

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

B E T W E E N:

SEARS CANADA INC., by its Court-appointed Litigation Trustee,
J. DOUGLAS CUNNINGHAM, Q.C.

Plaintiff

and

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

Defendants

MOTION RECORD OF THE ESL PARTIES
(Motion To Strike Returnable April 17-18, 2019)

March 18, 2019

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Lampert

TO: **THE LITIGATION SERVICE LIST**

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Court File No. CV-18-00611214-00CL

**ONTARIO
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COMMERCIAL LIST**

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J. DOUGLAS CUNNINGHAM, Q.C.

Plaintiff

and

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MCBURNEY, DEBORAH ROSATI and DONALD ROSS

Defendants

**NOTICE OF MOTION
(RE MOTION TO STRIKE)**

The defendant ESL Parties will make a motion to the Honourable Justice McEwen on April 17, 2019 at 10:00 a.m. or as soon after that time as the motion can be heard at the Court House, 330 University Avenue, 7th Floor, Toronto, Ontario, M5G 1R7.

PROPOSED METHOD OF HEARING: The motion is to be heard orally.

THE MOTION IS FOR:

- (a) an order striking out, without leave to amend, the following full and partial paragraphs and subparagraphs of the Litigation Trustee's statement of claim on the grounds that those references do not disclose a reasonable cause of action:

Reference	To Be Struck
1(d)	The words “Sears Canada and”
86	The entire paragraph
86(a)	The entire subparagraph
86(b)	The words “Sears Canada and”
87	The words “on its own behalf and” and “all similarly”

- (b) an order striking out, without leave to amend, the reference to “pensioners” at paragraph 1.1(a) of the Litigation Trustee’s response to the demand for particulars on the grounds that it is an abuse of process;
- (c) costs of this motion; and
- (d) such further and other relief as to this Honourable Court may seem just.

THE GROUNDS FOR THE MOTION ARE

The parties

- (a) Sears Canada Inc. (“**Sears Canada**”) was a Canadian retailer and publicly traded company. It is incorporated under the *Canada Business Corporations Act*, R.S.C., 1985, c. C-44 (“**CBCA**”).
- (b) The plaintiff, the Litigation Trustee, the Honourable J. Douglas Cunningham Q.C., was appointed by this Court to pursue various claims on behalf of the creditors of the Sears Canada estate. In accordance with that order, the Litigation Trustee is an officer of the Court.

- (c) The defendants, Edward S. Lampert, ESL Investments Inc., ESL Partners, LP, SPE I Partners, LP, SPE Master I, LP, and ESL Institutional Partners, LP (the “**ESL Parties**”), were minority shareholders of Sears Canada at the time of the 2013 Dividend (defined below).

Background

- (d) On June 22, 2017, Sears Canada Inc. (“**Sears Canada**”) and a number of its operating subsidiaries obtained an initial order under the *Companies' Creditors Arrangement Act*, R.S.C., 1985, c. C-36 (“**CCAA**”).
- (e) On December 19, 2018, Morneau Shepell Ltd., in its capacity as administrator of the Sears Canada pension plan, brought an action against the same defendants to this action, alleging, among other things, that the Sears Canada board’s unanimous declaration of a December, 2013 dividend (the “**2013 Dividend**”) was oppressive to the Sears Canada pension plan and its beneficiaries (the “**Pensioners**”).
- (f) In his statement of claim, also filed on December 19, 2018, the Litigation Trustee seeks, among other relief, “a declaration that the authorization and payment of the [2013 Dividend] was oppressive and unfairly disregarded and was prejudicial to the interests of Sears Canada and its stakeholders and an Order setting aside the [2013 Dividend]”.
- (g) On January 18, 2019, the ESL Parties delivered a demand for particulars, seeking particulars as to the identity and expectations of the “stakeholders” the Litigation Trustee alleges to have been oppressed.

- (h) On January 31, 2019, the Litigation Trustee responded to the demand for particulars, asserting that it is bringing the oppression claim on behalf of “all of Sears Canada’s stakeholders, including its creditors, landlords, employees, **pensioners**, and the holders of its securities”. [Emphasis added]

Section 241(2) of the CBCA does not protect Sears Canada’s interests as a corporation

- (i) At paragraphs 1, 86, and 87 of his statement of claim, the Litigation Trustee alleges that Sears Canada *itself* was oppressed pursuant to s. 241 of the CBCA. In particular, the statement of claim alleges that:
- (1) **paragraph 1(d)**: “[T]he Dividend was oppressive and unfairly disregarded and was prejudicial to the **interests of Sears Canada** and its stakeholders”;
 - (2) **paragraph 86**: “[T]he Former Directors and Bird acted in an oppressive manner towards Sears Canada” by “(a) disregarding the **reasonable expectation of Sears Canada**” and “(b) using their powers to authorize the Dividend, which [...] **disregarded the interests of Sears Canada** and its creditors.”; and
 - (3) **paragraph 87**: “It is appropriate for Sears Canada, by way of its Litigation Trustee, to be the complainant for an oppression claim **on its own behalf** and on behalf of its creditors”.
- (j) Section 241(2) of the CBCA only protects oppressive conduct against any “security holder, creditor, director, or officer” of a corporation, rather than as against a corporation itself.
- (k) The statement of claim—as supplemented by the response to the demand for particulars—does not articulate a basis on which Sears Canada, a corporation, could reasonably be construed as a “security holder, creditor, director, or officer” as required under s. 241(2) of the CBCA. Accordingly, that portion of the pleading discloses no cause of action.

The inclusion of a Pensioner oppression claim is duplicative and an abuse of process

- (l) In the response to the demand for particulars dated January 31, 2019, the Litigation Trustee purports to be bringing an oppression claim on behalf of all “stakeholders” of Sears Canada, including the Pensioners.
- (m) The Pensioners have commenced a separate claim against the ESL Parties founded on the same subject matter in *Morneau Shepell Ltd. in its capacity as administrator of the Sears Canada Inc Registered Pension Plan v ESL Investments Inc et al*, Court file No CV-18-611217-00CL.
- (n) It is impermissibly duplicative and an abuse of process for the Litigation Trustee to seek relief on behalf of the Pensioners on a basis identical to that sought by the Pensioners themselves in a separate claim.

Other Grounds

- (o) Rules 21.01(1)(b), 21.01(3)(c) and (d), 25.11 of the *Rules of Civil Procedure*, R.R.O. 1990, Reg. 194;
- (p) Section 241 of the CBCA; and
- (q) Such further and other grounds as the lawyers may advise.

THE FOLLOWING DOCUMENTARY EVIDENCE will be used at the hearing of the motion

- (r) The pleadings filed in this proceeding;
- (s) The Litigation Trustee’s response to the demand for particulars;

- (t) The statement of claim in *Morneau Shepell Ltd. in its capacity as administrator of the Sears Canada Inc Registered Pension Plan v ESL Investments Inc et al*, Court file No CV-18-611217-00CL; and
- (u) Such further and other evidence as the lawyers may advise and this Honourable Court permit.

March 18, 2019

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ESL Partners L.P., SPE I Partners, LP, SPE
Master I, LP, and ESL Institutional
Partners, L.P.

TO: **THE LITIGATION SERVICE LIST**

SEARS CANADA INC., by its Court-appointed Litigation Trustee, J.
DOUGLAS CUNNINGHAM, Q.C.
Plaintiff

-and-
ESL INVESTMENTS INC. et al.
Defendants

Court File No. CV-18-00611214-00CL

**ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST**

PROCEEDING COMMENCED AT
TORONTO

**NOTICE OF MOTION
(RE MOTION TO STRIKE)**

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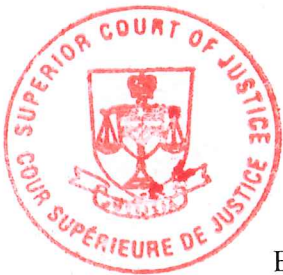
Tab 2

CV-18-00611214-00CL

Court File No.

**ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)**

BETWEEN:



SEARS CANADA INC., by its Court-appointed Litigation Trustee,
J. DOUGLAS CUNNINGHAM, Q.C.

Plaintiff

and

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

Defendants

STATEMENT OF CLAIM

TO THE DEFENDANTS

A LEGAL PROCEEDING HAS BEEN COMMENCED AGAINST YOU by the Plaintiff. The Claim made against you is set out in the following pages.

IF YOU WISH TO DEFEND THIS PROCEEDING, you or an Ontario lawyer acting for you must prepare a Statement of Defence in Form 18A prescribed by the Rules of Civil Procedure, serve it on the Plaintiff's lawyer or, where the Plaintiff does not have a lawyer, serve it on the Plaintiff, and file it, with proof of service in this court office, WITHIN TWENTY DAYS after this Statement of Claim is served on you, if you are served in Ontario.

