Court File No. CV-19-617792-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

B E T W E E N:

1291079 ONTARIO LIMITED

Plaintiff

and

SEARS CANADA INC., SEARS HOLDING CORPORATION, ESL INVESTMENTS INC., WILLIAM C. CROWLEY, WILLIAM R. HARKER, DONALD CAMPBELL ROSS, EPHRAIM J. BIRD, DEBORAH E. ROSATI, R. RAJA KHANNA, JAMES MCBURNEY and DOUGLAS CAMPBELL

Defendants

Proceeding under the *Class Proceedings Act, 1992*

STATEMENT OF DEFENCE OF ESL INVESTMENTS, INC.

1. The defendant, ESL Investments, Inc. ("**ESL Investments**"), denies the allegations contained in the fresh as amended statement of claim.

Overview

2. This action must fail for each of the following reasons:

(a) the class is a contingent judgment creditor with an unproven claim, and therefore lacks standing to bring the action under the oppression remedy;

(b) the declaration and payment of the 2013 dividend was not, on the facts and the law, an act of oppression by Sears Canada Inc. (**"SCI"**) or the named directors;

(c) the declaration and payment of the 2013 dividend was not, on the facts and the law, an act of oppression by ESL Investments; and

(d) ESL Investments did not receive a dividend from SCI.

3. No entitlement to oppression remedy. The class has no claim in oppression because it was not a "security holder, creditor, director or officer" of SCI at the time of the alleged oppressive acts. The "interest" it claims was oppressed is an unproven class action bearing Court File 3769/13 (the "**2013 Wishart Action**") that has never been tried. The class does not even propose to prove its underlying claim in this action. Instead, it seeks to enforce against ESL Investments an agreement it struck with the Monitor in SCI's insolvency proceedings. The agreement itself states the obvious: it is not binding on third parties. It is clearly not enforceable against ESL Investments.

4. No oppression by SCI and the directors. Even if the class had a claim in oppression, SCI had no obligation to preserve its assets for the benefit of the plaintiff. SCI treated the 2013 Wishart Action in accordance with applicable accounting principles, International Financial Reporting Standards and the reasonable business judgment of SCI's directors, following the receipt of professional advice. In any event, SCI could not have endangered the class' lawsuit by payment of the dividend since, even after that payment, there remained ample cash reserves to fund SCI's ongoing liabilities into the foreseeable future.

5. No oppression by ESL Investments. The class' attempt to make ESL Investments liable for SCI's alleged oppressive acts hinges upon three key assertions: that ESL Investments controlled SCI's board of directors; that it "denuded" SCI of its "prime assets"; and that it had an "urgent" and "immediate need for cash" to fund redemption obligations from the hedge funds it promoted (the "**ESL Funds**"). Each of these assertions is false.

6. First, ESL Investments was not a shareholder or affiliate of SCI, and it did not control, direct, or unduly influence 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 composed of directors who were carefully selected for their competence and expertise. Six of the eight directors who unanimously voted for the dividend had no connection whatsoever to ESL Investments. Although Sears Holdings Corporation ("**SHC**"), which was at times majority-owned by the ESL Funds and was the largest (indirect) shareholder of SCI, had a total of two nominees on the eight-member board, neither of them remained employed by SHC or ESL Investments at the time of the dividend.

7. Second, the stores SCI sold in 2013 were not SCI's "crown jewels" or "prime assets" as the class 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 class' "denuding" 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 alleged motive for the sale of the so-called "crown jewels" —that the ESL Funds were facing an "urgent" and "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. Moreover, 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 having the alleged motive to remedy a fabricated “urgent” need for cash, Edward Lampert (“**Lampert**”), the CEO of ESL Investments, demonstrated by his actions the opposite intention. Lampert continuously supported 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 Funds) only grew over time. In October, 2014, Lampert increased the ESL Funds’ shareholdings—as well as his own direct shareholdings—in SCI to their highest level ever. Given Lampert’s and the ESL Funds’ substantial stake in SCI, as well as Lampert’s role as CEO of SHC, no one had a greater interest in the success of SCI as a continuing retail business than Lampert and the ESL Funds.

10. SCI continued to operate, pay its debts and employ and pay benefits to its personnel for three-and-a-half years after it paid the impugned 2013 dividend. The class does not seek to prove that the 2013 dividend caused SCI’s 2017 insolvency 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 ESL Investments.

