

CV-18-604470-00CL

Court File No.

**ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST**



BETWEEN:

**KLAUDIO LESHNJANI, WILLIAM R. HARKER, WILLIAM C. CROWLEY,
DONALD C. ROSS, JAMES McBURNEY, EPHRAIM J. BIRD, CALVIN R.
McDONALD, RONALD BOIRE, DEIDRA C. MERRIWETHER, AND
DOUGLAS CAMPBELL**

Applicants

- and -

SEARS HOLDINGS CORPORATION

Respondent

NOTICE OF APPLICATION

TO THE RESPONDENT:

A LEGAL PROCEEDING HAS BEEN COMMENCED by the Applicant. The Claim made by the Applicant appears on the following page.

THIS APPLICATION will come on for a hearing before a Judge of the Ontario Superior Court of Justice presiding over the Commercial List at 10 a.m. on Thursday, October 18, 2018 at 330 University Avenue, 8th Floor, Toronto, Ontario.

IF YOU WISH TO OPPOSE THIS APPLICATION, to receive notice of any step in the application or to be served with any documents in the application you or an Ontario lawyer acting for you must forthwith prepare a notice of appearance in Form 38A prescribed by the *Rules of Civil Procedure*, serve it on the Applicant's lawyer or, where the Applicant does not have a lawyer, serve it on the Applicant, and file it, with proof of service, in this court office, and you or your lawyer must appear at the hearing.

IF YOU WISH TO PRESENT AFFIDAVIT OR OTHER DOCUMENTARY EVIDENCE TO THE COURT OR TO EXAMINE OR CROSS-EXAMINE WITNESSES ON THE APPLICATION, you or your lawyer must, in addition to serving your notice of appearance, serve a copy of the evidence on the Applicant's lawyer or, where the Applicant does not have a lawyer, serve it on the Applicant, and file it, with proof of service, in the court office where the application is to be heard as soon as possible, but at least four days before the hearing.

IF YOU FAIL TO APPEAR AT THE HEARING, JUDGMENT MAY BE GIVEN IN YOUR ABSENCE AND WITHOUT FURTHER NOTICE TO YOU. IF YOU WISH TO OPPOSE THIS APPLICATION BUT ARE UNABLE TO PAY LEGAL FEES, LEGAL AID MAY BE AVAILABLE TO YOU BY CONTACTING A LOCAL LEGAL AID OFFICE.

Date SEP 04 2018

Issued by


Local Registrar **May Nikolaidis**

Address of
court office:

330 University Avenue, 7th Floor
Toronto, ON M5G 1E6

TO: LENCZNER SLAGHT ROYCE SMITH GRIFFIN LLP
Suite 2600
130 Adelaide Street West
Toronto, ON M5H 3P5

Peter J. Osborne
Tel: 416.865.3094
Fax: 416.865.3974
posborne@litigate.com

Matthew B. Lerner
Tel: 416.865.2940
Fax: 416.865.2840
mlerner@litigate.com

Chris Kinnear Hunter
Tel: 416.865.2874
Fax: 416.865.2866
chunter@litigate.com

Chris Trivisonno
Tel: 416.865.3059
Fax: 416.865.3707
ctrivisonno@litigate.com

Lawyers for the Respondent, Sears Holdings Corporation

APPLICATION

1. The Applicants make an application for the following orders:
 - (a) upon the initial return of this application on October 18, 2018,
 - (i) if necessary, an order abridging the time for service of this application and dispensing with service on any person other than those served;
 - (ii) an interim order directing Sears Holdings Corporation ("**SHC**"), on an interim basis, to pay the legal fees incurred by the Former Directors (as defined herein), and reimburse any amounts already incurred, associated with the extant CCAA proceedings of Sears Canada Inc. (the "**Sears Canada CCAA Proceedings**"), including legal fees associated with defending against and responding to claims asserted in or arising out of the Sears Canada CCAA Proceedings, and costs of Coverage Counsel (as defined herein) (collectively, "**Funded Amounts**");
 - (iii) an order allowing SHC to recover from each Former Director any Funded Amounts previously paid by SHC to such Former Director, but only to the extent that such Funded Amounts are later reimbursed by XL Speciality Insurance Company ("**XL**"), or any other insurance company providing directors' and officers' insurance, to such Former Director;
 - (iv) the costs of the initial hearing, plus all applicable taxes;
 - (b) at a subsequent hearing of this application to be held only if a final judicial or arbitral determination has been made that there is no coverage or less than full coverage available to the Applicants under SHC XL Policy (as defined herein), the following final orders:

