Court File No. CV-18-00611219-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

B E T W E E N:

FTI CONSULTING CANADA INC.,
in its capacity as Court-appointed monitor in proceedings
pursuant to the *Companies' Creditors Arrangement Act*, RSC 1985, c. c-36

Plaintiff

and

ESL INVESTMENTS INC., ESL PARTNERS, LP, SPE I PARTNERS, LP, SPE MASTER I, LP, ESL INSTITUTIONAL PARTNERS, LP, EDWARD S. LAMPERT, WILLIAM R. HARKER and WILLIAM C. CROWLEY

Defendants

STATEMENT OF DEFENCE OF ESL INVESTMENTS, INC., ESL PARTNERS, LP, SPE I PARTNERS, LP, SPE MASTER I, LP, ESL INSTITUTIONAL PARTNERS, LP and EDWARD S. LAMPERT

1. The defendants ESL Investments, Inc., ESL Partners, LP, SPE I Partners, LP, SPE Master I, LP, ESL Institutional Partners, LP and Edward S. Lampert (together, the "**ESL Parties**") deny the allegations contained in the statement of claim.

Overview

2. In a bid to enrich the estate of Sears Canada Inc. ("**SCI**"), the Monitor seeks to claw back a dividend lawfully declared and paid by SCI over five years ago in circumstances that did not remotely render the company insolvent. SCI declared the dividend in reasonable and unremarkable circumstances—it had over $1 billion in cash and virtually no debt, and its business was considered to be in recovery.

3. The Monitor does not bring its claim under s. 101 of the BIA, the provision that applies to the reversal of a dividend. Instead, it seeks to manoeuvre around s. 101 by advancing, under s. 96, an unprecedented theory that the 2013 dividend was a non-arm's length "transfer at undervalue". Further, to avail itself of the five-year look-back provision in s. 96(1)(b)(ii), the Monitor pleads that the ESL Parties conspired with SCI's eight directors, six of whom were entirely independent of the ESL Parties, to sell assets and declare a dividend with the intent of defrauding, defeating or delaying SCI's creditors.

4. This action must fail because s. 96 does not apply to the claw-back of a dividend. Even if it did, the Monitor's allegation in support of relief under s. 96 that the 2013 dividend was the product of a conspiracy to defraud creditors is demonstrably false.

5. The Monitor's case against the ESL Parties rests on three key assumptions: that the ESL Parties "controlled" SCI; that the ESL Parties conspired with SCI's directors to sell its "crown jewels"; and that the ESL Parties took these actions because of their "immediate need for cash" to fund redemption obligations from the hedge funds operated by the ESL Parties (the "**ESL Funds**"). Each of these is false.

6. First, neither Edward S. Lampert nor any of the other ESL Parties controlled, directed, or unduly influenced any of the decisions taken by the SCI board or its management. SCI was, at all times, an independently run public company whose board was comprised of eight directors, six of whom had no connection whatsoever to Lampert or the other ESL Parties. Although Sears Holdings Corporation ("**SHC**"), which was at times majority-owned by the ESL Parties and was SCI's parent, had a total of two nominees on the eight-member board, neither of them remained employed by SHC or the ESL Parties at the time of the dividend.

7. Second, the stores SCI sold in 2013 were not SCI's "crown jewels" as the Monitor alleges. Although they may have had that appearance—many were large stores located in prime urban locations—they were in fact selected by SCI for liquidation because they produced among the *lowest returns* of all of SCI's stores. Their sale was part of a well-considered strategy to reduce SCI's retail footprint to allow SCI to concentrate on more profitable locations. After the 2013 sales, SCI continued to operate over 100 full-line stores in Canada. The Monitor's "crown jewels" myth is founded on this basic misconception of SCI's retail strategy which was—and continues to be—well-accepted and common in the retail industry.