If you are served in another province or territory of Canada or in the United States of America, the period for serving and filing your Statement of Defence is forty days. If you are served outside Canada and the United States of America, the period is sixty days.

Instead of serving and filing a Statement of Defence, you may serve and file a Notice of Intent to Defend in Form 18B prescribed by the Rules of Civil Procedure. This will entitle you to ten more days within which to serve and file your Statement of Defence.

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IF YOU FAIL TO DEFEND THIS PROCEEDING, JUDGMENT MAY BE GIVEN AGAINST YOU IN YOUR ABSENCE AND WITHOUT FURTHER NOTICE TO YOU. IF YOU WISH TO DEFEND THIS PROCEEDING BUT ARE UNABLE TO PAY LEGAL FEES, LEGAL AID MAY BE AVAILABLE TO YOU BY CONTACTING A LOCAL LEGAL AID OFFICE.

TAKE NOTICE: THIS ACTION WILL AUTOMATICALLY BE DISMISSED if it has not been set down for trial or terminated by any means within five years after the action was commenced unless otherwise ordered by the court.

Date December 19th 2018 Issued by Ray Williams Ray Williams, Registrar
Local Registrar

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CLAIM

1. The Plaintiff claims:
 - (a) damages on a joint and several basis in the amount of \$509 million,
 - (i) as against the Former Directors (as defined below) and Ephraim J. Bird (“**Bird**”) for breach of fiduciary duty, breach of the duty of care, and conspiracy;
 - (ii) as against the ESL Parties (as defined below), for inducing the Former Directors and Bird to breach their duties owed to Sears Canada Inc. (“**Sears Canada**”), knowing assistance, and conspiracy;
 - (b) in the alternative to paragraph (a) (ii) above, damages against the ESL Parties on a joint and several basis in the amount of \$402 million for inducing the Former Directors and Bird to breach their duties owed to Sears Canada, knowing assistance, and conspiracy;
 - (c) a declaration that the ESL Parties knowingly received the proceeds of a breach of fiduciary duty and/or were unjustly enriched, hold the proceeds of the Dividend (as defined below) in trust for Sears Canada and must disgorge the proceeds they received on account of the Dividend to Sears Canada;
 - (d) a declaration that the authorization and payment of the Dividend was oppressive and unfairly disregarded and was prejudicial to the interests of Sears Canada and its stakeholders and an Order setting aside the Dividend;

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- (e) punitive and exemplary damages;
- (f) pre-judgment and post-judgment interest in accordance with sections 128 and 129 of the *Courts of Justice Act*, R.S.O. 1990, c. C.43, as amended;
- (g) the costs of this proceeding, plus all applicable taxes; and
- (h) such further and other relief as to this Honourable Court may seem just.

Overview

2. In the early 2010s, Sears Canada was one of Canada's largest retailers. It operated more than 100 of its own full-line department stores, and had more than 25,000 employees.

3. However, Sears Canada was facing serious financial and operational challenges. Since 2007, its revenues and EBITDA had declined each year. In 2011, its management recognized that Sears Canada was falling behind its peers and identified a need to modernize its business in order to keep pace in an increasingly competitive retail environment. This required significant capital investment in order to refresh Sears Canada's stores and improve its e-commerce platform.

4. Despite these warnings, Sears Canada's board of directors ("**Board**") failed to authorize capital investments in the business. Instead, between 2005 and 2012, the company sold assets worth approximately \$2.86 billion and distributed approximately \$2.97 billion in capital to its shareholders.

5. The primary recipients of these distributions were Sears Holdings Corp. ("**Sears Holdings**"), the hedge fund ESL Investments, Inc. ("**ESL**") and its affiliates, and ESL's founder and proprietor, the billionaire investor Edward S. Lampert (collectively, the "**Significant Shareholders**").

6. In late 2013, Sears Canada was in the midst of its worst year yet. Its revenues declined by more than \$300 million year-over-year and its operating losses reached almost \$188 million. In September, its CEO resigned in frustration at the refusal of the Board to allocate sufficient capital to implement a turnaround strategy.

7. At the same time, ESL was experiencing a liquidity crisis. Its investors had submitted billions of dollars in redemption requests, which it was having difficulty funding.

8. Over the course of the year, Sears Canada sold off a number of its most important assets (the “**Key Asset Sales**”): the leases underlying some of its largest and most lucrative stores. The Sears Canada directors involved in the Key Asset Sales included a number of former ESL employees who had been selected for their roles by Lampert. In addition, even though he was not an officer or director of Sears Canada, Lampert was personally involved in the negotiations concerning these transactions.

9. The Key Asset Sales generated extraordinary proceeds of approximately \$591 million. At a November 2013 meeting of the Board held at the offices of Sears Holdings’ lawyers in New York City, less than a week after the final sale closed (the “**November 2013 Meeting**”), Sears Canada’s management proposed a plan to distribute more than \$509 million to its shareholders through an extraordinary dividend (the “**Dividend**”).

10. The Board was not given any advance notice of the proposed Dividend: it did not even appear on the agenda for the November 2013 Meeting. Although the Board was given extensive materials by management, those materials did not address the proposed Dividend or any analysis of its potential impacts on Sears Canada’s business. Nor did the Board receive legal or financial advice in relation to it. Nevertheless, the Board authorized the payment of the Dividend.

11. Lampert and ESL improperly used their influence with the Board to procure the Dividend, for the purpose of providing funds to the Significant Shareholders. In accordance with their shareholdings in Sears Canada, 79% of the Dividend was paid to Significant Shareholders.

12. The payment of the Dividend diverted funds from Sears Canada at a time when the Defendants knew, or ought to have known, that it would be in the best interests of Sears Canada to reinvest the funds in the business or to preserve liquidity to satisfy increasing losses and creditor claims. By mid-2017, Sears Canada had become insolvent, and, on June 22, 2017, it was granted protection under the *Companies' Creditors Arrangement Act* (the "*CCAA*"). Sears Canada has since liquidated its remaining assets and ceased operations, leaving massive unsatisfied debts owed to its unsecured creditors, including former employees and pensioners.

13. It was not until after the *CCAA* Proceeding (defined below) commenced that it was discovered that the declaration of the Dividend had taken place in improper circumstances.

14. The Plaintiff seeks to set aside the Dividend and seeks damages to compensate Sears Canada and therefore its creditors for the losses they have suffered as a result of the Dividend.

The Parties

15. The Plaintiff, Sears Canada, is a corporation incorporated under the laws of Canada, with its headquarters in Toronto.

16. Sears Canada is insolvent. It is an applicant in a *CCAA* proceeding commenced on June 22, 2017 (the "*CCAA Proceeding*"). By order dated December 3, 2018, the presiding court in that proceeding (the "*CCAA Court*") appointed the Honourable J. Douglas Cunningham, Q.C., as

Litigation Trustee for Sears Canada to pursue claims on behalf of Sears Canada and its creditors against third parties, including the Defendants.

17. The Defendant, ESL Investments Inc., is a corporation incorporated under the laws of Delaware, in the United States of America, with its headquarters in Bay Harbor Islands, Florida, in the United States of America. It is a hedge fund which operates through a number of subsidiary entities, namely: ESL Partners, LP, SPE I Partners, LP, SPE Master I, LP, and ESL Institutional Partners, LP. These entities are collectively referred to herein as “**ESL**”. As a whole, ESL was at all relevant times the largest shareholder of Sears Holdings.

18. The Defendant, Edward S. Lampert, is an individual residing in Indian Creek, Florida, in the United States of America. Lampert was the CEO of Sears Holdings from May 2013 to October 2018. Lampert owns and controls ESL, and has served as ESL Investments Inc.’s Chairman and Chief Executive Officer since he founded it in 1988. Collectively, ESL and Lampert are referred to herein as the “**ESL Parties**”.

19. The Defendant Ephraim J. Bird is an individual residing in Salado, Texas, in the United States of America. Bird was a director of Sears Canada between May 2006 and November 13, 2013, and its interim CFO, and later permanent CFO, from March 2013 until June 2016.

20. The Defendant Douglas Campbell (“**Campbell**”) is an individual residing in Toronto. Campbell was Sears Canada’s COO from November 2012 until September 24, 2013, and its CEO and a director from that date until October 2014.

21. The Defendant William Crowley (“**Crowley**”) is an individual residing in New York, New York, in the United States of America. Crowley was the Chairman of Sears Canada’s Board in late 2013, and was a director of Sears from May 2005 to April 2015.

22. The Defendant William Harker (“**Harker**”) is an individual residing in New York, New York, in the United States of America. Harker was a director of Sears Canada from November 2008 to April 2015.

23. The Defendant R. Raja Khanna (“**Khanna**”) is an individual residing in Toronto. Khanna was a director of Sears Canada from October 2007 to August 2018.

