Court File No. CV-17-11846-00CL

SEARS CANADA INC.,
AND RELATED APPLICANTS

THIRTY-EIGHTH REPORT OF FTI CONSULTING CANADA INC., AS MONITOR

August 14, 2020

Contents

Court File No. CV-17-11846-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

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

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF SEARS CANADA INC., 9370-2751 QUÉBEC INC., 191020 CANADA INC., THE CUT INC., SEARS CONTACT SERVICES INC., INITIUM LOGISTICS SERVICES INC., 9845488 CANADA INC., INITIUM TRADING AND SOURCING CORP., SEARS FLOOR COVERING CENTRES INC., 173470 CANADA INC., 2497089 ONTARIO INC., 6988741 CANADA INC., 10011711 CANADA INC., 1592580 ONTARIO LIMITED, 955041 ALBERTA LTD., 4201531 CANADA INC., 168886 CANADA INC. AND 3339611 CANADA INC.

APPLICANTS

THIRTY-EIGHTH REPORT TO THE COURT SUBMITTED BY FTI CONSULTING CANADA INC., IN ITS CAPACITY AS MONITOR

A. INTRODUCTION

1. On June 22, 2017, Sears Canada Inc. ("**Sears Canada**") and a number of its operating subsidiaries (collectively, with Sears Canada, the "**Applicants**") sought and obtained an initial order (as amended and restated on July 13, 2017, the "**Initial Order**"), under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended (the "**CCAA**"). The relief granted pursuant to the Initial Order was also extended to Sears Connect, a partnership forming part of the operations of the Applicants (and together with the Applicants, the "**Sears Canada Entities**"). The proceedings commenced under the CCAA by the Applicants are referred to herein as the "**CCAA Proceedings**".

2. The Initial Order, among other things:

   (a) appointed FTI Consulting Canada Inc. as monitor of the Sears Canada Entities (the "**Monitor**") in the CCAA Proceedings; and

   (b) granted an initial stay of proceedings against the Sears Canada Entities until July 22, 2017 (the "**Stay Period**"), which was most recently extended to September 30, 2020.

3. On October 13, 2017, the Court issued, among other orders, an order approving an agreement and a process for the liquidation of the inventory and furniture, fixtures and equipment at all remaining Sears Canada retail locations.

4. The liquidation is now completed and all Sears Canada retail locations are closed.

5. On March 2, 2018, the Court issued an Order (as amended on April 26, 2018, the "**Litigation Investigator Order**") appointing Lax O'Sullivan Lisus Gottlieb LLP as Litigation Investigator, with a mandate to identify and report on certain rights and claims that the Sears Canada Entities or any creditors of the Sears Canada Entities may have against any parties.

6. On December 3, 2018, the Monitor and the Honourable J. Douglas Cunningham, Q.C. as Court-appointed litigation trustee (the "**Litigation Trustee**"), were authorized by the Court to pursue litigation against certain third parties, on behalf of Sears Canada and its creditors, in connection with the payment of certain dividends (the "**2013 Dividend**") by Sears Canada to its shareholders in 2013 (the "**Estate 2013 Dividend Litigation**"). The Court also lifted the stay of proceedings in the Initial Order to allow the Estate 2013 Dividend Litigation, as well as a claim by Morneau Shepell Ltd. (the "**Pension Plan Administrator**"), as administrator of the Sears Canada Registered Retirement Plan (the "**Pension Plan**") and class action claims (collectively, the "**Dealer Class Action**") by certain "Sears Hometown" store dealers, each also arising from the 2013 Dividend, to be commenced or continued.

7. Following the December 3, 2018 orders, the following claims were commenced:

(a) A claim of the Monitor against ESL Investments Inc., ESL Partners, LP, SPE I Partners, LP, SPE Master I, LP, ESL Institutional Partners, LP, Edward S. Lampert (collectively, the "**ESL Parties**"), William Harker and William Crowley, as subsequently amended to include Sears Holdings Corporation ("**SHC**") as an additional defendant (the "**Monitor Claim**");

(b) A claim of Sears Canada Inc., by the Litigation Trustee, against the ESL Parties, Ephraim J. Bird, Douglas Campbell, William Crowley, William Harker, R. Raja Khanna, James McBurney, Deborah Rosati and Donald Ross, as amended to include SHC as an additional defendant (the "**Litigation Trustee Claim**"); and

(c) A claim of the Pension Plan Administrator against the ESL Parties, Ephraim J. Bird, Douglas Campbell, William Crowley, William Harker, R. Raja Khanna, James McBurney, Deborah Rosati and Donald Ross, as amended to include SHC as an additional defendant ("**Pension Administrator Claim**").

