

SUPERIOR COURT OF JUSTICE – ONTARIO

- COMMERCIAL LIST

RE: IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*,
R.S.C. 1985, c. C-36, AS AMENDED

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT
OF SEARS CANADA INC., 9370-2751 QUEBEC INC., 191020 CANADA INC.,
THE CUT INC., SEARS CONTACT SERVICES INC., INITIUM LOGISTICS
SERVICES INC., INITIUM TRADING AND SOURCING CORP., SEARS
FLOOR COVERING CENTRES INC., 173470 CANADA INC., 2497089
ONTARIO INC., 6988741 CANADA INC., 10011711 CANADA INC., 1592580
ONTARIO LIMITED, 955041 ALBERTA LTD., 4201531 CANADA INC.,
168886 CANADA INC., AND 3339611 CANADA INC.

BEFORE: Hainey, J.

COUNSEL: *Susan M. Ursel, Kathryn O'Rourke*, Employee Representative Counsel

Andrew J. Hatnay, Amy Tang, Pension Representative Counsel

Kiran Patel, for Morneau Shepell Ltd.

Elizabeth Rathbone, for Superintendent of Financial Services

Alan Merskey for the Monitor

HEARD: April 24, 2019

ENDORSEMENT

Overview

[1] Ursel Phillips Fellows Hopkins LLP, in its capacity as representative counsel ("Employee Representative Counsel") to certain non-unionized active and former employees of Sears Canada Inc. and its affiliates ("Sears Canada Entities") in these proceedings under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended ("CCAA"), seeks an order for directions under a financial letter of agreement ("FLA") between Sears Canada Inc. ("Sears") and Sun Life Assurance Company of Canada ("Sun Life") with respect to Employee Representative Counsel's claim to approximately \$850,000 available for refund ("Deposit Fund Surplus") resulting from the termination of insurance coverage provided by Sun Life for the benefit of employees of Sears and certain of its subsidiaries ("Employees"). Employee Representative Counsel seeks payment of the Deposit Fund Surplus to the Employees on a *pro rata* basis.

Facts

[2] Pursuant to an order issued by me on July 13, 2017, Employee Representative Counsel was appointed to represent the interests of non-unionized active employees and former employees of the Sears Canada Entities.

[3] The following facts are not in dispute:

- (a) Sears arranged for basic and optional life insurance coverage for the Employees;
- (b) Both Sears and the Employees paid for the premiums;
- (c) Payment for the premiums was deposited into a fund with Sun Life by Sears;
- (d) Sun Life performed an annual accounting identifying surpluses or deficits;
- (e) Under the contract with Sun Life, Sears was required to fund any deficit in the payment of premiums; and
- (f) Under the contract with Sun Life, Sears was entitled to use or receive the surplus.

[4] Life insurance coverage was an Employee benefit provided by Sears through Sun Life under a life insurance policy.

[5] The life insurance coverage had the following components:

- i.) A “basic” life insurance component for which, in general, Sears Canada paid the premiums; and
- ii.) Optional life, optional spousal life and optional child life insurance coverage (“Optional Insurance”), for which the participating Employees paid most of the premiums. Of the annual insurance premiums paid to Sun Life under these policies, up to 80% were paid by the participating Employees.

[6] Sears Canada entered into the FLA with Sun Life under which each year a surplus/deficit calculation was performed. Any surplus identified by this calculation was transferred to either a claims fluctuation reserve (“CFR”) or a deposit fund (“Deposit Fund”), both of which were maintained by Sun Life.

[7] The CFR assisted in stabilizing rate fluctuations for adverse claims experience from year to year. The FLA required Sears to fund the CFR, which was to be kept at a target level of 25% of the annualized premiums. If the annual surplus/deficit calculation resulted in a surplus, the portion of the yearly surplus that was not required to reduce any previously accumulated deficit was transferred to the CFR until the CFR balance reached the target level.

[8] The Deposit Fund was funded by the portion of the yearly surplus not required to bring the CFR to target level. The Deposit Fund operated as a “float” which Sears Canada could use to fund any deficit that accumulated in the future.

[9] Over the last few years, there have been ongoing transfers into the Deposit Fund. The balance in the Deposit Fund is currently \$854,565.50 (“Surplus”).

[10] Employee Representative Counsel, the Sears Canada Entities and the Monitor cannot agree on whether the Surplus ought to form part of the estate of the Sears Canada Entities or be distributed to the Employees that contributed to the Surplus (“Participating Employees”).

[11] On February 22, 2018, I issued an Employee and Retiree Claims Procedure Order (“Claims Procedure Order”), which approved a process for the identification and adjudication of their claims.

[12] On April 9, 2018, Employee Representative Counsel filed a Proof of Claim Form pursuant to the Claims Procedure Order requesting that Sears surrender a portion of the Surplus representing the percentage of premiums paid by Participating Employees, to be distributed to them on a *pro rata* basis (“Surplus Claim”).

[13] The Monitor issued a Notice of Disallowance and Employee Representative Counsel filed a Notice of Dispute.

[14] The Surplus Claim remains an unresolved claim that must be resolved on this motion.

Issue

[15] Should the Surplus Claim be allowed as a restructuring period claim and distributed to the Participating Employees on a *pro rata* basis?

Positions of the Parties

[16] Employee Representative Counsel submits that the Surplus Claim ought to be allowed as a restructuring period claim and the Surplus distributed to the Participating Employees on a *pro rata* basis because Sears was acting as the Participating Employees’ agent when it remitted their insurance premiums to Sun Life.

