

**ONTARIO  
SUPERIOR COURT OF JUSTICE  
COMMERCIAL LIST**

B E T W E E N:

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

Plaintiff

- and -

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

Defendants

**STATEMENT OF DEFENCE OF  
DEBORAH E. ROSATI AND R. RAJA KHANNA**

1. The defendants Deborah E. Rosati (“**Rosati**”) and R. Raja Khanna (“**Khanna**”) admit the allegations contained in paragraphs 3, 7, 8, 10(e), 10(g), 12, 22(a)-(c) (except that Rosati and Khanna have no knowledge of the alleged “Monetization Plan”), 26, 34(d), 34(f), and 45 of the statement of claim.
2. The defendants Rosati and Khanna deny the allegations contained in paragraphs 1, 11, 13, 14, 15, 18, 25, 29, 30, 31, 32, 33, 36, 37, 38, 39, 40, 41, and 42 of the statement of claim.

3. The defendants Rosati and Khanna have no knowledge in respect of the allegations contained in paragraphs 2, 4, 5, 6, 9, 10(a), 10(b), 10(c), 10(d), 10(f), 16, 17, 19, 20, 21, 23, 24, 27, 28, 34(a), 34(b), 34(c), 34(e), 35, 43, and 44 of the statement of claim.

### **Relationship with Sears Canada**

4. Sears Canada Inc. (“**Sears Canada**”) is a *Canada Business Corporations Act* (“**CBCA**”) corporation with its head office located in Toronto, Ontario. Sears Canada operated primarily as a department store chain from approximately 1952 until June 22, 2017, when it filed for and obtained protection under the *Companies’ Creditors Arrangement Act* (“**CCAA**”).

5. The defendant Rosati is a resident of Ontario and served as an independent director of Sears Canada from April 26, 2007 until her resignation effective August 14, 2018. She was not a nominee of any of the ESL parties, nor of Sears Holdings Corporation, nor of any other Sears Canada shareholder. She is a Fellow Chartered Professional Accountant and has over 30 years of experience serving in financial, operational, and strategic management and as a director of numerous public and private corporations.

6. The defendant Khanna served as an independent director of Sears Canada from October 25, 2007 until his resignation effective August 14, 2018. He was not a nominee of any of the ESL parties, nor of Sears Holdings Corporation, nor of any other Sears Canada shareholder. He holds a Bachelor of Laws degree from Osgoode Hall Law School and has over 25 years of experience serving as a director and officer of numerous public and private corporations.

7. In their capacities as directors, Rosati and Khanna received regular updates and projections from Sears Canada's management regarding Sears Canada's business operations and financial situation.

### **The 2010 to 2013 Dividends**

8. From 2010 to 2013, the Board of Directors of Sears Canada (the "**Board**") unanimously approved the following dividends, which were paid by Sears Canada:

- (a) a dividend of approximately \$376.7 million approved on May 18, 2010 and paid on June 4, 2010;
- (b) a dividend of approximately \$376.7 million approved on September 9, 2010 and paid on September 24, 2010;
- (c) a dividend of approximately \$102 million approved on December 12, 2012 and paid on December 31, 2012; and
- (d) a dividend of approximately \$509 million approved on November 18 and/or 19, 2013 and paid on December 6, 2013.

9. Prior to issuing each of the 2010 to 2013 dividends:

- (a) the Board considered the interests of Sears Canada's various stakeholders, including shareholders, creditors, and debenture holders;
- (b) the Board was informed by Sears Canada's management that Sears Canada had sufficient cash on hand to pay the dividends;

- (c) the Board received a certificate from Sears Canada's management confirming that the declaration and payment of each of the dividends was in compliance with section 42 of the *CBCA*, and in particular, certifying that:
  - (i) there were no reasonable grounds for believing that Sears Canada was, or after the payment of each of the dividends would be, unable to pay its liabilities as they became due; and
  - (ii) there were no reasonable grounds for believing that the realizable value of Sears Canada's assets, after giving effect to the payment of the dividend, would be less than the aggregate of Sears Canada's liabilities and the stated capital of all classes; and
- (d) the Board determined that issuing each of the dividends was in the best interests of Sears Canada.

10. Contrary to what is alleged in the statement of claim, Rosati and Khanna did not approve the 2013 dividend (or any other dividend) fraudulently or dishonestly for the purpose of benefiting the defendants Lampert or ESL (as defined in the statement of claim), or for any other improper purpose. Rosati and Khanna at all times acted as independent directors, and sought to do so in the best interests of Sears Canada.

