services operations.

NO BREACH OF ANY DUTIES

131. At all material times, Sears Canada complied with its obligations to the Plan under the Pension Benefits Regime in its distinct roles as administrator and plan sponsor.

No Breach of Duties as Sponsor

132. As sponsor, Sears Canada had a statutory obligation to fund the Plan in accordance with the Pension Benefits Regime. At all material times, Sears Canada complied with its duties as sponsor and, in particular, made all the funding contributions required by the Pension Benefits Regime.

133. As sponsor, Sears Canada did not owe fiduciary duties to the Plan or its members.

134. Provided that the sponsor complies with its funding obligations under the Pension Benefits Regime, decisions about whether to fund a pension plan above the minimum requirements are a matter of business judgment by the sponsor.

135. Sears Canada had no obligation to immediately liquidate the solvency deficiency, or the hypothetical wind up deficiency, of the Plan or otherwise fund the Plan above the statutory requirements.

136. The Former Directors and Bird did not owe any duties, whether fiduciary, statutory, or otherwise, to the Plan or its members. They complied at all times with the duties they owed to Sears Canada in relation to the Plan. The Former Directors and Bird had no duty to cause Sears Canada to fund the Plan above the statutory requirements or to immediately liquidate the solvency deficiency of the Plan.

137. The Former Directors and Bird did not owe any duty of care to the Plan or its members. In the alternative, they were not negligent in relation to Sears Canada's role as sponsor of the Plan. There was no reason in November 2013 to believe that it would be necessary to wind up the Plan three and a half years later.

No Breach of Duties as Administrator

138. As administrator of the Plan, Sears Canada had both statutory and fiduciary duties. Those duties relate primarily to the management and administration of the Plan. As set out above, Sears Canada adopted a robust pension governance structure, including the creation of an Investment Committee, and the retention of expert advisors.

139. The duty to fund a pension plan is not the duty of the administrator, but the duty of the sponsor. The administrator's duty in relation to funding is to ensure that the sponsor meets its

obligations, and to report to the regulator (the Superintendent of Financial Services) if the sponsor fails to do so.

140. At the time of the 2013 Dividend, Sears Canada had no duty (nor did the Former Directors and Bird) to consider or implement any additional funding contributions to the Plan. Sears Canada was not insolvent or near insolvent, and it was not foreseeable that it would become insolvent three and a half years later.

141. Sears Canada met its statutory and fiduciary duties in relation to the administration of the Plan at all times. Sears Canada was not negligent in its management and administration of the Plan. Sears Canada administered the Plan diligently.

142. The Former Directors and Bird did not owe any duties, whether fiduciary, statutory, or otherwise, to the Plan or its members. They complied at all times with the duties they owed to Sears Canada in relation to the management and administration of the Plan. The Former Directors and Bird had no duty to cause Sears Canada to fund the Plan above the statutory requirements or to immediately liquidate the solvency deficiency of the Plan. In the alternative, if they had any such duties, then they met those duties.

143. The Former Directors and Bird did not owe a duty of care to the Plan or its members in relation to the management and administration of the Plan. In the alternative, they were not negligent in relation to Sears Canada's role as administrator of the Plan

The 2013 Dividend Had No Impact on Sears Canada's Ability to Fund the Plan

144. The payment of the 2013 Dividend caused no harm to the Plan or its members. It had no impact on Sears Canada's ability to fund the Plan. As at February 1, 2014, Sears Canada had $513.8 million in cash. Although Sears Canada did not have a duty immediately to liquidate the solvency deficiency, or the hypothetical wind up deficiency, it had more than enough cash to

make the maximum contribution for 2014 permitted by the ~~Income Tax Act~~ <u>ITA</u> as reported in the 2013 Actuarial Report, being $133 million.

145. In any event, when the 2013 Dividend was declared and paid, the Former Directors and Bird had no reason to believe that Sears Canada would become insolvent three and a half years later – especially given the value of its assets and the fact that it had virtually no debt. They also had no reason to believe that the 2013 Dividend could have an impact on Sears Canada's ability to continue to make special payments to the Plan three and a half years later. On the contrary, they were actively planning to improve Sears Canada's performance and expected that Sears Canada would continue to operate indefinitely.

146. Sears Canada continued to meet its funding obligations up to the time of the commencement of CCAA proceedings. The decision in October 2017 to wind up the Plan was not made by the Former Directors or Bird.

NO OPPRESSION

147. None of the acts or omissions of the Former Directors or Bird was oppressive. Neither the Plan nor its beneficiaries had any reasonable expectation that Sears Canada would liquidate the solvency deficiency or the hypothetical wind up deficiency instead of paying the 2013 Dividend.

148. To the extent that the Plan members had any reasonable expectations in respect of the funding of the Plan, those expectations were that Sears Canada would comply with its statutory and common law duties as administrator and sponsor of the Plan. As set out above, it did so.