8. Third, the Monitor's alleged motive for the sale of the so-called "crown jewels"—that the ESL Funds were facing an "immediate need for cash" to fund redemption obligations—is a bald fabrication. The ESL Funds had no need for cash. They had the option to distribute securities they owned in fulfilment of their redemption obligations, which, in part, they did. At the time of the dividend, the ESL Funds had far more cash and securities on hand than they needed to satisfy the outstanding redemptions. By the end of 2013, the ESL Funds had **US$1.433 billion** in residual cash.

9. Far from the alleged motive to "extract cash" from SCI to remedy a fabricated "urgent need for funds", Lampert's own actions demonstrate the opposite intention—to support SCI's long-term viability as a significant Canadian retailer. Lampert's commitment to SCI began in 2002, and his stake in SCI, through one or more of the ESL Parties, only grew over time. In October, 2014, Lampert increased the ESL Parties' shareholdings in SCI to their highest level ever, namely 49.5%. Given that stake, no one had a greater interest in the success of SCI as a continuing retail business.

10. The fact is that the 2013 dividend was a reasonable exercise of business judgment that harmed none of SCI's stakeholders. The 2013 dividend, which had been anticipated by market analysts who covered the company, was publicly announced in November, 2013. After the dividend was declared, the market continued to ascribe substantial value to SCI as a going concern: in 2014, arm's-length bidders for SCI offered between $14 and $18 per share to purchase the company, valuing SCI at between $1.4 and $1.8 billion. SCI's market capitalization on the day after the dividend was paid was over $1 billion. The Monitor's attempt to attribute harm to the 2013 dividend some five years later is an exercise in arrant hindsight.

11. SCI continued to operate, pay its debts, employ and pay benefits to its personnel and fund its pension liabilities for three-and-a-half years after it paid the 2013 dividend. Despite this, to make out its claim the Monitor must prove that the purpose of the 2013 dividend was to defraud, defeat or delay creditors. The only way this is possible is if the Monitor proves that the 2013 dividend caused or was intended to cause SCI's 2017 insolvency. But it does not seek to prove this because doing so would be impossible—the causes of SCI's 2017 insolvency had nothing to do with the 2013 dividend and certainly nothing to do with the ESL Parties. The 2017 insolvency was unforeseeable and unimaginable in 2013.

12. This claim should be dismissed not only because it has been brought under the wrong section of the BIA. Its unprecedented attempt to reverse a solvent public company's more than five-year-old dividend would compromise corporate decision-making, undermine investment and create confusion and uncertainty in the Canadian capital markets.

The parties

The plaintiff

13. FTI Consulting Canada Inc. is the court-appointed Monitor to Sears Canada Inc. ("**SCI**") under the *Companies' Creditors Arrangement Act*, RSC, 1985, c. C-36 (the "**CCAA**"). SCI was a Canadian retailer and publicly traded company. It is incorporated under the *Canada Business Corporations Act*, RSC, 1985, c. C-44 (the "**CBCA**"). On June 22, 2017, SCI and its related entities made an initial application and were granted protection from creditors under the CCAA. This Court later authorized the Monitor to bring a claim against the ESL Parties and two former SCI directors.

The ESL Parties

14. The defendants Edward S. Lampert ("**Lampert**"), ESL Investments, Inc. ("**ESL**"), ESL Partners, LP, SPE I Partners, LP, SPE Master I, LP, and ESL Institutional Partners, LP (collectively the "**ESL Parties**") operate investment funds that make a limited number of long-term investments (the "**ESL Funds**").

15. In 1988, Lampert established ESL, which is registered as an investment advisor with the U.S. Securities and Exchange Commission. ESL is the promoter of the ESL Funds.

16. Lampert is the chair and CEO of ESL. From 2005 to February 14, 2019, Lampert was the chair of the board of directors of SHC, which was the indirect majority shareholder of SCI at the time of SCI's 2013 dividend. He was also the CEO of SHC from 2013 to 2018. He was never a director or officer of SCI.