24. The Defendant James McBurney (“**McBurney**”) is an individual residing in London, in the United Kingdom. McBurney was a director of Sears Canada from April 2010 until 2015.

25. The Defendant Deborah Rosati (“**Rosati**”) is an individual residing in Wainfleet, Ontario. Rosati was a director of Sears Canada from April 2007 to August 2018.

26. The Defendant Donald Ross (“**Ross**”) is an individual residing in New York, New York, in the United States of America. Ross was a director of Sears Canada from May 2012 until 2014.

27. The Defendants, other than the ESL Parties and Bird, are referred to herein as the “**Former Directors**”. All of the Former Directors were members of the Board during the November 2013 Meeting.

Lampert’s Purchase of Sears Holdings

28. In early 2005, the ESL Parties acquired a controlling share in the American retailer Sears, Roebuck & Co. (“**Sears Roebuck**”), the then-parent company of Sears Canada. After the

acquisition, the ESL Parties established Sears Holdings to hold their stakes in Sears Roebuck and Kmart, another retailer.

29. Lampert appointed himself Chairman of Sears Holdings, and later made himself CEO. From 2005 onwards, he played a direct role in the formulation of Sears Holdings' business strategy.

30. Soon after the acquisition, Lampert replaced the existing senior management of Sears Roebuck, in many cases with former ESL executives. Appointments to key positions at Sears Holdings made by Lampert included:

- (a) Crowley, the President and COO of ESL, who became Sears Holdings' CFO;
- (b) Harker, the former General Counsel of ESL, who became Sears Holdings' General Counsel and Corporate Secretary;
- (c) Bird, the CFO of ESL from 1991 to 2002, who became a board member and the CFO of Sears Hometown and Outlet Stores, Inc., an important Sears Holdings subsidiary; and
- (d) Jeffrey Stollenwerck ("Stollenwerck"), a Vice President at ESL, who became Senior Vice President and then President of Sears Holdings' real estate business.

31. Over the last several years, Sears Holdings has closed hundreds of Kmart and Sears stores and laid off thousands of employees. On October 15, 2018, Sears Holdings filed for bankruptcy protection under Chapter 11 of the U.S. Bankruptcy Code.

32. By 2013, Sears Canada was an independent public company and was no longer a Canadian operating subsidiary of Sears Holdings.

Lampert's Involvement in the Operations of Sears Canada

33. As he had at Sears Holdings, Lampert took a direct role in developing Sears Canada's business strategy.

34. The ESL Parties had significant direct shareholdings in Sears Canada. As of November 2013, the ESL Parties beneficially owned more than 28.1 million Sears Canada shares, amounting to 27.6% of its outstanding shares.

35. Lampert influenced the appointment of Sears Canada's management, including its chief executive officers. This included the appointment of Bird, a former ESL executive.

36. Crowley was appointed as the Chairman of the Board of Sears Canada in 2006, and Harker became a director in 2008. Bird was appointed as a Sears Canada director from 2006 to November 13, 2013, when he resigned from the Board but stayed on as the company's CFO.

Sears Canada's Financial and Operational Problems

37. Between 2011 and 2013, Sears Canada suffered aggregate operating losses of more than \$310 million.

38. As early as September 2011, the company's 2011-2014 Strategic Plan (the "**Strategic Plan**") explained that "Sears Canada requires a full transformation to be able to compete and win in the increasingly competitive Canadian retail environment."

39. Management provided the Board with regular updates on Sears Canada's operations, including the progress of the Strategic Plan. A March 2012 presentation to the Board noted that:

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“Customer and employee perceptions have been in decline, yet to find bottom”, “Sears is ... failing to connect with the next generation”, and “[we h]ave underinvested recently in stores”.

40. In September 2013, Sears Canada’s CEO, Calvin McDonald (“**McDonald**”), resigned. McDonald later told the press that he had left in frustration at not being able to take the steps necessary to save the company, as a result of Lampert’s refusal to authorize investments in Sears Canada’s business. McDonald stated that “there was not a real long term commitment to save this business”.

41. The minutes of Sears Canada’s September 23, 2013 Board meeting summarize a presentation given by Douglas Campbell, Sears Canada’s then-COO, which noted that “At current trends, the projection for 2016 EBITDA will be -\$105 million”, and that sales “continue to decline across the business at 2.6%”. Campbell joined the Board the following day.

42. At the same meeting, the Board received a presentation on the Strategic Plan, which explained that the company’s e-commerce system was “seriously substandard”, and advised that “To catch competitors, significant investment and transformation is required.”

43. By October 2013, the Board was well aware of the problems facing Sears Canada and that its long term viability was at risk. In the circumstances, it was obvious to the Board that Sears Canada urgently needed capital to invest in its business or to preserve value to satisfy its rapidly growing losses and liabilities.

44. However, instead of investing in Sears Canada’s business or preserving value to fund liabilities and increasing losses, the Former Directors authorized a plan under which the company sold off its most lucrative assets and sent the proceeds directly to its shareholders.

The Dividend Plan

ESL's Need for Liquidity to Satisfy Redemptions

45. In 2012, ESL received a large number of redemption requests from its investors. These requests totaled approximately \$3.5 billion (US), an amount equal to more than half of ESL's total assets under management at the time. The redemptions were payable in 2013.

46. ESL did not have sufficient cash on hand to satisfy its investors' demands. As a result, it was forced to liquidate significant portions of its portfolio and to pay in-kind redemptions, made up of shares of the companies it owned.

47. To help ESL fund the redemptions, Lampert devised a plan to cause Sears Canada to make a large dividend payment, the majority of which would go to the Significant Shareholders. ESL would use the cash it received to fund redemptions, or distribute its Sears Holdings shares, which would be increased in value as a result of the Dividend, to its own investors as in-kind redemptions.

Sale of Sears Canada's Assets

48. As a result of its large operating losses, Sears Canada did not have sufficient cash on hand to fund a large dividend payment. The only way it could raise the necessary funds was to liquidate a number of its "crown jewels": the long-term under-market-value leases for its largest and most lucrative stores.

49. Sears Canada had liquidated many of its assets since being acquired by the ESL Parties in 2005. However, in that context, the 2013 Key Asset Sales were notable for their size and impact on Sears Canada's operations.

50. Over the course of 2013, Sears Canada sold seven of its most valuable leases for approximately \$591 million. The sales were carried out in two transactions:

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- (a) the sale of two leases – at the Yorkdale Shopping Centre in Toronto and the Square One Mall in Mississauga – to Oxford Properties Group in June 2013 for \$191 million; and
- (b) the sale of five leases – its flagship store in the Toronto Eaton Centre and four other large stores (two in the Greater Toronto Area, and one each in London, Ontario and Richmond, BC) – in November 2013 to Cadillac Fairview Corporation Limited for \$400 million (the “**Cadillac Fairview Sale**”).

51. Sears Canada also reached an agreement, in early November 2013, to sell its 50% interest in a group of eight Quebec shopping centres to Montez Income Properties Corporation for \$315 million. That transaction closed in January 2014.

52. Lampert played a direct role in negotiating the Key Asset Sales, even though he was not a director or an officer of Sears Canada. He provided direct instructions to Sears Canada on the price sought by Sears for the Key Asset Sales. Among other things, Lampert personally directed the negotiation strategy in connection with the Cadillac Fairview Sale. Stollenwerck, a senior executive at Sears Holdings’ real estate division and a former ESL employee, was the primary negotiator for Sears Canada, even though he was not a Sears Canada employee.

53. The Former Directors and Bird knew that the Key Asset Sales would significantly reduce Sears Canada’s earnings capacity, since the stores being closed were some of the company’s most valuable locations. A presentation to the Board (which at the time included Bird) at its September 2013 meeting projected a significant loss in earnings as a result of the liquidation of four of the large stores that were ultimately included in the Cadillac Fairview Sale.

The Dividend Proposal

54. At the same time the Cadillac Fairview Sale was closing in November 2013, three former ESL employees – Bird, Crowley, and Harker – worked to finalize the proposal for a large extraordinary dividend. Over the course of the ten-day period from November 8 to 18, 2013, Bird, Crowley and Harker settled on a proposed dividend payment of \$5 per share, or more than \$509 million in total.

55. At the time, the Significant Shareholders owned more than 79% of Sears Canada's outstanding shares, and therefore stood to receive a total of approximately \$402 million from a \$5 per share Dividend.

Lack of Notice and Undue Haste

56. The Cadillac Fairview Sale closed on Tuesday, November 12, 2013. The Dividend was approved at a board meeting held less than a week later, on the following Monday and Tuesday, November 18-19, 2013.

57. No information about or notice of the proposed Dividend was provided to the Board by Sears Canada's management in the lead-up to the meeting. Indeed, the Dividend was not even referred to in the agenda for the November 2013 Meeting.