- (i) a declaration that, for a period of six years after October 15, 2014, SHC has an obligation to provide and continuously maintain directors' and officers' liability and fiduciary liability coverage for current and former directors of Sears Canada Inc. ("**Sears Canada**") for acts and omissions in their capacity as such occurring at or prior to the date of October 15, 2014 (the "**D&O Insurance**"), pursuant to the Cooperation Agreement (as defined herein) (the "**Insurance Obligation**");
- (ii) a declaration that SHC breached the Insurance Obligation;
- (iii) a final order directing SHC to compensate the Former Directors for SHC's breaches of the Insurance Obligation, including a final order directing SHC to pay to the Former Directors the Funded Amounts and other amounts (including indemnification for liability) that would have been covered by the D&O Insurance mandated by the Cooperation Agreement if SHC had, in fact, purchased such compliant coverage; and
- (iv) costs of this subsequent hearing, plus all applicable taxes.

2. The grounds for the application are:

Claims Against the Former Directors

- (a) On June 22, 2017, Sears Canada, along with certain of its affiliates (the "**Applicants**") and SearsConnect, was granted protection under the *Companies' Creditors Arrangement Act*;
- (b) Among the parties to the Sears CCAA Proceedings are certain former directors and officers of Sears Canada, ten of whom (namely, Klaudio Leshnjani, William R. Harker, William C. Crowley, Donald C. Ross, James McBurney, Ephraim J. Bird,

Calvin R. McDonald, Ronald Boire, Deidra C. Merriwether, and Douglas Campbell) are currently represented by Cassels Brock & Blackwell LLP ("**Cassels Brock**") in these proceedings (each a "**Former Director**" and, collectively, the "**Former Directors**");

- (c) On December 8, 2017, the Court issued an order (the "**Claims Procedure Order**") approving a claims process (the "**Claims Process**") for the purpose of identifying, determining, and adjudicating claims of creditors against the Applicants and their current and former officers and directors;
- (d) On February 22, 2018, the Court issued a further order establishing a claims procedure (the "**E&R Claims Process**") for the identification and quantification of Employee Claims and Retiree Claims (as defined therein) against (i) the Applicants and (ii) the current and former directors of the Applicants (the "**E&R Claims Procedure Order**");
- (e) Since the Claims Procedure Order and the E&R Claims Procedure Order were issued, a number of claims have been submitted to the Monitor against the Former Directors in accordance with the Claims Process and the E&R Claims Process (the "**Former D&O Claims**");
- (f) The Former D&O Claims are based on alleged acts and omissions of the Former Directors taking place while such Former Directors were acting as directors and/or officers of Sears Canada and generally relate to, *inter alia*, the following matters:
 - (i) the dividend paid to certain shareholders of Sears Canada on December 31, 2012 in the approximate amount of \$102 million;

- (ii) the dividend paid to certain shareholders of Sears Canada on December 6, 2013 in the approximate amount of \$509 million;
- (iii) Sears Canada's surrender of its exclusive right to use the Craftsman trademark in Canada in connection with the sale by SHC of the Craftsman business to Stanley Black & Decker in March 2017;
- (iv) alleged assurances and representations made by the Directors and others about the solvency of Sears Canada and its ability to continue to meet its obligations under various leases and other agreements;
- (v) alleged liability for environmental contamination/remediation and building rectification;
- (vi) allegations regarding misrepresentations regarding the detrimental consequences of not purchasing extended warranties;
- (vii) allegations of oppression, breaches of fiduciary duty, and transactions at undervalue, and alleged failure to ensure that Sears Canada adequately funded its contractual obligations, including lease obligations;
- (viii) alleged claims by employees of Sears Canada and its affiliates on account of wages, salaries, commissions, other compensation, benefits, and amounts payable pursuant to applicable employment standard statutes and corporate statutes (such as the *Canada Business Corporations Act*), including statutes of multiple Canadian provinces where Sears Canada carried on business;