8. These claims as well as the Dealer Class Action claim (collectively, the "**Claims**") are proceeding on the Commercial List of the Ontario Superior Court of Justice under the case management of Justice McEwen.

9. On March 17, 2020, the Court granted an order approving a settlement of the Claims as against SHC (the "**SHC Settlement**"). That settlement was also approved by the United States Bankruptcy Court in the proceedings of SHC under Chapter 11 of the United States Bankruptcy Code on April 22, 2020. Pursuant to this settlement with SHC, the plaintiffs in the Claims, collectively, will have an allowed Class 4 general unsecured claim in an amount equal to CDN$200 million under the *Modified Second Amended Joint Chapter 11 Plan of Sears Holdings Corporation and its Affiliated Debtors*. The settlement with SHC is described in greater detail in the Thirty-Fifth Report of the Monitor.

10. Materials in connection with the Estate 2013 Dividend Litigation are posted on the Monitor's website at: http://cfcanada.fticonsulting.com/searscanada/.

11. In connection with the CCAA Proceedings, the Monitor has provided thirty-seven reports and twenty-three supplemental reports (collectively, the "**Prior Reports**"), and prior to its

appointment as Monitor, FTI also provided to this Court a pre-filing report of the proposed Monitor dated June 22, 2017 (the "**Pre-Filing Report**"). The Pre-Filing Report, the Prior Reports, and other Court-filed documents and notices in these CCAA Proceedings are, or will be made, available on the Monitor's website.

B. PURPOSE

12. The purpose of this thirty-eighth report of the Monitor (the "**Thirty-Eighth Report**") is to provide the Court with information regarding the motion by the plaintiffs in the Claims (the "**Plaintiffs**") for an order approving a settlement of the Claims solely as against Ephraim J. Bird, Douglas Campbell, William Crowley, William Harker, R. Raja Khanna, James McBurney, Deborah Rosati and Donald Ross (collectively, the "**Director Defendants**"), and the Monitor's comments and recommendations in connection with the foregoing.

C. TERMS OF REFERENCE

13. In preparing this Thirty-Eighth Report, the Monitor has relied upon audited and unaudited financial information of the Sears Canada Entities, the Sears Canada Entities' books and records, certain financial information prepared by the Sears Canada Entities, and discussions and correspondence with, among others, the Creditors' Committee (as defined in the Litigation Investigator Order), legal counsel to the Litigation Trustee, legal counsel to the plaintiffs in the Dealer Class Action, and legal counsel to the Pension Plan Administrator (collectively, the "**Information**").

14. Except as otherwise described in this Thirty-Eighth Report, the Monitor has not audited, reviewed, or otherwise attempted to verify the accuracy or completeness of the Information in a manner that would comply with Generally Accepted Assurance Standards pursuant to the *Chartered Professional Accountants of Canada Handbook*.

15. Future-oriented financial information reported in or relied on in preparing this Thirty-Eighth Report is based on assumptions regarding future events. Actual results will vary from these forecasts and such variations may be material.

16. The Monitor has prepared this Thirty-Eighth Report in connection with its request for approval of the Plaintiffs' settlement with the Director Defendants. The Thirty-Eighth Report should not be relied on for any other purpose.

17. Unless otherwise stated, all monetary amounts contained herein are expressed in Canadian Dollars.

18. Capitalized terms not otherwise defined herein have the meanings ascribed to them in the Director Defendants Settlement Agreement (as defined below).

D. CLAIMS AGAINST THE DIRECTOR DEFENDANTS

19. The Monitor Claim and the Litigation Trustee Claim are each asserted in the amount of $509 million plus interest and costs. The Pension Administrator Claim is asserted in the amount of the wind up deficit of the Pension Plan, then estimated at approximately $260 million. Each of the Claims relates to a $509 million dividend declared by Sears Canada and paid to its shareholders in 2013. The Dealer Class Action claim is asserted in the amount of $80 million.

20. The Director Defendants were all directors or officers of Sears Canada at the time of the 2013 Dividend.

21. The Claims allege that the Director Defendants, or in the case of the Monitor Claim certain of the Director Defendants, are jointly and severally liable for all amounts claimed therein.

22. Copies of the Statements of Claim (as may have been amended) issued in the Monitor Claim, the Litigation Trustee Claim, the Pension Administrator Claim and the Dealer Class Action are attached hereto as Appendix "A". Copies of the Statements of Defence filed by the Director Defendants in these actions are attached hereto as Appendix "B".