11. This claim should be dismissed not only because its allegations are unfounded. 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

1291079 Ontario Inc.

12. 1291079 Ontario Inc. ("**129**") is the representative plaintiff in this class action. 129 carried on business as a Sears Hometown dealer between 2007 and 2013 under an authorized dealer agreement ("**Dealer Agreement**"). As part of that business, 129 sold, on commission, inventory owned by SCI. Like other Hometown dealers, 129 was also a catalogue agent for SCI, and received commission for catalogue items ordered or picked up at its store. 129 first entered into a Dealer Agreement on June 30, 2007, and renewed the agreement on June 30, 2012 and June 30, 2013. In or around August 2013, 129 provided SCI with notice that it was terminating the Dealer Agreement. 129 ceased operating as a Hometown dealer in or around December, 2013.

13. 129 was also the representative plaintiff in the 2013 Wishart Action, which it commenced on July 5, 2013 on behalf of all entities carrying on business as a Sears Hometown Store in Canada pursuant to a Dealer Agreement ("**Dealers**"). In that action, 129 alleged that the Dealers were entitled to relief under the *Arthur Wishart Act (Franchise Disclosure),* SO 2000, c 3 (the "**Wishart Act**") as a result of SCI's alleged breaches of the duty of fair dealing and its allegedly inadequate disclosure. 129 further alleged that SCI breached its obligations under the Dealer Agreements. The 2013 Wishart Action has never been tried.

14. On October 21, 2015, 129 commenced this action, alleging that the conduct of the defendants in relation to the declaration and payment of the 2013 dividend was oppressive to its interests as a contingent judgment creditor in the unproven 2013 Wishart Action.

ESL Investments

15. In 1988, Lampert established ESL Investments, which is registered as an investment advisor with the U.S. Securities and Exchange Commission. ESL Investments is the promoter of the ESL Funds. The ESL Funds pay ESL Investments for management services. The payments are based on the size of the investment and the success of the funds.

16. Lampert is the chair and CEO of ESL Investments. 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. At the time of the 2013 dividend ESL Investments itself did not own any shares of SCI or SHC. ESL Investments received no part of the 2013 dividend.

18. From 2012 onward, the ESL Funds and Lampert held shares in SCI directly and held an indirect interest in SCI through shares in SHC. Together these interests in SCI represented a small fraction of the total assets of the ESL Funds.

Sears Holdings Corporation

19. SHC is an American holding company. It is the parent company of Kmart Holding Corporation ("**Kmart**") and Sears, Roebuck & Co ("**Sears, Roebuck**"). Through its interest in Sears, Roebuck and a number of wholly owned subsidiaries, SHC was the majority shareholder of SCI at the time of SCI's declaration of the 2013 dividend.

20. From 2005 to October, 2014, SHC indirectly held a majority of the shares of SCI. Public shareholders held the balance of the shares.

The ESL Funds' 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 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. Lampert believed that this strategy, if employed with SHC and with SCI, would produce good results.

SHC nominates Crowley and Harker to the SCI board

22. 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.

23. 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 Investments 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 Investments to found Àshe Capital Management, LP, an investment fund unaffiliated with ESL Investments, SHC or SCI.

24. 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.

Project Matrix

25. 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 SCI to concentrate its efforts on those stores that could generate a higher ROI.

26. 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).

27. Lampert thought Project Matrix made sound business sense for SCI. But SCI managed the process itself. Lampert and ESL Investments provided advice from the sidelines.

The 2013 dividend

28. 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.

29. Although Lampert expressed his opinion to Crowley, Lampert knew well that the SCI board would make the 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 Investments had no need for cash prior to the 2013 dividend

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

31. The class’ assertion that ESL Investments had an “urgent” need for cash to fund redemptions in the ESL Funds 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 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 SCI declared the 2013 dividend, 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

32. On November 19, 2013, the SCI board approved the declaration of a 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.

33. 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.

No dividend in 2014

34. 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.

35. 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

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

37. 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.

38. Ultimately, no transaction came to fruition.

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

39. 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.

40. Through the 2014 SHC rights offering, the ESL Funds and Lampert 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 Funds and Lampert became the holders of approximately 49.5% of the outstanding shares of SCI. Following the rights offering, ESL Investments continued to hold zero shares of SCI.

41. 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

42. 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.

43. 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 Investments from 2008 to 2010.

44. 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.

45. 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.

46. 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.