- (ix) alleged liability under the claim brought by 1291079 Ontario Limited in the Ontario Superior Court of Justice (Milton) (Court File No. 4114/15) and an earlier action (Milton Court File No. CV-3769/13-CP) against Sears Canada, SHC, certain of the Former Directors (William C. Crowley, William R. Harker, Donald C. Ross, Ephraim J. Bird, and Douglas Campbell), and others relating to the Sears Hometown Dealer store program; and
 - (x) allegations of underfunding of Sears Canada's pension plan including a claim from Morneau Shepell Ltd. in its capacity as Administrator of Sears Canada's Registered Retirement Plan;
- (g) In addition, a number of the Former D&O Claims also allege, among other things, that, in connection with their acting as directors or officers of Sears Canada prior to October 15, 2014, the Former Directors:
- (i) engaged in negligent and/or wrongful conduct;
 - (ii) breached their fiduciary duties owed to Sears Canada, its creditors, and/or others;
 - (iii) approved dividends to shareholders to the corresponding detriment of creditors (oppressive conduct);
 - (iv) approved transaction(s) at under value to the detriment of Sears Canada and/or its creditors;
 - (v) conspired with others in furtherance of their negligent and/or wrongful conduct; and

- (vi) failed to ensure that Sears Canada adequately funded its obligations under its contractual agreements, including leases and pension plans, when they knew that failing to do so would be unjustifiably prejudicial to Sears Canada's creditors;

The Cooperation Agreement

- (h) On October 1, 2014, Sears Canada and SHC entered into a cooperation agreement setting out the terms and conditions on which Sears Canada would cooperate with SHC to facilitate SHC's offering (the "**Cooperation Agreement**");
- (i) The Cooperation Agreement is subject to Ontario law and proceedings relating to it must be brought in Ontario;
- (j) Among the terms of the Cooperation Agreement is a provision requiring SHC to put or maintain in place directors' and officers' insurance for the Former Directors for a period of six years following the Offering (as defined therein) in order to ensure that the Former Directors have sufficient insurance to cover their acts and omissions during the period that they served as directors and officers of Sears Canada prior to the closing of the Offering;
- (k) The Cooperation Agreement states the following, in relevant part:
- (i) SHC will agree to indemnify and hold harmless each of Sears Canada, its subsidiaries and their respective directors, officers, employees and representatives from and against all liabilities, claims, damages and costs (including settlement costs and reasonable fees of counsel) arising out of or based upon:
-
- all actions taken in connection with the Offering or at the request of SHC, provided such actions are taken in good faith and without negligence or willful misconduct; and
 - any breach by SHC of this letter agreement.

(hereafter the "**Indemnification Obligation**");

- (ii) For a period of 6 years following the closing of the Offering, SHC will continuously maintain directors' and officers' liability and fiduciary liability coverage for current and former directors of Sears Canada for acts and omissions in their capacity as such occurring at or prior to the closing of the Offering...on terms no less favourable to such directors and officers in any material respect than those of the insurance policies providing such coverage in effect on the date hereof; provided that this requirement shall be deemed to be satisfied if SHC elects to obtain prepaid policies (i.e., "tail coverage") which in the aggregate provide such directors and officers with the coverage described herein for an aggregate period of 6 years following closing of the Offering with respect to claims arising from acts or omissions that occurred at or before the Closing.

(hereafter, the "**Insurance Obligation**");

The Directors' and Officers' Insurance Policies

- (l) XL is the issuer of primary director and officer coverage for both SHC (the "**SHC XL Policy**") and Sears Canada (the "**Sears Canada XL Policy**");
- (m) The SHC XL Policy and the Sears Canada XL Policy (collectively, the "**XL Policies**") may each relate to a different policy period with the Sears Canada XL Policy covering claims based on facts occurring after October 15, 2014 and the SHC XL Policy covering claims based on events before such date;

The Former Directors' Insurance Claim is Denied

- (n) On March 8, 2018, and March 19, 2018, the Former Directors provided notice of the Former D&O Claims to XL under the XL Policies (the "**XL Notices**");
- (o) On May 4, 2018, XL issued coverage letters under the XL Policies (the "**Coverage Letters**") that denied that XL has any obligation to provide coverage and reimbursement of defence costs to the Former Directors in respect of the Former D&O Claims;
- (p) Because XL has refused to reimburse defence costs or indemnify against liability pursuant to the SHC XL Policy, the Former Directors have engaged Covington &