17. ESL is the general partner of RBS Partners, LP. RBS Partners, LP is the general partner of ESL Partners, LP, SPE I Partners, LP, and SPE Master I, LP. ESL Institutional Partners, LP is associated with the ESL Funds.

18. At the time of the 2013 dividend the ESL Parties were, collectively, direct minority shareholders of SCI. Furthermore, the ESL Parties have had an indirect interest in SCI since 2002 through their ownership stake in SCI's American parent corporations, Sears, Roebuck & Co. ("**Sears, Roebuck**") and later in SHC. At the time of the declaration of the 2013 dividend, the ESL Parties controlled 55.4% of the outstanding shares of SHC. On December 2, 2013, the ex-dividend date for the 2013 dividend, the ESL Parties' interest in SHC dropped to 48.4%.

19. Through the 2013 dividend, the ESL Parties cumulatively received $140,790,245. The ESL Parties received the following amounts individually:

ESL Party	Amount
Lampert	$52,165,440
ESL Investments, Inc.	$0
ESL Partners, LP	$79,106,030
ESL Institutional Partners, LP	$21,905
SPE I Partners, LP	$4,154,260
SPE Master I, LP	$5,342,610

20. Another entity within the ESL Funds, CRK Partners, LLC, received $1,595 as a result of the dividend. CRK Partners is not named in these proceedings.

Lampert's investment strategy

21. The ESL Funds invested in corporations that faced business challenges but could be made viable in the long term through the implementation of strategies carefully tailored to their circumstances. The ESL Funds' turn-around strategies did not generally involve significant

corporate restructuring. Instead, Lampert encouraged the companies within the ESL Funds' portfolio to test limited initiatives to determine which, if any, produced positive results. Those that succeeded would be adopted on a larger scale. Underlying the ESL Funds' strategy was the view that well-judged changes implemented by strong, independent leadership could produce major improvements in revenues and long-term results. The ESL Parties believed that this strategy, if employed with SHC and with SCI, would produce good results.

The ESL Parties' early indirect investment in SCI

22. The retailer Kmart Corporation ("**Kmart**") filed for Chapter 11 protection in the United States in 2002. Shortly afterwards, the ESL Parties acquired a substantial amount of its debt. As part of the plan of reorganization, the ESL Parties' debt holdings were converted to equity. On May 6, 2003, following the implementation of the plan, the ESL Parties held over 51% of Kmart's shares and Lampert became the chairman of Kmart's board.

The ESL Parties' acquisition of an interest in Sears, Roebuck and SCI

23. In 2002, the ESL Parties also acquired a substantial minority position in Sears, Roebuck the then-controlling shareholder of SCI. Then, following the acquisition of the controlling majority interest in Kmart, Lampert and the other ESL Parties caused Kmart to acquire all of Sears, Roebuck, with the objective of building a great combined retail operation. The deal was announced November 17, 2004 and closed on March 24, 2005, resulting in a new corporation, SHC. SHC continued to operate stores under both the Sears and Kmart brands.

24. Around the time the deal closed and until October, 2014, SHC held a majority of the shares of SCI. Public shareholders held the balance of the shares.

SHC nominates Crowley and Harker to the SCI board

25. Because of his positions with SHC, Lampert was entitled to exercise a degree of oversight over the affairs of SCI and to be kept informed by its management and to be consulted by them. However, Lampert was primarily focused on the management responsibilities he owed to SHC and the challenges it faced. He accepted that SCI had its own board of directors exercising oversight over its affairs. SCI, moreover, represented a relatively small part of SHC's business and an insignificant part of the portfolios of the ESL Funds.

26. Lampert also relied upon two trusted and highly competent individuals nominated to SCI's board by SHC. William Crowley was a Yale-educated lawyer, with a master's degree from Oxford, who came to ESL in 1999 from his position as a Managing Director of Goldman Sachs. He joined SHC in 2005 as EVP and CFO and served on the SCI board from March, 2005 until April, 2015. William Harker was a University of Pennsylvania-educated Wall Street lawyer who served as SHC's SVP and General Counsel from 2005 to 2012. He served as SHC's nominee to the SCI board from November, 2008 until April, 2015. In or about late 2012, both Crowley and Harker left SHC and ESL to found Àshe Capital Management, LP, an investment fund unaffiliated with ESL, SHC or SCI.