E. SETTLEMENT NEGOTIATIONS WITH DIRECTOR DEFENDANTS

23. In accordance with the Court-ordered timetable for the Claims, the parties involved in the Claims attended a non-judicial mediation in February 2020 (the "**First Mediation**").

24. While the details of the discussions at the First Mediation are confidential, the Monitor can advise that the First Mediation did not result in a settlement of any of the Claims. However, it did result in the commencement of a dialogue between counsel for the Plaintiffs and counsel for the Director Defendants regarding potential settlement.

25. On April 22, 2020, a judicial mediation regarding the Claims was directed by Justice McEwen (the "**Judicial Mediation**").

26. The Judicial Mediation was conducted by Justice Hainey commencing on June 8, 2020.

27. Following lengthy negotiations in the context of the Judicial Mediation, the Director Defendants and the Plaintiffs have agreed, as a global settlement of all claims that the Plaintiffs may have against the Director Defendants, that the Plaintiffs, collectively, would receive $50 million, to be paid by the Insurers (as defined below) subject to the terms of the Director Defendant Settlement Agreement (as defined and described in greater detail below).

28. Subject to Court approval, the Monitor has agreed to the proposed settlement and is, for the reasons set out below, supportive of the economic terms of the proposed settlement:

    (a) The proposed settlement is fair and reasonable in view of: (i) the merits and risks associated with the claims against the Director Defendants in the Estate 2013 Dividend Litigation; (ii) uncertainties around the ability to recover any judgment from the Director Defendants personally; and (iii) the amount of available insurance under the D&O Policies (as defined and described below).

    (b) The proposed settlement is also consistent with the purposes of the CCAA as it would reduce the litigation costs to be incurred by the estate of Sears Canada and, in the case of the Monitor's claim, provides an opportunity for recovery on a claim advanced pursuant to Section 36.1 of the CCAA.

29. The Monitor and the Litigation Trustee provided updates to, and consulted with, the Creditors' Committee on the status of the settlement discussions with the Director

Defendants. The Monitor has been advised that the Creditors' Committee supports the proposed settlement.

F. D&O INSURANCE

30. The amounts payable pursuant to the Director Defendant Settlement Agreement are to be funded by the insurers under the policies that provide coverage to the Director Defendants in connection with the Claims.

31. Counsel for the Plaintiffs have reviewed the director and officer liability insurance policies that were identified by the Director Defendants as the policies applicable to the Claims (the "**D&O Policies**"). These D&O Policies relate to the May 15, 2015 to May 15, 2016 policy period. The Plaintiffs were informed that the 2015 – 2016 policy year is the relevant policy year for the Claims because the Dealer Class Action claim was commenced during that policy year. These D&O Policies cover SHC and certain of its affiliates, including Sears Canada. The aggregate limits under all primary and excess layers for the D&O Policies is US$150 million.

32. While the maximum available insurance coverage significantly exceeds the value of the proposed settlement with the Director Defendants, the Plaintiffs were required to consider the portion of the available insurance coverage that could reasonably be allocated solely to the settlement of the Plaintiffs' Claims against the Director Defendants. The Monitor has been informed by counsel for the Director Defendants that prior to the commencement of the Actions, the insurance coverage had already been eroded in connection with prior claims. In addition to the Plaintiffs' Claims, there may be other material claims by other parties against these same D&O Policies that provide coverage for directors and officers of SHC and other affiliates of SHC, particularly in the context of the Chapter 11 proceedings of SHC.

33. For example, Sears Holdings Corporation ("**SHC**") and several other related companies have commenced proceedings in the United States Bankruptcy Court for the Southern District of New York (White Plains (Court File No. 19-08250-rdd) (the "**SHC Proceeding**") against numerous officers and directors of SHC as well as a number of the ESL Parties. The Monitor has been informed by counsel to the Director Defendants that

the defendants in the SHC Proceeding have taken the position that they are entitled to receive payment from the Insurers of defence costs and indemnification for liability under the D&O Policies. The Monitor further understands from counsel to the Director Defendants that the defence costs of the Director Defendants in the Claims have been paid out of such policies. The Settlement Funds will also be paid under such policies. The Monitor intends to give notice of this motion to the defendants in the SHC Proceeding.

34. The Monitor is informed by counsel for the Director Defendants that the Insurers were actively engaged in the negotiation of the Director Defendant Settlement Agreement.

G. DIRECTOR DEFENDANT SETTLEMENT AGREEMENT[1]

35. The terms of the proposed settlement with Director Defendants are set out in a settlement agreement between the Plaintiffs and the Director Defendants (the "**Director Defendant Settlement Agreement**"). A copy of the Director Defendant Settlement Agreement is attached hereto as Appendix "C".