47. 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

48. 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.

49. 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.

50. 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

51. 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.

52. 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 2013 Wishart Action

53. The present action is premised on the allegation that the approval and payment of the 2013 dividend prevented the class from recovering damages in the still unproven 2013 Wishart Action. The class in that action was composed of all Dealers carrying on business under a Dealer Agreement with SCI at any time between July 5, 2011 and March 17, 2015.

54. ESL Investments was not a party to the 2013 Wishart Action. At the time of this pleading, ESL Investments has no access to the productions exchanged in the 2013 Wishart Action or to SCI's potentially relevant documents. ESL Investments relies on the facts and defences asserted in the statement of defence of SCI in the 2013 Wishart Action as further amended April 29, 2016.

55. 129 made three principal allegations in the 2013 Wishart Action: (1) that SCI breached duties owed to Dealers under provincial franchise legislation; (2) that SCI misrepresented the profitability of the Hometown stores to the Dealers; and (3) that the changes SCI made in August 2012 to Dealers' commission rates and advertising subsidies were detrimental to the Dealers.

56. The 2013 Wishart Action was certified as a class proceeding on September 8, 2014. The Court certified the following four common issues:

> (a) Has Sears Canada at any time since July 5, 2011 breached its obligations under the Dealer Agreements with each of the class members including the asserted obligation to exercise contractual discretion in good faith by:

(i) Failing to increase commission paid to class members;

(ii) Changing commissions paid to class members in August 2012;

(iii) Selling directly to consumers located within the class members' Market Areas (as defined in their respective Dealer Agreements), or, alternatively, by failing to pay commission to the class members for goods sold directly to consumers located within the class members' Market Areas through direct channels;

(iv) Changing local store advertising subsidies;

(v) Failing to provide a monthly accounting of how compensation was calculated; or

(vi) Imposing handling fees payable by customers on catalogue sales made by dealers?

(b) Has Sears Canada been unjustly enriched by any of the acts or omissions (a)(i) to (vi) above?

(c) If liability is established what is the appropriate measure of damages or compensation, if any, for the class?

(d) Is Sears Canada a "franchisor" within the meaning of the *Arthur Wishart Act (Franchise Disclosure)*, 2000, S.O. 2000, c. 3 (*Arthur Wishart Act)*? If so:

(i) Did Sears Canada breach the duty of fair dealing under s. 3 of the *Arthur Wishart Act* by any of the acts or omissions (a)(i) to (vi) above, and if so, what are the damages for the class?

(ii) Was Sears Canada required to deliver to each class member a disclosure document within the meaning of s. 5 of the *Arthur Wishart Act* at least fourteen days before the class member signed a Dealer Agreement or any material amendment thereof, and if so, were the provisions of s. 5(3) of the *Act* otherwise complied with? If s. 5 was not complied with, what are the damages for the class under s. 7?

57. SCI defended the 2013 Wishart Action on the basis that the class' allegations were completely without merit. In particular, in its statement of defence as further amended April 29, 2016:

(a) SCI denied that the Dealers were franchisees within the meaning of provincial franchise legislation. Under the terms of the Dealer Agreement, Dealers do not make any payments or commitments to make payments, directly or indirectly, to SCI. Rather, Dealers hold inventory owned by SCI on consignment and sell it for a commission;

(b) SCI denied that it misrepresented the profitability of the Hometown stores to the Dealers. Historically, SCI had limited visibility into the Dealers' profitability, as stores were operated as independent businesses. When SCI conducted a survey of Dealers in 2012, only 78 of 236 Dealers who had been open more than 12 months chose to respond;

(c) SCI rejected the class' questionable theory that SCI was responsible for guaranteeing the profitability of each and every Hometown store. SCI's position was that profitability depends on many factors outside of SCI's control, including both market factors and factors that lie within the Dealers' control;

(d) SCI pleaded that the August 2012 amendments to the Dealers' commission rates and advertising subsidies were within SCI's contractual rights under the Dealer Agreements and were implemented taking into account the interests of the Dealers, with the purpose of increasing Dealers' revenue. The 2013 Wishart Action class included Dealers who entered into or renewed Dealer Agreements with full knowledge of the terms of those contracts, including the August 2012 changes;

(e) SCI denied the remaining allegations regarding misrepresentation, breach of contract, breach of the duty of good faith and unjust enrichment; and

(f) SCI denied that the class members suffered any damages.