27. Lampert never demanded that Crowley or Harker take specific positions in board votes or in other functions related to SCI. He respected their counsel. Lampert knew that Crowley and Harker exercised regular oversight over SCI as members of its board. He and they communicated irregularly concerning SCI's affairs. Crowley and Harker would, at their own instance, solicit Lampert's views on operational and strategic issues. Their relationship with Lampert was consultative and collaborative.

The ESL Parties' acquisition of a direct interest in SCI

28. The ESL Parties acquired a direct interest in SCI in 2012 and, in the years after the 2013 dividend, continued to invest more in SCI. The ESL Parties first acquired their direct interest in SCI through a partial spin-off of SCI by SHC in 2012. In connection with the 2012 spin-off, SHC distributed approximately 45 million common shares of SCI on a *pro rata* basis to holders of SHC's common stock. As a result, the ESL Parties acquired approximately 27% of the shares of SCI.

Project Matrix

29. Starting in March, 2012, SCI's management embarked on a strategic plan that would later be named "**Project Matrix**". The project called for an evaluation of which stores should continue to be operated as retail, or "trading", stores and which the company would be better off selling, with a view to the most efficient use of capital. As part of Project Matrix, management prepared recommendations to the board that included the identification of those stores whose "four-wall EBITDA" demonstrated the lowest return on investment ("**ROI**") as compared to the stores' underlying asset value. A store's four-wall EBITDA represented that store's net earnings before interest, taxes, depreciation and amortization. Those stores with the lowest ROI would be considered for sale, thereby reducing SCI's footprint of under-performing stores and allowing it to concentrate its efforts on those stores that could generate a higher ROI.

30. The stores with particularly poor ROI tended to be those in large, urban locations for which the value of the store's lease was highest. The retail market in such locations was shifting to a more upscale consumer that attracted retailers such as Nordstrom, Saks Fifth Avenue and the newly transformed Hudson's Bay Company. The Sears brand, on the other hand, was perceived to appeal

to middle-market consumers and to be, increasingly, incompatible with pricier urban locations. The SCI stores identified as having among the lowest ROI were locations such as the Eaton Centre in Toronto (which became a Nordstrom), Sherway Gardens in Mississauga (which became a Saks Fifth Avenue) and the Pacific Centre in Vancouver (which became a Nordstrom).

31. Lampert supported Project Matrix as making sound business sense for SCI. SCI managed the process itself. Lampert and the ESL Parties provided advice from the sidelines.

The 2013 dividend

32. On November 8, 2013, Lampert received an email from Crowley seeking his view on a potential dividend being considered by the SCI board. Lampert understood that, as a result of the sale of leases for those low-ROI stores identified by Project Matrix, SCI had raised approximately $800 million in cash, leaving SCI with total cash reserves of approximately $1 billion. Lampert also understood, through his position on SHC's board and infrequent conversations with Crowley, Harker and SCI management, that SCI's business plan required only a fraction of these funds for ongoing operations. Lampert therefore expressed his view to Crowley that the SCI board should authorize as large a dividend as SCI could reasonably support.

33. Although Lampert expressed his opinion to Crowley, Lampert knew well that the SCI board would make a decision in what it determined to be the best interests of SCI and without any further input from him. Lampert had no communication at any time, let alone during the period of deliberation over the dividend, with the other six independent board members who he knew would have to consider and vote on the proposed dividend. He did not in any way request or direct Crowley, Harker or any other person to exert any pressure or influence on other members of the board.

ESL had no need for cash prior to the 2013 dividend

34. Contrary to the allegations in the statement of claim, Lampert had no motive to "conspire" with, unduly influence or direct the SCI board to declare a dividend even if, practically, he possessed particular influence over the board (which he did not).