58. Approval of the Dividend was treated as a foregone conclusion by Bird, Crowley and Harker. Although, as discussed below, the Board was not presented with any financial analysis of the Dividend, the minutes of the November 2013 Meeting note that the Board was “presented [with] a draft press release relating to the dividend” at the beginning of their discussion.

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59. Notwithstanding the fact they did not receive adequate notice of the proposed Dividend before being asked to vote on it, the Former Directors did not seek any information or advice about the proposal before they approved it.

Insufficient Information Provided to the Board

60. The Board was not given sufficient information to understand the impact of the Dividend, nor did they seek additional information from management.

61. Extensive background materials (the “**Materials**”) were prepared by management and given to the Board before the November 2013 Meeting. However, the Materials did not contain any analysis of the Dividend. In fact, the Materials contained no references to the Dividend at all. The financial and operational plans included with the Materials also omitted any reference to the Dividend and failed to account for the Dividend in their calculations.

62. Even though Crowley, Bird, and Harker had previously undertaken a financial analysis of various Dividend scenarios in the weeks leading up to the declaration of the Dividend, none of their findings were presented to the Board.

63. Without even basic financial information or any professional advice, the Board was not in a position to properly assess the Dividend, even if it had tried or wanted to do so, which it did not.

Lack of Governance Procedures

64. The procedures adopted by Sears Canada’s Board at the November 2013 Meeting were manifestly insufficient for a transaction as large as the Dividend, particularly in light of Sears Canada’s precarious financial and operational position at the time.

65. The Board did not, *inter alia*:

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- (a) seek advice from outside legal counsel;
- (b) commission any analysis from financial, accounting, or other advisors; or
- (c) convene an *in camera* session of the independent directors to discuss the Dividend prior to its approval.

66. The failure to take any of these steps before approving the Dividend differed from the Board's conduct with respect to previous dividends and failed to comply with proper governance procedures.

67. For example, before authorizing the payment of two smaller dividends in 2010, the Board implemented a number of significant governance procedures.

68. In 2010, Sears Canada's management provided the Board with a series of capital structure presentations, which were updated several times. These presentations explained the benefits and risks of returning capital to the Company's shareholders and included both extensive financial analysis and in-depth discussions of potential alternatives.

69. The proposed 2010 dividends were discussed during at least five separate board meetings between April and September 2010. The independent directors held an *in camera* meeting to discuss the dividend, and asked outside counsel to attend and provide information on the implications of the payment of an extraordinary dividend, as well as other potential options for use of the company's capital.

70. In November 2013, despite Sears Canada's far worse financial and operational situation, the Board did not conduct *any* of this due diligence. Instead, it approved the Dividend proposed

by Lampert's representatives in management and on the Board without any analysis of the implications to the company itself, or its minority shareholders, employees, creditors, or other stakeholders.

Sears Canada's Board Rubber-Stamps the Dividend Payment

71. After authorizing the liquidation of its most valuable assets, the Board failed to ensure that the proceeds were used for Sears Canada's benefit or to ensure that sufficient value would be available to satisfy creditor claims that would continue to accumulate as losses increased.

72. To the contrary, the Former Directors, almost immediately and without scrutiny or evaluation, decided to dividend out almost all of the money that Sears Canada earned from the Key Asset Sales.

73. The Former Directors could not have reasonably concluded that the Dividend was in Sears Canada's best interest based on the extremely limited information available to them at the time they approved the Dividend. Indeed, the Dividend was not in Sears Canada's best interest. By approving the Dividend, the Former Directors breached their common law and statutory obligations to Sears Canada.

Effects of the Dividend

74. Payment of the Dividend caused serious harm to Sears Canada and its stakeholders.

75. The funds used to pay the Dividend were derived from the sale of leases for some of Sears Canada's largest and best-performing stores, which were located in some of Canada's most densely populated areas. These divestments brought about a significant decline in Sears Canada's revenue-generation capacity without any corresponding long-term investment in its operations.

76. The main beneficiaries of the Dividend were Sears Holdings, ESL, and Lampert. Sears Canada did not receive any benefit from the Dividend.

77. After three more years of enormous losses, Sears Canada became insolvent in 2017. It has since liquidated all of its remaining inventory and assets and closed all of its stores. Sears Canada's liquidation has cost more than 15,000 employees their jobs, and has left its creditors with hundreds of millions of dollars in uncollectable debts.

The CCAA Proceeding

78. On June 22, 2017, Sears Canada and a number of its affiliates commenced the *CCAA* Proceeding.

79. Although the existence of the Dividend was known at the time it was paid, prior to the commencement of the *CCAA* Proceeding, the circumstances surrounding the Board's authorization of and the ESL Parties' involvement in the Dividend were not known to anyone other than Sears Canada's senior management and directors, and the Significant Shareholders.

80. These facts, including Lampert's involvement in the sale of the real estate assets, the non-independent Directors' role in the plan to declare the Dividend, and the absence of information and manifestly inadequate governance procedure at the November 2013 Meeting, were not known and were only uncovered after the *CCAA* Proceeding commenced.

The Claims

81. The facts surrounding the authorization and payment of the Dividend give rise to a number of claims by Sears Canada against the Former Directors, Bird, and the ESL Parties.

The Former Directors and Bird: Breaches of Duties and Oppression

82. The Former Directors breached their common law and statutory duties of care and fiduciary duties by:

- (a) authorizing the Dividend in circumstances where it was not in the best interests of Sears Canada, thereby favouring the interests of the Significant Shareholders over those of the company and its other stakeholders; and
- (b) failing to exercise the care, diligence and skill that a reasonably prudent person would have exercised in comparable circumstances by, among other things, neglecting to obtain any information or professional advice about the impact on the business of Sears Canada in paying the Dividend, or in the alternative investing the \$509 million into its business or preserving this value to satisfy liabilities, before agreeing to authorize it.

83. Although Bird was not a director of Sears Canada at the time the November 2013 Meeting was held, he had been a director until immediately prior to the meeting. Bird attended the November 2013 Meeting in his capacity as chief financial officer of Sears Canada, and as such, he continued to owe fiduciary duties and a duty of care and loyalty to Sears Canada after his resignation from the Board.

84. Bird breached the duties he owed to Sears Canada by:

- (a) proposing the Dividend in circumstances where the Dividend was not in the best interests of Sears Canada;
- (b) proposing the Dividend for the benefit of the Significant Shareholders;

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- (c) preparing and planning for the distribution of the Dividend without providing adequate information to the Board, in the hope that the Dividend would be declared by the Board;
- (d) withholding relevant financial information from the Former Directors that they required to properly analyze the merits of the Dividend, including information about Sears Canada's pension deficit; and
- (e) proposing and recommending the Dividend and then resigning from the Board before the November 2013 Meeting.

85. As a result of the breaches referred to in paragraphs 82 to 84 above, Sears Canada seeks to unwind the Dividend and seeks damages against the Former Directors and Bird in the amount of \$509 million.

86. Further, the Former Directors and Bird acted in an oppressive manner towards Sears Canada by:

- (a) disregarding the reasonable expectation of Sears Canada that their powers would be used for the benefit of the company, rather than for that of third parties like the Significant Shareholders; and
- (b) using their powers to authorize the Dividend, which was unfairly prejudicial to and disregarded the interests of Sears Canada and its creditors.

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87. It is appropriate for Sears Canada, by way of its Litigation Trustee, to be the complainant for an oppression claim on its own behalf and on behalf of its creditors, who are all similarly affected by the oppressive conduct described above.

88. As a result of the Former Directors' and Bird's oppression Sears Canada seeks an Order:

- (a) declaring that the Former Directors and Bird, breached their duties owed to Sears Canada;
- (b) setting aside the Dividend; and
- (c) ordering the Former Directors and Bird to pay damages to Sears Canada on a joint and several basis in the amount of \$509 million.

89. An order setting aside the Dividend, imposing a constructive trust over those funds, and/or ordering compensatory payments in the same amount would remedy the Former Directors' and Bird's oppression and return to Sears Canada the funds that rightly belong to it, for the ultimate benefit of its creditors.

The ESL Parties: Inducing Breaches of Duties; Knowing Assistance, Knowing Receipt, and Unjust Enrichment

90. The ESL Parties knowingly induced, encouraged, assisted and participated in the Former Directors' and Bird's breaches of fiduciary duty. They knew of the fiduciary duties the Former Directors and Bird owed to Sears Canada, and that the Dividend would harm Sears Canada. The ESL Parties nonetheless influenced and encouraged the Former Directors to authorize the Dividend for the ESL Parties' own benefit.

91. But for the ESL Parties' inducement of and their assistance given to the Formers Directors' and Bird's breaches of their fiduciary duties to Sears Canada, those defendants would not have been put in circumstances where the breach of their duties in this manner was possible.