Burling LLP ("**Coverage Counsel**") to pursue coverage under the SHC XL Policy and, if necessary, by commencing proceedings in the United States. Coverage Counsel may also pursue coverage, including by commencing proceedings, if necessary, in relation to the Sears Canada XL Policy;

- (q) Unless and until there is a determination that the SHC XL Policy does provide coverage for defence costs and indemnification for liability, there is good reason to believe that SHC may not be in compliance with the Insurance Obligation including, in particular, the obligation undertaken by SHC to "continuously maintain directors' and officers' liability and fiduciary liability coverage";
- (r) Given that XL has denied coverage and that defence costs are not being paid by XL, it does not appear that SHC "continuously" maintained the required coverage in place since as at present XL is asserting that the specified coverage does not exist;
- (s) Further, the Indemnification Obligation imposes a general obligation on SHC that is in addition to the Insurance Obligation, including the duty to fund defence costs and the costs of coverage counsel, at least on an interim basis;

Request for Indemnification from SHC

- (t) The Sears Canada XL Policy and the SHC XL Policy provide coverage that is stated to be secondary to amounts that the Former Directors are able to recover through corporate indemnification agreements provided by, respectively, Sears Canada and SHC. Any Sears Canada indemnification agreements are of little practical effect given that Sears Canada is insolvent. Further, SHC has taken the position that the indemnification provisions in its corporate Charter only require SHC to indemnify directors and officers of Sears Canada for periods when they

were also acting as directors or officers of SHC, and only if those Former Directors had been specifically asked by SHC to undertake a position with Sears Canada;

- (u) To date, SHC has taken the position that, at best, it may have an obligation to indemnify certain of the Former Directors, but only in respect of the limited period in which these Former Directors concurrently served as directors of Sears Canada and were employed by SHC. SHC has indicated that any such indemnity would be quite limited given that the relevant period of time appears to predate many of the Former D&O Claims. In any event, and as at the present date, SHC has not provided any indemnity to any of the Former Directors in respect of any time period;
- (v) SHC's conduct, including its failure to place insurance coverage that is responsive to the Former D&O Claims, is oppressive to the rights of the Former Directors;

Additional Grounds

- (w) The further grounds as set out in the Affidavit of William Richard Harker, dated August 10, 2018;
- (x) the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended;
- (y) Rules 1.04, 1.05, 2.03, 3.02, 16, 38 and 57 of the *Rules of Civil Procedure*, RRO 1990, Reg. 194;
- (z) Sections 96, 97, 99, 101 and 131 of the *Courts of Justice Act*, RSO 1990, c C-43;
- (aa) Section 242 of the *Canada Business Corporations Act*, RSC, 1985, c C-44; and
- (bb) Such further and other grounds as counsel may advise and this Court may permit.

3. The following documentary evidence will be used at the hearing of the application:
- (a) the Affidavit of William Richard Harker, dated August 10, 2018; and
 - (b) such further and other evidence as the lawyers may advise and this Honourable Court may permit.

September 4, 2018

CASSELS BROCK & BLACKWELL LLP
2100 Scotia Plaza
40 King Street West
Toronto, ON M5H 3C2

John N. Birch LSO #: 38968U
Tel: 416.860.5225
Fax: 416.640.3057
jbirch@casselsbrock.com

Mary I.A. Buttery LSO #: 34599R
Tel: 604.691.6118
Fax: 604.691.6120
mbuttery@casselsbrock.com

Natalie Levine LSO #: 64908K
Tel: 416.860.6568
Fax: 416.640.3207
nlevine@casselsbrock.com

Lawyers for the Applicants

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Sears Holdings Corporation

- and -

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**ONTARIO
SUPERIOR COURT OF JUSTICE
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PROCEEDING COMMENCED AT TORONTO

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Cassels Brock & Blackwell LLP
2100 Scotia Plaza
40 King Street West
Toronto, ON M5H 3C2

John N. Birch LSO#: 38968U
Tel: 416.860.5225
Fax: 416.640.3057
jbirch@casselsbrock.com

Mary I.A. Buttery LSO#: 34599R
Tel: 604-691-6118
Fax: 604-691-6120
mbuttery@casselsbrock.com

Natalie E. Levine LSO#: 64980K
Tel: 416.860.6568
Fax: 416.640.3207
nlevine@casselsbrock.com

Lawyers for the Applicants