35. The plaintiff's assertion that the ESL Funds had a "desperate" need for cash is demonstrably false. Prior to the declaration of the 2013 dividend on November 19, 2013, the ESL Funds had received all of the redemption requests from unitholders that they had to satisfy by the end of the year. The standard terms of unitholder agreements permitted the ESL Funds to satisfy redemption requests either with cash or through the transfer of securities. When the dividend was declared, the ESL Funds were sitting on far more cash and other easily transferred assets than they required to satisfy all outstanding redemptions. After all redemptions were satisfied at year-end, the ESL Funds retained cash of **US$1.433 billion**. In comparison, the ESL Funds received approximately US$83 million from the 2013 dividend. The dividend accounted for less than 6% of the ESL Funds' retained cash.

SCI declares a dividend of $509 million

36. On November 19, 2013, the SCI board approved the declaration of an extraordinary dividend of $509 million. Lampert believed, and public records confirmed, that the financial position of SCI could reasonably have supported a larger dividend. The dividend was in fact conservative in light of the disparity between SCI's significant cash on hand and the much smaller amount that SCI required for its ongoing operations.

37. According to its audited financial statements for the 2013 fiscal year, after payment of the dividend SCI retained over **$513 million** in cash on hand. This was $72.5 million more than SCI had following its payment of a dividend in 2010 (the **"2010 Dividend"**), and $276.8 million more than it had following its payment of a dividend in 2012 (the **"2012 Dividend"**). Moreover, SCI reported $2.39 billion in assets and $1.32 billion in liabilities in 2013. This compares closely to the assets reported following the 2010 and 2012 Dividends, namely $2.51 billion and $2.48 billion respectively, as well as favourably to the liabilities following the 2010 and 2012 Dividends, namely $1.51 billion and $1.40 billion respectively.

The Plan was appropriately funded at the time of the 2013 dividend

38. At the time the 2013 dividend was declared, the defined benefit component of the Plan was funded in accordance with SCI's obligations under the terms of the Plan and the *Pension Benefits Act*, RSO 1990, c P.8 ("**PBA**"). The defined benefit component of the Plan had been frozen effective July 1, 2008, meaning that although then-existing Plan members would continue to be entitled to benefits under the defined benefit component of the Plan, they would cease to accrue credited service under the Plan's defined benefit formula and no new members were allowed to join the defined benefit component. Employee contributions to the defined benefit component of the Plan ceased June 30, 2008. There was also a defined contribution component of the Plan, which was added to the Plan as of July 1, 2008.

39. According to a December 31, 2010 actuarial report—the most recent triennial actuarial report at the time the dividend was declared—the Plan complied with the regulations. Like many defined benefit pension plans at the time, it had under-funded liabilities: on a going concern basis of $68 million, on a solvency basis of $206 million and on a hypothetical wind-up basis of $307

million. As a result of the report, SCI was required to make payments of approximately $29 million per year in 2012 and 2013. These payments specified in the actuarial report were the only payments SCI was legally required to make into the Plan. There was no legislative requirement that SCI immediately eliminate any funding deficiency. SCI made the required payments in 2012 and 2013 and also remitted an additional $15 million in 2013.

40. The first actuarial report after the dividend, effective December 31, 2013 and completed in June, 2014, confirmed that as of the effective date—25 days after the payment of the dividend—SCI had properly funded the Plan and that the Plan had a surplus of almost $15 million on a going concern basis. The report confirmed that the funded status of the Plan improved significantly on all measures, as shown in the following table:

Pension Plan Funded Surplus / (Deficit)

Basis	December 31, 2010	December 31, 2013	Improvement
Going Concern	($68 million)	$15 million	$83 million
Solvency	($205 million)	($76 million)	$129 million
Wind-Up	($307 million)	($133 million)	$174 million
Solvency Ratio	86%	95%	9%

41. Because of the strong position of the Plan at the time and the additional $15 million contributed in 2013, the report permitted SCI to make no contributions in 2014. Going forward, the report required SCI to contribute approximately $19 million in 2014 and approximately $20 million in 2015. It did this and in fact contributed $20 million ($1 million more than required) in 2014.