36. A summary of the material terms of the Director Defendant Settlement Agreement is set out below:

(a) Settlement Funds: The Director Defendants will cause the Insurers to pay to the Plaintiffs the amount of $50,000,000 in full and final satisfaction of all Released Claims (as defined and described below) (the "**Settlement Funds**"). The term "Insurers" as used in the Director Defendant Settlement Agreement shall not include QBE Insurance Corporation as insurer under the first excess layer of the D&O Policies.[2] The Settlement Funds are to be paid to the Monitor, in trust for

[1] This summary is provided for general information purposes only. In the case of any inconsistency between this summary and the terms of the Director Defendant Settlement Agreement, the Director Defendant Settlement Agreement shall govern.

[2] The Monitor has been informed that QBE Insurance Corporation has taken the position that it has no obligation to provide coverage to the Director Defendants in connection with, among other things, the Claims. This matter is subject to an ongoing proceeding in Illinois. The Director Defendant Settlement Agreement provides that if QBE Insurance Corporation agrees to pay or does in fact pay the full limits of its policy in respect of the Settlement Funds or defence expenses, then QBE shall be treated as an Insurer for the purposes of the Director Defendant Settlement Agreement.

the Plaintiffs, within ten business days after the required approval order of the Court is granted and has become final and non-appealable.

(b) Effective Date: The settlement shall become effective upon: (i) the court order approving the settlement becoming a final order, (ii) releases in the form attached to the Director Defendant Settlement Agreement being signed, and (iii) receipt of the Settlement Funds by the Monitor.

(c) Released Claims: The Settlement Agreement provides for releases in favour of: (i) the Director Defendants; (ii) the Insurers (other than QBE Insurance Corporation); and (iii) all other Insured Persons solely in regard to claims with respect to Loss arising from one or more Wrongful Acts of that other Insured Person undertaken in that person's capacity as an Insured Person (as those capitalized terms are defined in the primary layer of the D&O Policies) (the "**Released Claims**").

(d) No Admission of Liability: Payment of the Settlement Funds will not in any manner constitute an admission of liability or wrongdoing on the part of the Director Defendants.

(e) Court Approval: The settlement is conditional upon receipt of approval of this Court and of the court in the Dealer Class Action proceedings (the "**Approval Order**"). The terms of the proposed Approval Order are discussed in greater detail below.

(f) Obligations Regarding Production and Assistance: If requested by the Plaintiffs, the Director Defendants shall appear and give sworn evidence as witnesses at the trials of the Claims as against the ESL Parties. Sears Canada shall pay the legal costs of the Director Defendants' current counsel in connection with the Director Defendants' preparation for testimony at the trials of the Claims in an amount not to exceed $100,000 in the aggregate.

(g) CCAA Plan: Sears Canada agrees to amend its Joint Plan of Compromise and Arrangement (the "**CCAA Plan**") to provide for full and complete releases in favour of the Director Defendants consistent with the Director Defendant

Settlement Agreement. However, the Monitor notes that the effectiveness of the settlement is not conditional upon the prior implementation of the CCAA Plan as so amended.

(h) Director Defendant Indemnity Claims: The Director Defendants agree that they will waive any distribution on account of their indemnity claims and release any such indemnity claims filed in the CCAA Proceedings to the extent that those indemnity claims relate to the subject matter of the Claims.

37. The terms of the Director Defendant Settlement Agreement are, in the Monitor's view, reasonable and consistent with the usual terms of settlement agreements entered into in proceedings under the CCAA.

H. APPROVAL ORDER

38. The proposed settlement is conditional upon the granting of the Approval Order substantially in the form of the order attached as Schedule "C" to the Director Defendant Settlement Agreement.

39. The form of Approval Order would, among other things:

(a) approve the Director Defendant Settlement Agreement, including for the purposes of the *Class Proceedings Act, 1992* in the case of the Dealer Class Action;

(b) approve releases and bar orders for the Released Claims described in the Director Defendant Settlement Agreement, which releases and bar orders shall apply to Released Claims asserted by all persons, including those not party to the Director Defendant Settlement Agreement;

(c) confirm that the Claims of the Plaintiffs as against the ESL Parties are not barred, which claims are scheduled to go to trial starting September 8, 2020; and

(d) direct that the Plaintiffs' recovery from the ESL Parties with which any Director Defendant is judicially determined to be jointly and severally liable shall be limited to only that proportion of damages attributable to the liability of the ESL Parties.