92. The ESL Parties knowingly assisted the Former Directors and Bird to take the wrongful step of authorizing and encouraging the Dividend, which resulted in prejudice to Sears Canada's rights, in circumstances where there was no right in the circumstances for the Former Directors and Bird to take such steps.

93. The ESL Parties are liable to Sears Canada for damages in the amount of \$509 million for inducing breaches of fiduciary duties and knowing assistance in the Former Directors' and Bird's breaches of their duties.

94. In the alternative, the ESL Parties are liable for disgorgement in the amount of \$140.8 million for knowingly receiving the proceeds of the Former Directors' and Bird's breaches of fiduciary duty.

95. In addition, or in the further alternative, the ESL Parties were unjustly enriched by receiving \$140.8 million by way of the Dividend in circumstances where it should not have been approved. The Dividend was paid gratuitously as a benefit to the ESL Parties, and caused a corresponding deprivation to Sears Canada. There was no juristic reason for the ESL Parties to receive the Dividend.

96. The appropriate remedy for the ESL Parties' unjust enrichment is the imposition of a constructive trust in favour of Sears Canada over the portion of the Dividend received by them.

Conspiracy By All Defendants

97. All of the Defendants acted together to generate the funds for and authorize the Dividend to the benefit of the Significant Shareholders and to the detriment of Sears Canada. This was unlawfully carried out through the Former Directors' and Bird's breaches of the duty of care, fiduciary duties, and oppressive conduct, as planned and directed by the ESL Parties. This conduct was directed at Sears Canada in circumstances where the Defendants knew, or ought to have known, that damage to Sears Canada would result.

98. The Defendants knew, or ought to have known, that it was not in the best interests of Sears Canada to distribute over half a billion dollars to its shareholders at a time when capital needed to be re-invested in the corporation to arrest its decline or to preserve value to satisfy liabilities. Instead, the distribution of the extraordinary revenues generated by the Key Asset Sales to shareholders accelerated Sears Canada's decline, thereby damaging its interests in the short-, medium-, and long-term, and ensured that \$509 million did not remain to satisfy increasing liabilities.

99. The Defendants are liable to Sears Canada for damages in the amount of \$509 million for conspiracy.

Service *Ex Juris*, Statutes Relied Upon, and Location of Trial

100. The Plaintiff is entitled to serve any Defendants who reside outside Ontario without a court order because this claim relates to a tort committed in Ontario, and because the Defendants carried on business in Ontario.

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101. The plaintiff pleads and relies upon the *Canada Business Corporations Act*, R.S.C. 1985, c. C-44, sections 122, 238, and 241 and Rules 17(g) and 17(p) of the *Rules of Civil Procedure*, R.R.O. 1990, Reg. 194.

102. The plaintiff proposes that this action be tried in the City of Toronto.

December 19, 2018

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J. DOUGLAS CUNNINGHAM, Q.C.

Plaintiff

-and- ESL INVESTMENTS INC., et al.

Defendants

CV-18-0061121400CL

Court File No.

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

PROCEEDING COMMENCED AT
TORONTO

STATEMENT OF CLAIM

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Tab 3

**ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST**

B E T W E E N:

SEARS CANADA INC., by its Court-appointed Litigation Trustee,
J. DOUGLAS CUNNINGHAM, Q.C.

Plaintiffs

and

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

Defendants

DEMAND FOR PARTICULARS

The defendants Edward S. Lampert, ESL Investments Inc., ESL Partners, LP, SPE I Partners, LP, SPE Master I, LP, and ESL Institutional Partners, LP demand particulars of the following allegations in your statement of claim:

1. With respect to the relief requested in paragraph 1(d), namely a “declaration that the authorization and payment of the Dividend was oppressive and unfairly disregarded and was prejudicial to the interests of Sears Canada and its stakeholders”, identify:
 - (a) the “stakeholders” whose interests were allegedly oppressed; and
 - (b) the category of security holder, creditor, director, or officer into which each stakeholder fits.

2. With respect to the allegation in paragraph 86 that the “Former Directors and Bird acted in an oppressive manner towards Sears Canada by [...] using their powers to authorize the Dividend, which was unfairly prejudicial to and disregarded the interests of Sears Canada and its creditors”:

- (a) identify the dates on which the alleged acts of oppression occurred;
- (b) identify the “creditors” whose interests were prejudiced and unfairly disregarded;
- (c) of those creditors referred to in paragraph 2(b) of this demand for particulars, identify those creditors whose claims were unpaid at the date or dates that the alleged acts of oppression occurred; and
- (d) of those creditors referred to in paragraph 2(c) of this demand for particulars, identify those creditors whose claims remain unpaid.

3. With respect to the allegation in paragraph 86 that the “Former Directors and Bird acted in an oppressive manner towards Sears Canada by [...] using their powers to authorize the Dividend, which was unfairly prejudicial to and disregarded the interests of Sears Canada and its creditors”, identify:

- (a) the expectations of the “creditors” that are alleged to have been violated; and
- (b) the interests of the “creditors” that are alleged to have been unfairly prejudiced and unfairly disregarded.

4. With respect to the allegation in paragraph 87 that “[i]t is appropriate for Sears Canada, by way of its Litigation Trustee, to be the complainant of an oppression claim on its own behalf and on behalf of its creditors”:

- (a) identify the “creditors” of Sears Canada on whose behalf the Litigation Trustee acts as complainant;
- (b) specify whether the creditors referred to in paragraph 4(a) of this demand for particulars are the same as the creditors referred to in paragraph 2(d) of this demand for particulars; and
- (c) to the extent that there is a difference in membership between the class of creditors referred to in paragraph 2(d) of this demand for particulars and the class of creditors referred to in paragraph 4(a) of this demand for particulars, identify the creditors that fall exclusively into each class.

5. With respect to the allegation in paragraph 89 that “setting aside the Dividend [...] would remedy the Former Directors' and Bird's oppression and return to Sears Canada the funds that rightly belong to it, for the ultimate benefit of its creditors”:

- (a) identify the “creditors” of Sears Canada who will benefit from the return of the 2013 dividend funds to the estate of Sears Canada;
- (b) specify whether the creditors referred to in paragraph 5(a) of this demand for particulars are the same as the creditors referred to in paragraph 2(d) of this demand for particulars; and
- (c) to the extent that there is a difference in membership between the class of creditors referred to in paragraph 2(d) of this demand for particulars and the class of creditors referred to in paragraph 5(a) of this demand for particulars, identify the creditors that fall exclusively into each class.

January 18, 2019

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LP, SPE I Partners, LP, SPE Master I, LP, and
ESL Institutional Partners, LP

TO: The Litigation Service List

SEARS CANADA INC. by its litigation trustee
J. DOUGLAS CUNNINGHAM, Q.C..

-and- ESL INVESTMENTS INC., et al.

Plaintiffs

Defendants

Court File No. CV-18-00611214-00CL

**ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)**

PROCEEDING COMMENCED AT
TORONTO

DEMAND FOR PARTICULARS

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Master I, LP, and ESL Institutional Partners, LP

Tab 4

Court File No. CV-18-00611214-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE

B E T W E E N:

SEARS CANADA INC., by its Court-appointed Litigation Trustee,
J. Douglas Cunningham, Q.C.

Plaintiff

and

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

Defendants

RESPONSE TO DEMAND FOR PARTICULARS

The Plaintiff provides the following particulars in response to the defendants', Edward S. Lampert, ESL Investments Inc., ESL Partners, LP, SPE I Partners, LP, SPE Master I, LP, and ESL Institutional Partners, LP, Demand for Particulars, dated January 18, 2019:

1. **Particular(s) Requested:** With respect to the relief requested in paragraph 1(d), namely a "declaration that the authorization and payment of the Dividend was oppressive and unfairly disregarded and was prejudicial to the interests of Sears Canada and its stakeholders", identify:

- (a) the "stakeholders" whose interests were allegedly oppressed; and
- (b) the category of security holder, creditor, director, or officer into which each stakeholder fits.

1.1(a) **Response:** The stakeholders whose interests were oppressed by the authorization and payment of the 2013 Dividend are all of Sears Canada's stakeholders, including its creditors, landlords, employees, pensioners, and the holders of its securities (excluding the Significant Shareholders, as defined in the Statement of Claim) (collectively, the "Stakeholders").

1.1(b) **Response:** The categories into which the Stakeholders fit are set out in Response 1.1(a).

2. **Particular(s) Requested:** With respect to the allegation in paragraph 86 that the "Former Directors and Bird acted in an oppressive manner towards Sears Canada by [...] using their powers to authorize the Dividend, which was unfairly prejudicial to and disregarded the interests of Sears Canada and its creditors":

- (a) identify the dates on which the alleged acts of oppression occurred;
- (b) identify the "creditors" whose interests were prejudiced and unfairly disregarded;
- (c) of those creditors referred to in paragraph 2(b) of this demand for particulars, identify those creditors whose claims were unpaid at the date or dates that the alleged acts of oppression occurred; and
- (d) of those creditors referred to in paragraph 2(c) of this demand for particulars, identify those creditors whose claims remain unpaid.