58. ESL Investments understands that:

(a) the parties completed the document discovery phase of the 2013 Wishart Action, which involved voluminous productions;

(b) the 2013 Wishart Action was set to be tried in September 2017, more than four years into the litigation;

(c) SCI complied with International Financial Reporting Standards ("**IFRS**"), a set of widely-accepted accounting standards developed by the International Accounting Standards Board;

(d) in evaluating all pending lawsuits, SCI took into account available information, including guidance from experts (such as internal and external legal counsel) to determine whether it was probable that a present legal or constructive obligation existed with respect to the claim and whether SCI could reliably measure such an obligation; and

(e) with respect to all claims against it as of February 1, 2014, including the 2013 Wishart Action, SCI concluded that although the outcome of the proceedings could not be predicted with certainty, the final disposition was not expected to have a material financial adverse effect on its consolidated financial statements, including consolidated financial positions, net earnings, income, and cash flows.

59. ESL Investments had nothing to do with the decisions SCI took in response to the 2013 Wishart Action. To the extent necessary, ESL Investments relies on the reasonableness of SCI's assessment and treatment of the 2013 Wishart Action, including the reasonableness of the actions and assessments undertaken by the former directors and officers in relation to the claim.

No liability exists under the oppression cause of action

The directors complied with their duties at all times

60. In approving the declaration of the 2013 dividend, SCI's directors properly exercised their power under the common law, the articles and by-laws of SCI and ss. 42, 43(1) and 102(1) of the *Canada Business Corporations Act*, RSC, 1985, c C-44 ("**CBCA**").

61. The class does not dispute that the declaration and payment of the 2013 dividend accorded with both requirements in s. 42 of the CBCA. First, SCI was solvent at the time of the declaration of the dividend and it would remain so after the payment of the dividend. Second, after the payment of the dividend the realizable value of SCI's assets exceeded the aggregate of its liabilities and the stated capital of all classes of its shares.

62. In addition to considering the solvency test in that provision, SCI's directors and Bird, the Chief Financial Officer of SCI at the time:

- received and considered extensive information about the performance of SCI and its progress in achieving the goals set out in Project Matrix;
- knew that, in part as a result of the sale of real estate assets, SCI had cash on hand that was surplus to its contemplated requirements and, as a result, that the health of the continuing business of SCI would not be impaired by the payment of the 2013 dividend; and
- specifically obtained a solvency certificate from management confirming the solvency of SCI both before and after the payment of the 2013 dividend.

63. It was, at the same time, reasonable for SCI's directors to believe that the cash SCI had on hand was surplus to its contemplated requirements and that, as a result, the payment of the 2013 dividend would not impair the health of the continuing business of SCI in any way that would harm SCI's shareholders and other stakeholders. This is particularly true given that SCI retained assets whose value was, by a considerable margin, more than adequate to satisfy the liabilities it had in late 2013. The decision to approve the 2013 dividend was accordingly a legitimate exercise of business judgment on the part of the directors.

The class has no standing

64. The oppression remedy exists to enforce the reasonable expectations of certain enumerated corporate stakeholders in circumstances in which it is fair to require their observance by the respondents.

65. As a contingent judgment creditor with an unproven, unliquidated claim, the class did not have a legitimate interest in the manner in which the affairs of SCI were managed that would suffice to entitle it to standing as a "complainant" under s. 238(d) of the CBCA. Nor is the class a "security holder, creditor, director or officer" whose interests are capable of being oppressed under s. 241(2) of the CBCA. In particular, the class cannot have had any reasonable expectation that the affairs of SCI would be conducted with a view to protecting its interests. This is particularly true given the dubious merit of the 2013 Wishart Action. The class does not, therefore, have standing as a complainant to bring a claim in oppression under the CBCA.

66. Further, the class has not proven, and does not seek in this action to prove, that it is entitled to judgment in the 2013 Wishart Action. Absent any attempt to prove that it had an interest capable of being oppressed (rather than an interest in an unproven lawsuit), the class is not entitled to

standing as a complainant under the CBCA or to a finding that SCI oppressed an “interest” held by a “creditor”.

The class’ alleged expectations are unreasonable

67. To the extent the class has standing under the oppression remedy, which is denied, ESL Investments denies that the class’ expectations as pleaded are reasonable.

68. A stakeholder’s expectation is reasonable if and only if it is consistent with duties recognized by the law to be owed to it by a prospective respondent.