40. In addition, the Director Defendant Settlement Agreement is conditional upon the Approval Order containing the following declarations regarding the D&O Policies, which the Monitor understands are requested by the Insurers:

(a) The payment of the Settlement Funds is fair and reasonable in the circumstances, is made in good faith, does not violate the interest of any person who may claim against any person or entity potentially covered by the D&O Policies, and constitutes a covered Loss (as defined in the D&O Policies);

(b) The payment of the Settlement Funds by these Insurers reduces the remaining limits of the D&O Policies;

(c) The payment of the Settlement Funds is without prejudice to the coverage positions of the Insurers with respect to any other claim made under the D&O Policies; and

(d) After the effective date of the Director Defendant Settlement Agreement, and subject to the payment of defence costs, the Insurers are released from any further obligation in respect of the matters set out in the Claims with respect to the Director Defendants and any other Insured Person.

41. The Settlement Funds shall only be paid and the Director Defendant Settlement Agreement shall only become effective upon the Approval Order becoming final and non-appealable. The Monitor has been advised by counsel that regulations related to the COVID-19 pandemic could have the effect of suspending the appeal periods for orders granted by the Court at this time unless otherwise directed by the Court. The Plaintiffs seek an Order confirming that the appeal periods established under applicable legislation will continue to apply to the Approval Order.

I. RELEASES

42. The Director Defendant Settlement Agreement provides a comprehensive release in favour of the Director Defendants, Insurers, and other Insured Persons in respect of the Released Claims. The requested form of Approval Order contains similar releases that apply to all

potential claimants, and not just the parties to the Director Defendant Settlement Agreement.

43. The requested form of Approval Order also includes a bar of the Released Claims, which includes all D&O Claims (as defined in the Director Defendant Settlement Agreement) including claims against the Director Defendants contemplated in Section 5.1(2) and 19(2) of the CCAA. This is a requirement of the Director Defendant Settlement Agreement and is requested by the Director Defendants and the Insurers in return for the consideration paid by the Insurers. The Monitor notes that certain of the specific allegations in the Claims would fall within the scope of 5.1(2) and 19(2) of the CCAA.

44. The Monitor believes the Director Defendants' and the Insurers' requests for these releases is reasonable in the circumstances to provide finality in respect of any claims that may be raised against the Director Defendants or the Insurers in return for the payment of $50 million.

45. Pursuant to the Claims Procedure Order granted on December 8, 2017 and the Employee and Retiree Claims Procedure Order granted on February 22, 2018 in the CCAA Proceedings (collectively, the "**Claims Procedure Orders**"), the Monitor called for claims against the then current and former directors of the Applicants.

46. Each of the Claims Procedure Orders established a bar date for the filing of claims against the then current or former directors of the Applicants and those bar dates have now passed.

47. All claims filed against the current or former directors of Sears Canada under the Claims Procedure Orders have been either disallowed without dispute or resolved with the exception of (a) certain 'placeholder' claims in unspecified amounts; (b) claims that overlap with the subject matter of the Claims that are settled in the Director Defendant Settlement Agreement; (c) claims by other defendants in the Estate 2013 Dividend Litigation; (d) a single claim by an individual creditor that is in the process of being resolved and (e) a claim by an equity holder of Sears Canada for oppression and breaches of duty by the directors and officers of Sears Canada in connection with commencement of the CCAA Proceedings by Sears Canada.

48. The Monitor is not aware of any unresolved proof of claim filed pursuant to the Claims Procedure Orders against a Director Defendant that now advances a *specified claim* in a *specified amount* and that is unrelated to the subject matter of the 2013 Dividend litigation, other than the claim described in paragraph 47(d) and (e) above.

49. All parties with unresolved claims filed against the Director Defendants will receive notice of the proposed settlement with the Director Defendants. Any claims not filed in accordance with the Claims Procedure Orders are now barred in accordance with the Claims Procedure Orders.

50. The Monitor notes that, pursuant to the Litigation Investigator Order, the Litigation Investigator was appointed for the purpose of investigating, considering and reporting regarding any rights or claims that Sears Canada and/or any creditors of Sears Canada may have against any parties, including but not limited to the current and former directors of Sears Canada. After review of the Litigation Investigator's report, no claims other than the Litigation Trustee Claim and the Monitor Claim have been pursued by Sears Canada or the Monitor against the Director Defendants or any other directors and officers.

J. ALLOCATION OF SETTLEMENT FUNDS

51. The payment of the Settlement Funds pursuant to the Director Defendant Settlement Agreement will be made to the Monitor in trust for the Plaintiffs.

52. The Settlement Funds will then need to be allocated between the Dealer Class Action plaintiffs, Sears Canada, and the Pension Plan. The Plaintiffs are currently finalizing agreements with respect to the allocation of these proceeds.