### **Sears Canada's Declining Performance and CCAA Filing**

11. Following the payment of the 2013 dividend, Sears Canada continued to operate for the next three and a half years. However, its performance declined during that period, with net losses beginning in 2014.

12. In March 2014, the Board considered and discussed the declaration of another dividend. However, the Board determined not to declare a dividend at that time.

13. Factors contributing to Sears Canada's decline in financial performance included:

- (a) a general weakening of the traditional Canadian retail industry;
- (b) increased competition in the retail industry from new entrants, the growth of luxury retailers, and the expansion of online sales;
- (c) fixed costs from an overly broad footprint;
- (d) the decline of the Sears Canada catalogue business;
- (e) lower than expected conversion of catalogue customers to online customers;
- (f) the inability to secure an agreement with a financial institution for the management of Sears Canada's credit and financial services operations; and
- (g) the weakening of the Canadian dollar.

14. After a period of declining financial performance due to the factors set out above, Sears Canada became insolvent and filed for and obtained CCAA protection in June 2017.

### **The Sears Canada Registered Pension Plan**

15. Sears Canada was the sponsor employer and the administrator of the Sears Canada Inc. Registered Retirement Plan, a pension plan registered under the *Pension Benefits Act* (Ontario) (the "**Plan**").

16. The Board established an Investment Committee, which was charged with overseeing all investment activities of the Plan. Neither Rosati nor Khanna were on the Investment Committee when the Board authorized the 2013 dividend.

17. Sears Canada obtained and filed periodic actuarial valuation reports for the Plan pursuant to the provisions of the *Pension Benefits Act* (Ontario) and the regulations thereto for the purpose of establishing a funding range until the next actuarial valuation. The actuarial valuation reports for the years ended December 31, 2010, 2013, and 2015 were prepared by Aon Hewitt and set out the following going concern financial positions and solvency ratios:

	<b>2010</b>	<b>2013</b>	<b>2015</b>
<b>Going concern position</b>	\$(68,039,000)	\$14,645,000	\$29,936,000
<b>Solvency ratio</b>	0.86	0.95	0.85

18. Accordingly, as of December 31, 2013:

- (a) the Plan was fully funded on a going concern basis; and
- (b) the Plan's solvency ratio was well above 0.80, which, pursuant to pension regulations, indicates that there were no solvency concerns.

19. Contrary to what is alleged in the statement of claim, Rosati and Khanna did not prejudice the ability of Sears Canada to satisfy its pension funding obligations by approving the 2013 dividend.

20. In the two years following the payment of the 2013 dividend, the going concern position of the Plan improved by over \$15 million.

21. The metrics set out in the actuarial valuation reports were impacted by a multitude of factors unrelated to the 2013 dividend, including variances in returns on the Plan's investments and the Canadian Institute of Actuaries' adoption of revised standards applicable to pension plan valuations. The changes to applicable discount and interest rates alone increased the going concern liabilities between the 2010 and 2013 valuations by \$68,154,000.

22. The reports also calculated the scheduled special payments for the Plan, which Sears Canada was required to pay during the relevant time, and all of which were paid. When Sears Canada filed for and obtained CCAA protection, all contributions that were due to the Plan had been paid by Sears Canada.

### **Business Judgment Rule**

23. Rosati and Khanna exercised their business judgment when authorizing the 2013 dividend.

24. The decision to authorize the 2013 dividend was reasonable and appropriate at the time it was made.

25. The decision to authorize the 2013 dividend is entitled to deference under the business judgment rule.

### **No Breach of Fiduciary Duty**

26. Rosati and Khanna did not owe fiduciary duties to the Plan or the Plan beneficiaries.

27. In the alternative, to the extent that Rosati and Khanna did owe fiduciary duties to the Plan or the Plan beneficiaries (which is denied), they did not breach any such fiduciary duties by authorizing the 2013 dividend.

**No Inducement or Knowing Assistance of Breach of Fiduciary Duty**

28. The other Director Defendants (as defined in the statement of claim) did not owe fiduciary duties to the Plan or the Plan beneficiaries.

29. To the extent that the other Director Defendants did owe fiduciary duties to the Plan or the Plan beneficiaries (which is denied), they did not breach such fiduciary duties by authorizing the 2013 dividend.

30. As Plan sponsor, Sears Canada had an obligation to fund the Plan pursuant to pension regulations. As administrator of the Plan, Sears Canada owed fiduciary duties to the Plan and the Plan beneficiaries. Sears Canada did not breach any duties it owed to the Plan or the Plan beneficiaries by paying the 2013 Dividend.