42. Although the December 31, 2013 report was prepared after the declaration of the 2013 dividend, members of SCI's board and management knew at the time of the declaration of the

2013 dividend that the Plan's financial position was improving. In particular, Crowley, Harker and Bird sat on an investment committee that oversaw the Plan's investments. The investment committee received regular reports regarding the performance of the Plan's investments, and estimates from SCI management about the Plan's position on a going concern basis, solvency basis and hypothetical wind-up basis. These reports and estimates showed Bird and the Directors that the position of the Plan continuously improved between 2010 and the time the dividend was declared in late 2013.

No dividend in 2014

43. Despite further asset sales in 2013 and 2014 and despite the substantial retained cash on hand following the 2013 dividend, the board decided not to declare any dividends in 2014. Although its balance sheet was sound—it had $513 million in cash and $1.4 billion in assets—SCI had experienced disappointing fourth-quarter holiday sales in 2013, with same-store sales down 6.4%, reversing the positive trend from the prior quarter.

44. Lampert made no objection to the decision not to declare a dividend in 2014.

SCI was valued at between $1.4 and $1.8 billion by three independent bidders in 2014

45. In 2014, SHC elected to sell its stake in SCI. As chairman and CEO of SHC, Lampert was closely involved in these discussions.

46. SHC first sought offers for all of the outstanding shares of SCI. In June and July, 2014, Bank of America Merrill Lynch solicited a number of bids for SCI on behalf of SHC. Offers were made by at least three potential buyers, namely Kohlberg Kravis Roberts ("**KKR**"), Sycamore Partners Management, LLC ("**Sycamore**") and Hudson's Bay Company (**"HBC"**). KKR offered a

purchase price of $14 to $15 per share; Sycamore offered $16 to $18 per share; and HBC offered $14 to $16 per share. These values represented a premium of up to 33% over the shares' trading value, and suggested a valuation of SCI of between $1.4 and $1.8 billion.

47. Ultimately, no transaction came to fruition.

The ESL Parties increased their stake in SCI through a rights offering

48. In the absence of a buyer for all of its outstanding SCI shares, SHC proceeded to a rights offering on October 26, 2014 in relation to most of its 51% ownership interest in SCI. Through the rights offering, SHC sold off roughly 40% of SCI (and 75% of SHC's interest in SCI) at $10.60 per share. The price was the closing price of SCI's common shares on September 26, 2014, the last trading day before SHC requested SCI's cooperation with the filing of a prospectus for the rights offering. The rights offering was over-subscribed.

49. Through the 2014 SHC rights offering, the ESL Parties acquired a further 18 million shares of SCI, at a cost of approximately $190 million. This was the maximum allowed under the terms of the rights offering. As a result of this transaction, the ESL Parties became the holders of approximately 49.5% of the outstanding shares of SCI.

50. Lampert took this step because he believed the acquisition cost fairly reflected the value of SCI's assets. He also believed in SCI's value as a going concern. He expected its business would grow and the company would eventually conclude an advantageous sale to a third party.

Circumstances leading to SCI's insolvency

51. By April 23, 2015, Deborah Rosati and Raja Khanna were the only directors remaining from the time of the 2013 dividend. The new board members, who held six of eight positions on the board, became directors in 2014 or 2015.

52. The SCI board appointed Brandon Stranzl as acting CEO and Executive Chair on July 2, 2015. Stranzl was known to Lampert because he had worked as an analyst at ESL from 2008 to 2010.

53. Once appointed, Stranzl led SCI to change its strategic direction, through an initiative called "**Sears 2.0**". Sears 2.0 called for a more aggressive operating strategy to drive sales growth. The plan called for the sale of off-price discounted designer lines in apparel and home goods and new prototype stores which would feature significant changes to layout and offerings.