149. The payment of the 2013 Dividend did not have any impact on Sears Canada's ability to make contributions to the Plan that were required by the Pension Benefits Regime. It did not, therefore, oppress the Plan members, or prejudice or unfairly disregard their interests.

150. It was in the interests of the Plan members that Sears Canada continue to operate as a going concern and improve its performance. The Former Directors and Bird were actively engaged in attempting to achieve that by continuing to support and oversee management's plan to right-size Sears Canada's operations and thereby continue to carry on business in the ordinary course.

151. The 2013 Dividend could not be and was not oppressive on the basis that Sears Canada failed in 2017, after the Former Directors and Bird were no longer involved with the Company, and three and a half years after the 2013 Dividend was approved and paid.

NO KNOWING RECEIPT, NO UNJUST ENRICHMENT, NO CONSTRUCTIVE TRUST

152. There was no breach of any statutory, fiduciary, or other duty by any of the Former Directors or Bird, by Sears Canada, or by its Board. Harker and McBurney are therefore not liable for knowing receipt or unjust enrichment, and there is no basis for the imposition of a constructive trust over the dividend payments received by them.

153. Additionally, none of the elements of unjust enrichment is met. Neither Harker nor McBurney received an enrichment because a dividend is not an enrichment, but instead the conversion of a shareholder's interest from one form, the value of equity, to another, cash.

154. Moreover, neither the Plaintiff nor the Plan nor its members suffered any corresponding deprivation. Sears Canada paid the 2013 Dividend out of its own funds. At the time the 2013 Dividend was declared and paid, Sears Canada had made all contributions to the Plan that it was required to make. The Plan and its members had no entitlement to or claim over the funds used to pay the 2013 Dividend. In any event, even after payment of the 2013 Dividend, Sears Canada had sufficient cash to make all payments to the Plan that it was required to make, and it continued to make those payments for three and a half years. There was no proprietary nexus between the 2013 Dividend payment and the deficiency in the Plan determined on wind up in 2017.

155. Finally, there was a juristic reason for the payment received by Harker and McBurney. The 2013 Dividend was properly declared, in compliance with the CBCA, and once declared, the 2013 Dividend was payable to all shareholders of Sears Canada, including Harker and McBurney, who were legally entitled to receive it.

NO BREACH OF ANY OTHER DUTIES, NO KNOWING ASSISTANCE

156. The Former Directors and Bird did not breach their fiduciary duty or induce or knowingly assist anyone else to do so. They deny all other bases of alleged liability pleaded in the Amended Statement of Claim including, without limitation, knowing assistance and fraud.

NO LIABILITY OF NON-DIRECTOR

157. At the time the 2013 Dividend was approved, Bird was not a director of Sears Canada. He did not have any power to approve or reject the 2013 Dividend and thus cannot have any liability at law in respect of the 2013 Dividend. Bird did not instigate or urge the declaration of the 2013 Dividend or induce the Former Directors or the Board to breach any duties they owed to the Plan.

NO CAUSATION OF DAMAGES

158. For three and a half years after the 2013 Dividend, market events and corporate decisions made by management of Sears Canada intervened to shape the ultimate fate of Sears Canada. The 2013 Dividend did not cause or contribute to the deficiency in the Plan arising from the Company's CCAA filing. Even if the Former Directors and Bird had breached their duties, which is denied, none of their acts or omissions caused or contributed to any loss or damages.

FAILURE TO MITIGATE

159. Even if the Plan or its members suffered harm for which the Former Directors or Bird are liable, which is denied, the Plaintiff on behalf of the Plan and its members has failed to mitigate such damages, including by failing to assert the statutory trust provided for in the Pension Benefits Regime over Sears Canada's remaining estate.

160. Additionally, the Plaintiff, as administrator of the Plan, has failed to mitigate such damages by failing to make sound investment decisions for the Plan, which has denied the Plan and its members benefits from upward market trends that the Plan and its members would otherwise have realized.

THE ACTION IS TIME-BARRED

161. This action is time-barred. The declaration of the 2013 Dividend occurred on November 18, 2013. This action was commenced on December 19, 2018. That was over three years after the expiration of the two-year limitation period under section 4 of the *Limitations Act, 2002*, S.O. 2002, c. 24, Sch. B. (the "Limitations Act"). The Plaintiff's claim was discovered more than two years before this action was commenced.

THE ACTION SHOULD BE DISMISSED

162. The Former Directors and Bird plead and rely on the Pension Benefits Regime, the Limitations Act, the ITA, the CBCA, and the CCAA, and request that this action be dismissed with costs on a substantial indemnity basis.

May 10, 2019

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MORNEAU SHEPELL LTD. -and- ESL INVESTMENTS INC. *et al.*
Plaintiff Defendants

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PROCEEDING COMMENCED AT TORONTO

AMENDED STATEMENT OF DEFENCE OF THE DEFENDANTS WILLIAM HARKER, WILLIAM CROWLEY, DONALD CAMPBELL ROSS, EPHRAIM J. BIRD, JAMES MCBURNEY and DOUGLAS CAMPBELL

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