2.1(a) **Response:** The oppressive conduct took place in later 2013, and in particular in November 2013 and early December 2013. Other than the dates of the November 2013 Board

Meeting, as alleged in paragraph 56 of the Statement of Claim, the precise dates on which oppressive conduct took place are known to the Defendants but not the Plaintiffs.

2.1(b) **Response:** The creditors referred to in paragraph 86(b) are all of the Stakeholders of Sears Canada.

2.1(c) **Response:** See above. If appropriate, further information may be provided as part of the discovery process.

2.1(d) **Response:** See above. This question is not relevant and in any event the requested information is not necessary for the Defendants to plead. If appropriate, further information will be provided as part of the discovery process.

3. Particular(s) Requested: With respect to the allegation in paragraph 86 that the “Former Directors and Bird acted in an oppressive manner towards Sears Canada by [...] using their powers to authorize the Dividend, which was unfairly prejudicial to and disregarded the interests of Sears Canada and its creditors”, identify:

- (a) the expectations of the “creditors” that are alleged to have been violated; and
- (b) the interests of the “creditors” that are alleged to have been unfairly prejudiced and unfairly disregarded.

3.1(a) **Response:** The creditors reasonably expected that the power of Sears Canada’s directors would be exercised: (i) in the best interests of the company, rather than in a way that favoured the interests of the Significant Shareholders; and (ii) in such a way as to preserve capital

for the use of Sears Canada and its business or to satisfy obligations to Stakeholders rather than diverting it to the company's shareholders.

3.1(b) **Response:** The interests of the creditors included Sears Canada's ability to satisfy the obligations and debts owed to the Stakeholders or that would be owing to them by Sears Canada and the preservation of capital for that purpose.

4. Particular(s) Requested: With respect to the allegation in paragraph 87 that "[i]t is appropriate for Sears Canada, by way of its Litigation Trustee, to be the complainant of an oppression claim on its own behalf and on behalf of its creditors":

- (a) identify the "creditors" of Sears Canada on whose behalf the Litigation Trustee acts as complainant;
- (b) specify whether the creditors referred to in paragraph 4(a) of this demand for particulars are the same as the creditors referred to in paragraph 2(d) of this demand for particulars; and
- (c) to the extent that there is a difference in membership between the class of creditors referred to in paragraph 2(d) of this demand for particulars and the class of creditors referred to in paragraph 4(a) of this demand for particulars, identify the creditors that fall exclusively into each class.

4.1(a) **Response:** The creditors referred to in paragraph 87 are the Stakeholders.

4.1(b) **Response:** The creditors referred to in paragraph 87 are the Stakeholders.

4.1(c) **Response:** This question is not applicable.

5. Particular(s) Requested: With respect to the allegation in paragraph 89 that “setting aside the Dividend [...] would remedy the Former Directors’ and Bird’s oppression and return to Sears Canada the funds that rightly belong to it, for the ultimate benefit of its creditors”:

- (a) identify the “creditors” of Sears Canada who will benefit from the return of the 2013 dividend funds to the estate of Sears Canada;
- (b) specify whether the creditors referred to in paragraph 5(a) of this demand for particulars are the same as the creditors referred to in paragraph 2(d) of this demand for particulars; and
- (c) to the extent that there is a difference in membership between the class of creditors referred to in paragraph 2(d) of this demand for particulars and the class of creditors referred to in paragraph 5(a) of this demand for particulars, identify the creditors that fall exclusively into each class.

5.1(a) **Response:** The creditors who would benefit from a return to Sears Canada of funds owed to it are all of the unsecured creditors of Sears Canada.

5.1(b) **Response:** The creditors referred to in paragraph 89 are the Stakeholders.

5.1(c) **Response:** This question is not applicable.

January 31, 2019

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SEARS CANADA INC., by its Court-appointed Litigation Trustee, J. Douglas Cunningham, Q.C.
Plaintiff

-and- ESL INVESTMENTS INC. et al.
Defendants

Court File No. CV-18-00611214-00CL

**ONTARIO
SUPERIOR COURT OF JUSTICE**

PROCEEDING COMMENCED AT
TORONTO

RESPONSE TO DEMAND FOR PARTICULARS

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Lawyers for the Plaintiff

Tab 5

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

**ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)**

BETWEEN :

MORNEAU SHEPELL LTD. in its capacity as administrator of the
Sears Canada Inc. Registered 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

Defendants



STATEMENT OF CLAIM

A LEGAL PROCEEDING HAS BEEN COMMENCED AGAINST YOU by the plaintiff. The claim made against you is set out in the following pages.

IF YOU WISH TO DEFEND THIS PROCEEDING, you or an Ontario lawyer acting for you must prepare a statement of defence in Form 18A prescribed by the *Rules of Civil Procedure*, serve it on the plaintiff's lawyer or, where the plaintiff does not have a lawyer, serve it on the plaintiff, and file it, with proof of service, in this court office, WITHIN TWENTY DAYS after this statement of claim is served on you, if you are served in Ontario.

If you are served in another province or territory of Canada or in the United States of America, the period for serving and filing your statement of defence is forty days. If you are served outside Canada and the United States of America, the period is sixty days.

Instead of serving and filing a statement of defence, you may serve and file a notice of intent to defend in Form 18B prescribed by the *Rules of Civil Procedure*. This will entitle you to ten more days within which to serve and file your statement of defence.

IF YOU FAIL TO DEFEND THIS PROCEEDING, JUDGMENT MAY BE GIVEN AGAINST YOU IN YOUR ABSENCE AND WITHOUT FURTHER NOTICE TO YOU. IF YOU WISH TO DEFEND THIS PROCEEDING BUT ARE UNABLE TO PAY LEGAL FEES, LEGAL AID MAY BE AVAILABLE TO YOU BY CONTACTING A LOCAL LEGAL AID OFFICE.

TAKE NOTICE: THIS ACTION WILL AUTOMATICALLY BE DISMISSED if it has not been set down for trial or terminated by any means within five years after the action was commenced unless otherwise ordered by the court.

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Ray Williams, Registrar

Date: December 19, 2018

Issued by


Local registrarAddress of 330 University Avenue
court office 7th Floor
Toronto, Ontario M5G 1R7TO: ESL INVESTMENTS INC., ESL PARTNERS, LP, SPE I PARTNERS, LP,
SPE MASTER I, LP, ESL INSTITUTIONAL PARTNERS, LP and
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- 4 -

AND A
COURTESY
COPY TO:

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CLAIM

1. The Plaintiff, Morneau Shepell Ltd. ("**Morneau**") in its capacity as administrator of the Sears Canada Inc. Registered Pension Plan (the "**Plan**") claims:

- (a) Damages at law and in equity payable jointly and severally in the amount of the deficiency in the Plan as determined in the actuarial wind up report, which at present is estimated at approximately \$260 million:
- (i) as against the Defendants William Harker, William Crowley, Donald Campbell Ross, Deborah E. Rosati, R. Raja Khanna, James McBurney and Douglas Campbell (collectively the "**Director Defendants**") and Ephraim J. Bird for breach of fiduciary duty and negligence;
 - (ii) as against the Director Defendants and Ephraim J. Bird for inducing Sears Canada Inc. ("**Sears Canada**") and the other Director Defendants to breach their fiduciary duties and/or for knowingly assisting Sears Canada and the other Director Defendants in breaching such fiduciary duties;
 - (iii) as against the Defendants ESL Investments Inc., ESL Partners, LP, SPE I Partners, LP, SPE Master I, LP, ESL Institutional Partners, LP, and Edward S. Lampert for inducing Sears Canada, Ephraim J. Bird and/or the Director Defendants to breach their fiduciary duties and/or for knowingly assisting Sears Canada, Ephraim J. Bird and/or the Director Defendants in breaching such fiduciary duties;
- (b) a declaration that the Defendants ESL Investments Inc., ESL Partners, LP, SPE I Partners, LP, SPE Master I, LP, ESL Institutional Partners, LP, Edward S. Lampert, William Harker, Deborah Rosati, R. Raja Khanna and James McBurney

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(collectively the "**Shareholder Defendants**") received directly or indirectly the 2013 Dividend (as defined below) with knowledge that such payment was the result of a breach of fiduciary duty by Sears Canada, Ephraim J. Bird and/or the Director Defendants and an order imposing a constructive trust on the assets of each such Shareholder Defendant equal to the value of the dividend payments directly or indirectly received by them and an order requiring such amount be remitted to the Plaintiff for the benefit of the Plan beneficiaries;

- (c) a declaration that the authorization and payment of the 2013 Dividend was oppressive and unfairly prejudicial to the interests of the Plan and its beneficiaries and unfairly disregarded their interests and orders pursuant to section 241 of the *Canada Business Corporations Act* (the "**CBCA**") setting aside the declaration and payment of the 2013 Dividend and/or requiring the Defendants to pay to the Plaintiff as compensation or restitution the amount required to fully fund the benefits promised under the Plan;
- (d) punitive and exemplary damages;
- (e) pre and post-judgment interest in accordance with the *Courts of Justice Act*; and
- (f) costs of this action on a substantial indemnity basis.