[17] The Monitor opposes the payment of the Surplus to the Participating Employees because,

- (a) The Participating Employees have no right to the return of premiums under the terms of the life insurance policies;
- (b) Sears has a contractual entitlement to the Surplus based upon the terms of the FLA; and
- (c) Sears was not acting as agent and/or fiduciary for the Employees with respect to the insurance policies.

Analysis

[18] It is not disputed that I have authority to determine this issue pursuant to my supervisory jurisdiction under the CCAA.

[19] I agree with Employee Representative Counsel that Sears was acting as the Participating Employees’ agent when it remitted their insurance premiums to Sun Life. The Participating

Employees permitted Sears to deduct money from their salaries and they entrusted that money to Sears authorizing it to pay insurance premiums to Sun Life on their behalf. To allow Sears to now profit from the surplus in the Participating Employees' premiums would be a violation of this agent-principal relationship.

[20] In coming to this conclusion, I have relied upon the case of *Northern Alberta Institute of Technology Academic Staff Association v. Northern Alberta Institute of Technology*, [2002] A.J. No. 1013 (Q.B.) ("NAIT").

[21] In NAIT the staff association claimed an entitlement to proceeds received by their employer, NAIT, after the demutualization of their insurer, Mutual Life. The majority of the premiums paid to Mutual Life over the years were paid by NAIT. The only premiums paid by the employees related to basic life insurance coverage as well as dependent and optional insurance coverage.

[22] The trial judge, Wilson J., found that notwithstanding the absence of an agency agreement with the staff association or with the individual employees, an agency relationship existed between the staff and the employer in respect of the remittance of premiums, and the court also found that NAIT acted as fiduciary in respect of its employees' premiums. Wilson J. concluded that the employer was required to distribute the demutualization funds to employees and stated at paras 65 and 72 as follows:

65. ... The determination must be, was NAIT the agent? If it was, it must not make a profit from its agency. The point in time of accepting or keeping the profits is not determinative. If agency in relation to the policy is found, the remedy simply follows, in my opinion... To say simply that NAIT is stated to be the owner in the process, such that it ends the inquiry, is to make too simple a case of it, and to ignore equities long revered and enforced.

72. ... As to the payment premiums, I can see that the arrangement for payment of premiums by members, through NAIT, of their part of the premiums for insurance means that NAIT was a conduit for that money, and in the sense that premiums are paid by an insured to his agent, then NAIT was an agent for the members. ...

[23] The Alberta Court of Appeal affirmed Wilson J.'s conclusion that NAIT was not entitled to retain the demutualization proceeds for its own benefit and confirmed that the employees were entitled to that portion of the demutualization proceeds that resulted from their contributions.

[24] At para 45 of the Monitor's factum the Monitor submits that in order for me to find an agency relationship between Sears and the Participating Employees I would have to conclude that "...one party has conducted himself towards another in such a way that it is reasonable for that other to infer from that conduct assent to an agency relationship". That is exactly what I have concluded on the facts of this case. Sears was the conduit for the payment of the Participating Employees' insurance premiums and as such was acting as their agent.

[25] I do not accept the Monitor's submission that Sears was not acting as the Participating Employees' agent because it was not under a contractual obligation to provide insurance to its Employees or that the life insurance policies were not participating policies that provided the Participating Employees with an ownership interest in Sun Life.

[26] Neither of these factors changes the actual relationship between Sears and the Participating Employees. The Participating Employees allowed Sears to deduct the premiums from their salaries and remit the payments for their premiums to Sun Life on their behalf. In my view, this clearly establishes an agency relationship between Sears and them. As the Participating Employees' agent Sears is not entitled to retain the portion of the Surplus derived from the premiums paid by the Participating Employees. This would result in unjust enrichment of Sears and would constitute an unfair deprivation to the Employees. The Surplus essentially results from an overpayment by the Participating Employees, who, under the circumstances, are entitled to a refund of their overpayment.

[27] I am also not persuaded by the Monitor's submission that the FLA "provides a juristic reason" for Sears to retain the Surplus. The FLA was negotiated between Sears and Sun Life. The Participating Employees were not privy to this agreement. The FLA, therefore, cannot govern the rights between the Participating Employees and Sears.

[28] As the CCAA supervising judge in these proceedings I must consider the equities relating to disputes among stakeholders. In this case the Employees are among the most vulnerable stakeholders in this CCAA proceeding. They have lost their livelihoods, including their employment income and their insured benefits. Many still struggle to reach the same level of financial security that they enjoyed while employed by the Sears Canada Entities. In my view the equities dictate that I should accept the position advanced by Employee Representative Counsel on this motion and order that the Surplus must be distributed to the Participating Employees.

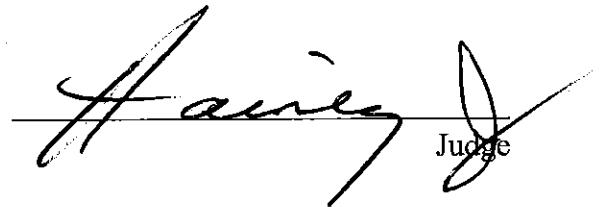
Conclusion

[29] For the reasons outlined above the Surplus Claim is granted. I order the Monitor to allow the percentage of the Surplus that corresponds to the percentage of premiums paid by the Participating Employees to be distributed to them on a *pro rata* basis.

Costs

[30] Counsel may address costs of the motion at a 9:30 a.m. attendance with me.

[31] I am grateful to counsel for their helpful submissions.


Judge

Date: June 13, 2019