54. Sears 2.0 required a substantial cash infusion and, at Stranzl's direction, SCI incurred new borrowings for the first time in over a decade.

55. Lampert did not support these decisions, which involved borrowing significant amounts on punitive terms in support of a strategy that carried with it significant risk. In particular, Lampert was of the view that the company should not be taking on new debt while engaging in dramatic price reductions. In Lampert's view, Stranzl's decisions would place SCI at risk of failure. Lampert suggested to Stranzl that the better approach was to close under-performing stores.

56. Despite his concern, Lampert did not make an effort to intervene with the board, in line with his regular practice of providing input where appropriate but leaving the board to direct the

company as it saw fit. Lampert was and is of the view that if Stranzl had taken his advice SCI would still be in operation today.

SCI borrowed on punitive terms

57. On March 20, 2017, SCI entered into a credit agreement on punitive terms with a number of parties, led by GACP Finance Co., LLC ("**GACP**") as administrative and syndication agent. There were two available tranches. The first was advanced on March 20, 2017, in the amount of $125 million. The second tranche was originally to be in the amount of $175 million.

58. On June 5, 2017, Stranzl caused SCI to draw on an existing Wells Fargo credit facility. As a result of the GACP credit facility, SCI faced a reduction in the amount of financing available to it under the Wells Fargo credit facility. SCI was able to draw only $33 million.

59. Following that, management determined that SCI could not expect to borrow the full amount under the second tranche of the GACP credit facility. Because of this, SCI concluded that it was not prudent to encumber its assets for borrowings that were significantly less than what it had expected.

SCI experienced a liquidity crisis

60. The need for cash caused by the Sears 2.0 plan and the inability to access the full amount of funding under the GACP credit facility contributed to a liquidity crisis that precipitated SCI's CCAA filing on June 22, 2017.

61. When SCI entered CCAA protection, both its management and the Monitor expected SCI might continue as a going concern. The initial application suggested a plan Lampert himself had

proposed earlier: closing those stores that were underperforming in order to keep a core-retail business going. Ultimately, SCI liquidated all of its stores.

The ESL Parties incurred substantial aggregate losses from their investments in SCI

62. Far from having extracted excessive amounts of capital from SCI, the ESL Parties sustained aggregate losses of approximately $552.7 million on their investments in SCI and as a result of its insolvency.

The 2013 dividend is not a transfer at undervalue

Section 96 of the BIA does not apply to the 2013 dividend

63. The Monitor improperly characterizes the 2013 dividend as a transfer at undervalue under s. 96 of the BIA. Section 96 does not provide a cause of action for the recovery of dividends. The recovery of dividends is addressed in s. 101 of the BIA, the provision entitled "Inquiry into dividends and redemptions of shares".

64. As a means of circumventing s. 101—a provision that the Monitor appears to concede would not provide relief in this case—the Monitor instead proposes an absurd interpretation of s. 96 that would create two contradictory regimes for an inquiry into the past dividends of an insolvent company. The Monitor's claim should thus fail for the simple fact that it has brought this action under the wrong section of the BIA.

The elements of s. 96 are not met

65. Even if s. 96 could apply to reverse a dividend declared and paid by a public company, none of the elements of s. 96 is made out in this case. Specifically:

(a) The 2013 dividend was not a transfer at undervalue within the meaning of ss. 2 and 96 of the BIA;

(b) The ESL Parties and SCI dealt at arm's length at all material times; and

(c) SCI did not intend to defraud, defeat or delay any of its creditors in declaring and paying the 2013 dividend.

The 2013 dividend was not a transfer at undervalue

66. The 2013 dividend was not a transfer at undervalue within the meaning of ss. 2 and 96 of the BIA. A dividend cannot be "undervalued" since the consideration received for a dividend cannot be "conspicuously less than the fair market value of the consideration" given up. Dividends, by definition, have no fair market value. There is no market for dividends; nor are dividends the product of negotiations between two parties. Dividends can be issued only to a corporation's shareholders, and no consideration is ever expected or received from shareholders in exchange for a dividend.