K. MONITOR'S RECOMMENDATION

53. The Director Defendant Settlement Agreement is the result of extensive arm's-length negotiations between the Plaintiffs and the Director Defendants and provides material and immediate value to Sears Canada and its stakeholders. For the reasons set out in paragraphs 23 through 29 of this Thirty-Eighth Report, the Monitor recommends that the Director Defendant Settlement Agreement be approved.

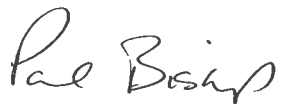
54. The Monitor also supports the proposed form of Approval Order. The Approval Order provides certainty and finality to the Director Defendants and the Insurers regarding the claims to which they may be subject in connection with Sears Canada. The Approval Order also ensures that the Plaintiffs are not in a position to receive duplicate recoveries from the Director Defendants, the Insurers and the ESL Parties, while preserving the Plaintiffs' ability to pursue the Claims against the ESL Parties.

55. The implementation of the Director Defendant Settlement Agreement will allow the remaining Claims against the ESL Parties to proceed efficiently to trial in September of this year.

The Monitor respectfully submits to the Court this, its Thirty-Eighth Report.

Dated this 14th day of August, 2020.

FTI Consulting Canada Inc.
in its capacity as Monitor of
the Sears Canada Entities



Paul Bishop
Senior Managing Director

Greg Watson
Senior Managing Director

APPENDIX "A"

AMENDED THIS July 5/19 PURSUANT TO
MODIFIÉ CE CONFORMÉMENT À
☐ RULE/LA RÈGLE 26.02 (
☑ THE ORDER OF Justice McEwen
L'ORDONNANCE DU
DATED/FAIT LE June 18, 2019

REGISTRAR SUPERIOR COURT OF JUSTICE / GREFFIER COUR SUPÉRIEURE DE JUSTICE

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

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

BETWEEN:

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, SEARS HOLDINGS CORPORATION, WILLIAM HARKER and WILLIAM CROWLEY

Defendants

AMENDED STATEMENT OF CLAIM

A LEGAL PROCEEDING HAS BEEN COMMENCED AGAINST YOU by the plaintiff. The claim made against you is set out in the following pages.

IF YOU WISH TO DEFEND THIS PROCEEDING, you or an Ontario lawyer acting for you must prepare a statement of defence in Form 18A prescribed by the *Rules of Civil Procedure*, serve it on the plaintiff's lawyer or, where the plaintiff does not have a lawyer, serve it on the plaintiff, and file it, with proof of service, in this court office, WITHIN TWENTY DAYS after this statement of claim is served on you, if you are served in Ontario.

If you are served in another province or territory of Canada or in the United States of America, the period for serving and filing your statement of defence is forty days. If you are served outside Canada and the United States of America, the period is sixty days.

Instead of serving and filing a statement of defence, you may serve and file a notice of intent to defend in Form 18B prescribed by the *Rules of Civil Procedure*. This will entitle you to ten more days within which to serve and file your statement of defence.

IF YOU FAIL TO DEFEND THIS PROCEEDING, JUDGMENT MAY BE GIVEN AGAINST YOU IN YOUR ABSENCE AND WITHOUT FURTHER NOTICE TO YOU. IF YOU WISH TO DEFEND THIS PROCEEDING BUT ARE UNABLE TO PAY LEGAL FEES, LEGAL AID MAY BE AVAILABLE TO YOU BY CONTACTING A LOCAL LEGAL AID OFFICE.

TAKE NOTICE: THIS ACTION WILL AUTOMATICALLY BE DISMISSED if it has not been set down for trial or terminated by any means within five years after the action was commenced unless otherwise ordered by the court.

Date: ~~May~~ December 19, 2018 ~~, 2019~~

Issued by "Ray Williams"
Local registrar

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CLAIM

1 The Plaintiff, FTI Consulting Canada Inc., in its capacity as Court-appointed monitor of Sears Canada Inc. (**Sears**) in proceedings pursuant to the *Companies' Creditors Arrangement Act*, RSC 1985, c. c-36 (the **CCAA**) (the **Monitor**) claims against the Defendants:

(a) a declaration that the transfer of funds to the Defendants, ESL Investments Inc. (**ESL Investments**), ESL Partners, LP, SPE I Partners, LP, SPE Master I, LP, ESL Institutional Partners, LP, ~~and~~ Edward S. Lampert (**Lampert**), Harker and Sears Holdings Corporation (**Holdings**), by means of a dividend of $5.00 per share paid by Sears on December 6, 2013 (the **2013 Dividend**):