The Parties

2. The Superintendent of Financial Services for Ontario (the "**Superintendent**") has declared that Ontario's Pension Benefits Guarantee Fund (the "**PBGF**") applies to the Plan in respect of Ontario Plan beneficiaries. As a result, to the extent of any payment out of the PBGF into the Plan, the Superintendent has rights of subrogation in respect of the claims outlined herein. The PBGF is administered by the Superintendent. Subject to Plan recoveries from the Sears

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Canada estates, the PBGF expects its contribution to the Plan to be material. As a result, the PBGF expects its subrogation rights in respect of these claims to be material.

3. Sears Canada is a corporation incorporated pursuant to the CBCA. Sears Canada and its affiliate companies obtained protection under the *Companies' Creditors Arrangements Act* (the "**CCAA**") on June 22, 2017.

4. The Plaintiff was appointed administrator of the Plan by the Superintendent effective October 16, 2017.

5. The Defendant ESL Investments Inc. ("**ESL Investments**") is a privately-owned hedge fund incorporated under the laws of Delaware. The Defendants ESL Partners, LP, SPE I Partners, LP, SPE Master I, LP, ESL Institutional Partners, LP (collectively, and together with ESL Investments, "**ESL**") are affiliates of ESL Investments.

6. The Defendant Edward S. Lampert ("**Lampert**") is an individual residing in Indian Creek, Florida. At all material times, Lampert controlled ESL, and has served as ESL Investments' Chairman and Chief Executive Officer since its creation in 1988.

7. The Director Defendants William Crowley, William Harker, Donald Campbell Ross, Deborah E. Rosati, R. Raja Khanna, James McBurney and Douglas Campbell were directors of Sears Canada at the time the 2013 Dividend was approved by the Sears Canada board of directors (the "**Board**").

8. The Defendant Ephraim J. Bird ("**Bird**") was a member of the Board until on or around November 13, 2013 and was at all material times the Chief Financial Officer of Sears Canada.

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9. At all material times, including from November 18, 2013 through to December 6, 2013, Lampert and ESL held a controlling ownership interest in Sears Holdings Corporation (“Holdings”) and beneficially owned 55% of Holdings’ outstanding shares. In turn, at all material times, Holdings held a controlling ownership interest in Sears Canada. On October 15, 2018, Holdings filed for Chapter 11 protection from creditors with the United States Bankruptcy Court. Holdings is not a party to this action.

10. At all material times, including from November 18, 2013 through to December 6, 2013, Holdings and each of the Shareholder Defendants was a direct or beneficial shareholder of Sears Canada, and held the following ownership interests:

- (a) Holdings beneficially owned 51,962,391 shares in Sears Canada, representing approximately 51% of the outstanding shares.
- (b) ESL beneficially owned 17,725,280 shares in Sears Canada, representing approximately 17.4% of the outstanding shares, which were directly held as follows:
 - (i) ESL Partners, LP: 15,821,206 shares;
 - (ii) SPE I Partners, LP: 830,852 shares;
 - (iii) SPE Master I, LP: 1,068,522 shares;
 - (iv) ESL Institutional Partners, LP: 4,381 shares; and
 - (v) CRK Partners, LLC (an affiliate of ESL Investments that was voluntarily cancelled effective June 1, 2018 and is not a party to these proceedings): 319 shares;

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- (c) Lampert owned 10,433,088 shares in Sears Canada, representing approximately 10.2% of the outstanding shares;
- (d) William Harker owned 4,604 shares in Sears Canada;
- (e) Deborah E. Rosati owned 2,600 shares in Sears Canada;
- (f) James McBurney owned 1,525 shares in Sears Canada; and
- (g) R. Raja Khanna owned 2,620 shares in Sears Canada.

The Plan

11. The Plan is a registered pension plan under the *Pension Benefits Act* (Ontario) which contains a defined benefit component. Sears Canada is the principal participating employer in the Plan and is obliged to make contributions to the Plan fund sufficient to ensure that the Plan fund has enough assets to pay all promised defined benefits when due.

12. Until October 16, 2017, Sears Canada was the administrator of the Plan and, as such, owed fiduciary duties to the Plan and the Plan beneficiaries.

13. In administering the Plan, Sears Canada acted through its officers and Board. These individuals (including the Director Defendants and Bird) also owed fiduciary duties and a duty of care to the Plan and the Plan beneficiaries.

14. Since at least 2010, Sears Canada and its directors have been aware of actuarial valuations disclosing that the assets held in respect of the defined benefit component of the Plan were insufficient to pay all of the promised defined benefits and that further employer contributions to the Plan fund were required in order to permit all promised benefits to be paid to Plan beneficiaries when due. To the knowledge of Sears Canada, Bird and the Director Defendants,

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as at December 31, 2010, the Plan had a funding deficit of \$68,039,000, a solvency deficit of \$205,788,000 and a wind-up deficit of \$307,330,000.

15. During the period subsequent to December 31, 2010, Sears Canada made only the minimum contributions to the Plan fund permitted by law, even after Sears Canada, Bird and the Director Defendants knew or ought to have known that that the long-term viability of Sears Canada, and thus its ability to fully fund the Plan liabilities from future revenues, was at serious risk.

16. The Plan was wound up by order of the Superintendent effective October 1, 2017 and the Plan's wind-up deficit which crystalized on that date is currently estimated at approximately \$260 million.

17. The assets available for distribution under the CCAA to meet all of Sears Canada outstanding obligations including its obligation to fully fund the Plan's wind-up deficit is estimated to be only approximately \$155 million. Excluding claims relating to the Plan's wind-up deficit, the claims of unsecured creditors against Sears Canada total approximately \$1.5 billion.

2013 Plan to Dispose of Real Estate Assets to Fund Dividends

18. Beginning in 2011, Sears Canada's financial performance began to decline sharply.

19. By 2013, ESL Investments and Lampert had an immediate need for cash from Sears Canada. ESL Investments had raised money from investors years earlier on terms that precluded these investors from redeeming their investment for a period of time. When this holding period had expired in 2013, these investors were entitled to withdraw funds and ESL Investments faced significant redemptions.

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20. In order to satisfy its redemption obligations, ESL and Lampert devised a plan to extract cash from Sears Canada through (a) the disposition of its most valuable real estate assets, and (b) the payment of an extraordinary dividend for the benefit of ESL and Lampert (collectively the "**Monetization Plan**").

21. To give effect to the Monetization Plan, Lampert personally directed the disposition of Sears Canada's real estate assets in 2013.

22. In accordance with the Monetization Plan:

- (a) Sears Canada entered into an agreement with Oxford Properties Group on or about June 14, 2013 to terminate Sears Canada's leases at Yorkdale Shopping Centre and Square One Mississauga in exchange for a payment to Sears Canada of \$191 million (the "**Oxford Terminations**"). The Oxford Terminations closed June 24, 2013.
- (b) Sears Canada pursued an agreement with Cadillac Fairview Corporation Limited (Cadillac Fairview) to terminate five additional high-value leases (Toronto Eaton Centre, Sherway Gardens, Markville Shopping Centre, Masonville Place and Richmond Centre) (the "**Cadillac Terminations**") for a payment of \$400 million. The Cadillac Terminations were approved by the Sears Canada Board on October 28, 2013 and closed on November 12, 2013.
- (c) Sears Canada negotiated the sale of Sears Canada's 50% interest in eight properties jointly owned with The Westcliff Group of Companies. Sears Canada's 50% interest was sold to Montez Income Properties Corporation in exchange for approximately \$315 million (the "**Montez Sale**"). The Sears Canada Board

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approved the Montez Sale on November 8, 2013 and the sale closed in January 2014.

23. Lampert directed Sears Canada to complete each of the Oxford Terminations, the Cadillac Terminations and the Montez Sale. These dispositions were part of the Monetization Plan and completed in order to provide ESL Investments with funds to address its redemption obligations. The assets disposed of by Sears Canada were its "crown jewels".

24. By September 23, 2013, the Board including Bird had received management presentations directly addressing Sears Canada's deteriorating operational and financial performance which reported that:

- (a) sales continued to decline across Sears Canada's business at a rate of 2.6% per year;
- (b) based on year-to-date current trends (and without appropriately accounting for stores closed in connection with the Monetization Plan), Sears Canada's projected EBITDA by 2016 would be negative \$105 million;
- (c) Sears Canada was struggling operationally: "Basics not fixed"; and
- (d) competition in the Canadian retail space was increasing with Target's entry into the market. Target had opened 68 stores in Canada in the second quarter of 2013 and planned to open a further 124 stores in Canada by year end.