31. Rosati and Khanna did not induce or knowingly assist Sears Canada or the other Director Defendants (as defined in the statement of claim) to breach any fiduciary or other duties Sears Canada or the other Director Defendants may have owed to the Plan or the Plan beneficiaries by authorizing the 2013 dividend.

**No Breach of the Duty of Care**

32. As set out above, Rosati and Khanna authorized the 2013 dividend after considering various stakeholder interests and the solvency of Sears Canada.

33. All contributions due and owing to the Plan were paid at the time of the 2013 dividend and continued to be paid until Sears Canada filed for CCAA protection three and a half years later.



34. Rosati and Khanna exercised the care, diligence and skill that a reasonably prudent director would exercise in comparable circumstances when authorizing the 2013 dividend.

35. Rosati and Khanna did not owe a duty of care to the Plan or the Plan beneficiaries.

36. To the extent that Rosati and Khanna did owe a duty of care to the Plan or the Plan beneficiaries (which is denied), they did not breach such duty of care by authorizing the 2013 dividend.

### **No Knowing Receipt**

37. The minimal payments that Rosati and Khanna received from the 2013 dividend on account of the Sears Canada shares they held were not assets transferred to them in breach of fiduciary duty.

38. If the payments that Rosati and Khanna received from the 2013 dividend on account of the Sears Canada shares they held were assets transferred to them in breach of fiduciary duty (which is denied), Rosati and Khanna had no knowledge of any such breach.

### **No Unjust Enrichment**

39. Rosati and Khanna were not unjustly enriched at the expense of the Plan and its beneficiaries by receiving payments from the 2013 dividend on account of the Sears Canada shares they held.

### **No Oppression**

40. The authorization of the 2013 dividend was not oppressive or unfairly prejudicial to the interests of the Plan and its beneficiaries and did not unfairly disregard their interests.

41. The plaintiff is not a proper “complainant” under the *CBCA*.

42. The plaintiff is not entitled to oppression relief under section 241 of the *CBCA*.

### **The Claim is Limitations Barred**

43. On January 20, 2014 – less than two months after the 2013 dividend was paid – counsel to beneficiaries of the Plan sent a letter to Sears Canada’s counsel and to each of the Board members at the time, including Rosati and Khanna, alleging that the payment of the 2013 dividend was unlawful and setting out the material facts that form the basis for the claim now asserted by the plaintiff.

44. On October 21, 2015, a putative class action was commenced by a Sears Hometown retailer against Sears Canada, Rosati, Khanna, and other defendants (including the Board at the time of the 2013 dividend and ESL Investments Inc., who are all defendants in this action) alleging that it and the putative class members were oppressed by the payment of the 2013 dividend. The material facts alleged in the statement of claim in that action are substantially the same as the material facts alleged by the plaintiff in this action.

45. The plaintiff commenced this action in December 2018 – five years after the payment of the 2013 dividend, almost five years after the January 2014 letter referred to above, and about three years after the October 2015 class action was commenced.

46. The plaintiff commenced this proceeding more than two years after the day on which the person(s) with the claim discovered the claim or on which a reasonable person with the abilities and in the circumstances of the person(s) with the claim first ought to have discovered the claim.

47. The plaintiff's claim is statute-barred by the two-year limitation period set out in section 4 of the *Limitations Act, 2002* (Ontario).

**No Damages**

48. Rosati and Khanna deny that the plaintiff has incurred losses or damage as alleged in the statement of claim, or at all. Even if the plaintiff did incur any losses or damage (which is denied):

- (a) any such losses or damages claimed are excessive, exaggerated and/or too remote to be recoverable at law;
- (b) any such losses or damage were not caused by any negligence, act, omission, breach of duty, or breach of contract on the part of the defendants in fact or in law; and
- (c) the plaintiff has failed to take reasonable or any measures to reasonably mitigate its damages.

49. The defendants Rosati and Khanna ask that this action be dismissed, with costs on an appropriate scale.

May 10, 2019

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CC: **LITIGATION SERVICE LIST**

MORNEAU SHEPELL LTD. IN ITS CAPACITY AS  
ADMINISTRATOR OF THE SEARS CANADA INC.  
REGISTERED PENSION PLAN  
Plaintiff

-and-

ESL INVESTMENTS INC. et al.

Defendants

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

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PROCEEDING COMMENCED AT  
TORONTO

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