(i) was a transfer at undervalue for the purposes of section 96 of the *Bankruptcy and Insolvency Act*, RSC, 1985, c. B-3 (the **BIA**), as incorporated into the CCAA by section 36.1 thereof (the **Transfer at Undervalue**); and

(ii) is void as against the Monitor;

(b) an order that the Defendants, either as parties to the 2013 Dividend or as privies thereto, or both, shall jointly and severally pay to Sears the full amount of the 2013 Dividend, being approximately $509 million in total;

(c) in the alternative, an order that the Defendants, either as parties to the 2013 Dividend or as privies thereto, or both, shall jointly and severally pay to Sears the portion of the 2013 Dividend received by the Defendants, collectively;

(d) in the further alternative, an order that each of the Defendants, either as parties to the 2013 Dividend or as privies thereto, or both, shall pay to Sears the amount of the 2013 Dividend that such Defendant received, or directly or indirectly benefitted from;

(e) pre and post-judgment interest in accordance with the *Courts of Justice Act*, RSO 1990, c. C.43; and

(f) costs of this action on a substantial indemnity basis.

The Parties

2 Sears and its affiliate companies obtained protection under the CCAA on June 22, 2017, and pursuant to section 11.7 of the CCAA, the Plaintiff was appointed as Monitor under the Initial Order. On December 3, 2018, the Monitor obtained authorization from the Court to bring this action.

3 The Defendant ESL Investments is a privately-owned hedge fund incorporated under the laws of Delaware with its principal executive offices located at 1170 Kane Concourse, Bay Harbor Islands, Florida. The Defendants ESL Partners, LP, SPE I Partners, LP, SPE Master I, LP, and ESL Institutional Partners, LP (collectively, and together with ESL Investments, **ESL**) are affiliates of ESL Investments.

4 The Defendant Lampert is an individual residing in Indian Creek, Florida. At all material times, Lampert controlled ESL, and has served as ESL Investments' Chairman and Chief Executive Officer since its creation in 1988.

4A The Defendant Holdings is a corporation incorporated under the laws of Delaware. Holdings principal executive offices are located at 3333 Beverly Road, Hoffman Estates,

Illinois. On October 15, 2018, Holdings filed for Chapter 11 protection from creditors with the United States Bankruptcy Court.

5 The Defendant William Crowley was a non-independent director of Sears from March 2005 to April 2015, including at the time the 2013 Dividend was approved by the Sears Board and paid to Sears' shareholders.

6 The Defendant William Harker was a non-independent director of Sears from November 2008 to April 2015, including at the time the 2013 Dividend was approved by the Sears Board and paid to Sears' shareholders.

7 At all material times, including on November 18, 2013 through to December 3, 2013, Lampert and ESL held a controlling ownership interest in Sears Holdings Corporation (**Holdings**) and beneficially owned 55% of Holdings' outstanding shares. In turn, at all material times, Holdings held a controlling ownership interest in Sears. ~~On October 15, 2018, Holdings filed for Chapter 11 protection from creditors with the United States Bankruptcy Court. Holdings is not a party to this action.~~

8 At all material times, including on November 18, 2013 through to December 6, 2013, ~~Holdings and~~ each of the Defendants other than Crowley was a direct or beneficial shareholder of Sears, and held the following ownership interests:

(a) Holdings beneficially owned 51,962,391 shares in Sears, representing approximately 51% of the outstanding shares~~.~~;

(b) ESL beneficially owned 17,725,280 shares in Sears, representing approximately 17.4% of the outstanding shares, which were directly held as follows:

(i) ESL Partners, LP: 15,821,206 shares;

(ii) SPE I Partners, LP: 830,852 shares;

(iii) SPE Master I, LP: 1,068,522 shares;

(iv) ESL Institutional Partners, LP: 4,381 shares; and

(v) CRK Partners, LLC (an affiliate of ESL Investments, Inc. that was voluntarily cancelled effective June 1, 2018 and is not a party to these proceedings): 319 shares;

(c) Lampert owned 10,433,088 shares in Sears, representing approximately 10.2% of the outstanding shares; and

(d) Harker owned 4,604 shares in Sears.

9 In this action, the Monitor seeks a declaration that the 2013 Dividend was a transfer at undervalue pursuant to section 96 of the BIA (as incorporated into proceedings under the CCAA by section 36.1 thereof) and is therefore void as against the Monitor, and it seeks payment from the Defendants who were parties and/or privies to the Transfer at Undervalue.