25. By September 23, 2013, the Director Defendants and Bird knew or ought to have known that Sears Canada's business was in decline, that its long-term viability was at risk, and that the divestment of these key assets in 2013 would have a dramatic negative impact on Sears Canada including its ability to fund the Plan. Despite such knowledge, neither Sears Canada nor

the Director Defendants nor Bird took any steps to ensure that the Plan was fully funded and able to satisfy the pension promise made to Plan beneficiaries.

The 2013 Dividend

26. On November 18 and 19, 2013, the Board held an in-person meeting (the "**November Meeting**") which was attended by the Director Defendants and Bird.

27. On November 12, 2013, prior to the November Meeting, the Board including Bird received a financial update on the performance of Sears Canada. Management reported that throughout the first three quarters of the year, Sears Canada had negative net income of \$49 million (\$27 million worse than the same period in 2012) and negative total cash flow of \$26.3 million.

28. On November 14, 2013, the Investment Committee of Sears Canada's Board was presented with material showing an estimated pension plan deficiency on a wind-up basis of \$313 million as at December 2013.

29. The materials provided to the Board and Bird in advance of the November Meeting included two analyst reports which reviewed the financial circumstances of Sears Canada and predicted its eventual failure:

Desjardins Capital Markets Report (October 30, 2013)

As long as consumers do not perceive that Sears Canada is going out of business and desert it, Sears may be able to manage its demise slowly over time, selling prime and non-core assets, and waiting for the elusive purchaser of 60–80 store locations to appear.

CIBC Report (November 4, 2013)

It is possible that SCC will simply operate its way into irrelevance, gradually selling off stores to stem the cash drain. That strategy would likely result in Sears occasionally cutting a special dividend cheque to all shareholders, not the worst way to create shareholder value. But that is dangerous to the

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operations, particularly as the primary, and most profitably flagship stores are vended.

30. During the short pre-dinner discussion on November 18, 2013, the Director Defendants, at the instigation and urging of one or more of them and Bird, unanimously resolved to declare an extraordinary dividend of \$5.00 per common share, for an aggregate dividend payment of approximately \$509 million (the "2013 Dividend").

31. The Director Defendants approved the 2013 Dividend unanimously and without any abstentions despite the fact that they did not have:

- (a) any advance notice that they would be asked to consider an extraordinary dividend at the November Meeting;
- (b) any written materials regarding a proposed dividend or possible dividend structures;
- (c) any written presentation analyzing the impact the proposed dividend would have on Sears Canada including its ability to meet its pension obligations;
- (d) any pro forma assessment of Sears Canada's liquidity and cash flows following the payment of a dividend;
- (e) any management presentation or recommendation on the proposed dividend; or
- (f) any legal advice with respect to their duties in connection with the declaration of a dividend.

32. The Director Defendants approved and/or acquiesced to the 2013 Dividend and Sears Canada paid the 2013 Dividend to satisfy the immediate financial needs of ESL. The 2013

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Dividend was directed by Lampert who was at all times acting in his personal capacity and as the directing mind of ESL and who:

- (a) knew that Sears Canada, Bird and the Director Defendants owed fiduciary duties to the Plan and the Plan beneficiaries;
- (b) knew that the Plan had a large unfunded deficit and that approval and payment of the extraordinary dividend would be contrary to the interests of the Plan beneficiaries; and
- (c) intended that the Director Defendants would approve and Sears Canada would pay the 2013 Dividend without regard to its impact on the Plan or the Plan beneficiaries.

33. The Director Defendants approved and/or acquiesced to the 2013 Dividend and Sears Canada paid said dividend fraudulently and dishonestly for the purpose of benefitting Lampert and ESL and in total disregard to the interests of the Plan and its beneficiaries. When they authorized the 2013 Dividend, the Director Defendants knew or should have known that the dividend would severely prejudice the ability of Sears Canada to satisfy its pension funding obligations.

34. Sears Canada paid the 2013 Dividend on December 6, 2013 and the Shareholder Defendants received the following dividend payments:

- (a) ESL: \$88,626,400;
- (b) Lampert: \$52,165,440;
- (c) William Harker: \$23,020;

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- (d) Deborah E. Rosati: \$13,000;
- (e) James McBurney: \$7,625; and
- (f) R. Raja Khanna: \$13,100.

35. ESL and Lampert also benefited from approximately \$259 million paid to Holdings through the 2013 Dividend.

36. When the Shareholder Defendants received the above payments directly or indirectly from Sears Canada they knew or ought to have known that such payments had been authorized by the Director Defendants and paid by Sears Canada in breach of the fiduciary duties owed by them to the Plan and its beneficiaries. The Shareholder Defendants specifically knew or ought to have known that Sears Canada and the Director Defendants owed fiduciary duties to the Plan fund and the Plan beneficiaries, that the Plan was then seriously underfunded, that the long term viability of Sears Canada was then at risk and that payment of the 2013 Dividend to the Shareholder Defendants would severely prejudice the ability of Sears Canada to satisfy its pension funding obligations.

37. As a result of the 2013 Dividend, Sears Canada has insufficient assets to satisfy its obligation to fully fund all benefits accrued under the Plan with the result that Plan beneficiaries will not receive full payment of the pensions promised in the Plan.

Liability of Defendants

38. In authorizing and/or acquiescing to the 2013 Dividend in the manner and circumstances set out above, without first considering the need of Sears Canada to take steps as Administrator to provide for the Plan to be funded ahead of payments to shareholders and acting on such consideration, each Director Defendant (i) breached the fiduciary duties and duty of care he or she owed the Plan and the Plan beneficiaries and (ii) induced Sears Canada and the other

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Director Defendants to breach the fiduciary duties they owed the Plan and the Plan beneficiaries and/or knowingly assisted Sears Canada and the other Director Defendants in breaching such duties.

39. In instigating and urging the approval and payment of the 2013 Dividend in the manner and circumstances set out above, without first considering the need of Sears Canada to take steps as Administrator to provide for the Plan to be funded ahead of payments to shareholders and acting on such consideration, Bird (i) breached the fiduciary duties and duty of care he owed the Plan and the Plan beneficiaries and (ii) induced Sears Canada and the Director Defendants to breach the fiduciary duties they owed the Plan and the Plan beneficiaries and/or knowingly assisted Sears Canada and the Director Defendants in breaching such duties.

40. In causing the Director Defendants to authorize the 2013 Dividend and in causing Sears Canada to pay such dividend in the manner and circumstances set out above, without first considering and at that time providing for appropriate funding or security for the Plan, the Shareholder Defendants induced the Director Defendants, Bird and Sears Canada to breach the fiduciary duties they owed the Plan and the Plan beneficiaries and/or knowingly assisted the Director Defendants, Bird and Sears Canada in breaching such duties.

41. In receiving directly and indirectly the 2013 Dividend payments in the manner and circumstances set out above, the Shareholder Defendants are in knowing receipt of assets transferred to them in breach of fiduciary duty and were unjustly enriched at the expense of the Plan and its beneficiaries and the Shareholder Defendants are required to account for all amounts so received for the benefit of the Plan beneficiaries.

42. Authorization and payment of the 2013 Dividend in the circumstances set out above was oppressive and unfairly prejudicial to the interests of the Plan and its beneficiaries and unfairly disregarded their interests and require an order pursuant to section 241 of the CBCA

setting aside the declaration and payment of the 2013 Dividend and requiring the Defendants to pay to the Plaintiff by way of compensation or restitution the amount required to fully fund the benefits promised under the Plan.

Service Ex Juris, Statutes Relied Upon, and Location of Trial

43. The Plaintiff relies upon paragraphs (g) and (n) and (p) of Rule 17.02 to serve this claim outside Ontario.
44. The Plaintiff relies upon the CBCA.
45. The Plaintiff proposes that the trial of this matter be heard in Toronto, Ontario.

December 19, 2018

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MORNEAU SHEPELL LTD. in its capacity as administrator and ESL INVESTMENTS INC. et al.

Plaintiff

Defendants

Court File No.:

CU-18-00611217-00CL

**ONTARIO
SUPERIOR COURT OF JUSTICE**

Proceeding commenced at Toronto

STATEMENT OF CLAIM

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Plaintiff

-and- ESL INVESTMENTS INC. et al.
Defendants

Court File No. CV-18-00611214-00CL

**ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST**

PROCEEDING COMMENCED AT
TORONTO

**MOTION RECORD OF THE ESL PARTIES
(Motion To Strike Returnable April 17-18, 2019)**

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