69. The reasonable expectations that the class alleges it had would attribute to directors a duty to manage the affairs of the corporation to the benefit of contingent judgment creditors. No such duties exist at law, so no such duties can be said to ground the class’ purported expectations. Contingent judgment creditors can have no reasonable expectation that a corporation will preserve and protect its assets for their potential benefit. Nor can they have a reasonable expectation that a corporation’s affairs will be conducted with a view to protecting their contingent interest.

No oppression

70. Even if the class has a proper claim under the oppression remedy and can prove that its pleaded expectations were reasonable, which is denied, the declaration and payment of the 2013 dividend were not oppressive to the interests of the class, they were not unfairly prejudicial to such interests, and they did not unfairly disregard such interests.

71. ESL Investments relies on the reasonableness of the professional advice SCI and its directors received and on the reasonableness of SCI and its directors’ assessment and subsequent

treatment of the 2013 Wishart Action. The directors were entitled to exercise their business judgment with regard to the treatment of the 2013 Wishart Action.

72. Although ESL Investments presently has no access to the underlying advice that SCI and its directors received regarding the 2013 Wishart Action, ESL Investments understands from publicly available documents that SCI and its directors received information and professional advice regarding the viability and materiality of the 2013 Wishart Action. With the benefit of professional advice, SCI, its directors and its auditors concluded that although the outcome of the proceedings could not be predicted with certainty, the final disposition was not expected to have a material financial adverse effect on SCI's consolidated financial statements, including consolidated financial positions, net earnings, income, and cash flows. The Officer's Certificate for the solvency tests under s. 42 of the CBCA of SCI's Chief Financial Officer, Bird, dated November 18, 2013 stated: "…it is unlikely that the Corporation will be required to make payment in respect of any contingent liability within a reasonably foreseeable period."

73. In making these assessments and in the subsequent treatment of the claim, it is clear that SCI and its directors acted reasonably, and in accordance with IFRS. With the advice of counsel, management made an assessment in each fiscal year that the lawsuit presented no significant risk to SCI and would have no material impact on its consolidated financial statements.

The 2013 dividend did not cause SCI's insolvency

74. The class does not allege that the 2013 dividend *caused* SCI's insolvency in 2017, an essential element to proving its alleged damages. Attributing the 2013 dividend to SCI's insolvency would be impossible, since: (i) it occurred over three-and-a-half years after the declaration of the 2013 dividend; (ii) it was not a foreseeable consequence of the declaration and

payment of the dividend; and (iii) it would have occurred regardless of the declaration and payment of the dividend. Therefore, the 2013 dividend could not have *caused* the class' inability to recover damages in the 2013 Wishart Action.

No harm suffered as a result of the 2013 dividend

75. The class has suffered no harm as a result of the declaration and payment of the 2013 dividend because it would not have recovered damages in the 2013 Wishart Action. ESL Investments relies on all defences pleaded by SCI in the 2013 Wishart Action, including those based on the *Limitations Act, 2002*, SO 2002, c 24, Sch B.

76. In the alternative, the quantum of any damages suffered by the class is limited to the amount each class member would have received in the 2013 Wishart Action, and must be assessed on an individual basis. Any other remedy would put class members in a better position than they would have been in had the payment of the 2013 dividend not occurred, which is not permitted under the oppression remedy.

77. Moreover, the class has a duty to mitigate losses. Losses have been mitigated by way of an agreement reached with the Monitor dated December 14, 2018, which entitles the class to share in the SCI estate.

ESL Investments is not liable to the plaintiff

78. Even if the directors' declaration and payment of the 2013 dividend was oppressive to the interests of the class and caused it to suffer damages, which is denied, setting aside the declaration of the 2013 dividend and requiring ESL Investments to repay the dividend would be unjust in the circumstances. ESL Investments did not receive any of the 2013 dividend. Moreover, it did not

know, and ought not reasonably to have known, that the declaration and payment of the 2013 dividend would be oppressive to the interests of the plaintiff. Nor did ESL Investments cause the 2013 dividend to be declared and paid. ESL Investments is not an affiliate of SCI, nor is it a shareholder. In these circumstances, a remedy in oppression against ESL Investments is unavailable.

Requested resolution

79. ESL Investments asks that this action be dismissed with costs.

June 29, 2019

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Plaintiff Defendants

Court File No. CV-19-617792-00CL

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