The 2013 dividend was transferred at arm's length

67. At all material times, including when the 2013 dividend was issued and paid, the ESL Parties dealt at arm's length with SCI and its directors. As a result, even if s. 96 could apply to dividends, which is denied, the Monitor could have proceeded only under s. 96(1)(a), in which case its claim would have been time-barred.

68. Contrary to paragraph 60 of the statement of claim, the ESL Parties and SCI were not "related persons" under s. 4 of the BIA. At the time SCI paid the 2013 dividend, the ESL Parties did not have direct or indirect legal control of SCI. Consequently, it would be impermissible and inappropriate to deem the ESL Parties, under s. 4(5) of the BIA, not to have dealt with SCI at arm's length.

69. In any event, at all material times, including when the 2013 dividend was declared and paid, the ESL Parties and SCI were in fact dealing at arm's length. The ESL Parties did not exercise any control over corporate decision-making, directly or indirectly. Instead, the 2013 dividend was unanimously approved by eight directors of SCI, six of whom were entirely independent of the ESL Parties.

SCI did not intend to defraud, defeat or delay any of its creditors

70. SCI did not "intend to defraud, defeat or delay" any of its present or future creditors in paying the 2013 dividend. SCI's directors reasonably believed that they had allocated adequate capital investment to support the business, and their intention in paying the 2013 dividend was to return capital to shareholders that the directors believed was excess to the requirements of the business. The absurdity of the allegation that SCI put money beyond the reach of creditors is demonstrated by the over $500 million in cash SCI left behind after the 2013 dividend—funds that helped to pay SCI's obligations for over three years until unrelated circumstances led to SCI's insolvency. No insolvency was in the contemplation of the directors and none occurred until more than three years had passed from the relevant date.

71. Furthermore, SCI's "intention" must be determined by reference to the intention of the eight directors who unanimously approved the 2013 dividend, six of whom were wholly independent of SCI. If a majority of the board did not intend to defraud, defeat or delay creditors, that intention cannot be ascribed to SCI. No director—let alone a majority of the directors—intended to defraud, defeat or delay present or future creditors.

72. In an obvious attempt to overcome the impossibility of demonstrating that SCI had the requisite intent to defraud, defeat or delay creditors, the Monitor ignores the language of the

provision to assert that SCI "recklessly disregarded" the fact that the 2013 dividend would have this effect. The Monitor cannot satisfy the element of intention under s. 96(1)(b)(ii)(B) by asserting recklessness by SCI. That provision expressly requires an actual and subjective intention to defraud, defeat or delay a creditor. Moreover, the directors did not recklessly disregard that the 2013 dividend would defraud, defeat or delay creditors.

The ESL Parties are not privies to the 2013 dividend

73. Contrary to the allegations at paragraphs 66-67 of the statement of claim, the ESL Parties are not persons who were privy to the 2013 dividend under s. 96(3) of the BIA. Parliament cannot have intended that section to apply to the recipients of a corporate dividend, which involves multiple transfers to multiple unrelated parties.

Requested resolution

74. The ESL Parties ask that this action be dismissed with costs on a substantial indemnity basis.

May 10, 2019

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FTI CONSULTING CANADA INC., in its capacity as Court-appointed monitor in proceedings pursuant to the *Companies' Creditors Arrangement Act*, RSC 1985, c. c-36
Monitor

-and-

ESL INVESTMENTS INC. et al.
Defendants

Court File No. CV-18-00611219-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

PROCEEDING COMMENCED AT
TORONTO

STATEMENT OF DEFENCE OF ESL INVESTMENTS INC., ESL PARTNERS, LP, SPE I PARTNERS, LP, SPE MASTER I, LP, ESL INSTITUTIONAL PARTNERS, LP and EDWARD S. LAMPERT

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