Sears' Operational Decline

10 Beginning in 2011, Sears' financial performance began to decline sharply. According to Sears' publicly-disclosed audited annual financial statements for 2010 – 2013 (as amended, in certain cases), Sears' revenues, operating profits/losses and gross margin rates were as follows:

Year	Total Revenues ($ million)	Operating Profit (Loss) ($ millions)	Gross Margin Rate
2010	4,938.5	196.3	39.3%
2011	4,619.3	(50.9)	36.5%
2012	4,300.7	(82.9)	36.7%
2013	3,991.8	(187.8)	36.2%

11 As early as 2011, Sears' management recognized that drastic, transformative action would be required for Sears to re-establish a foothold in the Canadian retail market. In the 2011 strategic plan (the **2011 Strategic Plan**) prepared for Sears' board of directors (the **Board**), then-Chief Executive Officer Calvin McDonald described the state of Sears as follows:

> Sears Canada is not a good retailer. Our business is broken: trading is awkward and inefficient, we lack product and merchandising focus and we are becoming irrelevant to customers while losing touch with our core.
>
> [...]
>
> We lack many of the fundamental processes, structures and culture of a strong retailer. In short, we lack 'retail rhythm'. However, most of our challenges are self-induced, meaning we are in a position to fix them.

12 The 2011 Strategic Plan also made clear that if transformative action was not taken, Sears could not expect to re-emerge as a successful retailer: "If we do not innovate, we will cease to be relevant." More directly, the 2011 Strategic Plan warned that "the current trajectory of growth and margin decline would take EBITDA into negative territory if we do not take drastic action."

13 Notwithstanding the concerning operational trends identified in the 2011 Strategic Plan, Sears failed to take the necessary action to reinvigorate its business. Between 2011 and 2013, Sears consistently invested fewer resources on growth and transformational initiatives relative to its industry peers. In particular, the Board rejected multiple attempts by management, including in particular McDonald, to use Sears' capital to revitalize its business.

2013 Plan to Dispose of Real Estate Assets to Fund Dividends

14 By 2013, ESL Investments and Lampert had an immediate need for cash from Sears. ESL Investments had raised money from investors years earlier on terms that precluded these investors from redeeming their investment for a period of time. In 2013, this holding period had expired, investors were entitled to withdraw funds and ESL Investments faced significant redemptions.

15 In order to satisfy its redemption obligations, ESL and Lampert devised a plan to extract cash from Sears through (a) the disposition of its most valuable real estate assets, and (b) the payment of an extraordinary dividend for the benefit of ESL, ~~and~~ Lampert, and Holdings (collectively the **Monetization Plan**).

16 To give effect to the Monetization Plan, Lampert personally directed the disposition of Sears' real estate assets in 2013. Lampert provided specific instructions to Sears on the price sought by Sears for its dispositions. The Monitor specifically denies Lampert's public statement on February 11, 2018:

> While I take no issue with the decisions that the board of Sears Canada made with regard to dividends and certain real estate sales, I have to emphasize that I have never served as a director or officer of Sears Canada, so I don't have firsthand knowledge of their internal deliberations and the alternatives considered.

17 At all materials times, Lampert directed and acted in concert with officers and directors of Sears to implement the Monetization Plan, including in particular with Crowley (then Chair of the Sears Board), Harker (then a director of Sears), and E.J. Bird (then Chief Financial Officer of Sears). Jeffrey Stollenwerck (then President, Real Estate Business Unit of Holdings) was also engaged by ESL and Lampert on these matters. Lampert had a longstanding professional and personal relationship with each of them:

(a) Crowley had acted as President and Chief Operating Officer of ESL Investments from January 1999 to May 2012, Executive Vice-President and Chief Administrative Officer of Holdings from September 2005 to January 2011 and Chief Financial Officer of Holdings for periods in 2005-2007;

(b) Harker was an Executive Vice-President and General Counsel of ESL Investments from February 2011 to June 2012 and an officer of Holdings from September 2005 until August 2012, during which time he acted variously as General Counsel, Corporate Secretary and Senior Vice-President, among other roles;

(c) Bird was the Chief Financial Officer of ESL Investments from 1991 until 2002; and

(d) Stollenwerck was the President of the Real Estate Business Unit of Holdings from February 2008 to April 2018 and a Senior Vice President, Real Estate for Holdings from March 2005 to February 2008. Before joining Holdings, Stollenwerck had acted as Vice-President, Research at ESL Investments.

18 In accordance with the Monetization Plan, Sears entered into an agreement with Oxford Properties Group on or about June 14, 2013 to terminate Sears' leases at Yorkdale Shopping Centre and Square One Mississauga in exchange for a payment to Sears of $191 million (the **Oxford Terminations**). The Oxford Terminations closed June 24, 2013.

September 2013 Board Presentations

19 On September 23, 2013, two years after the 2011 Strategic Plan, the Board received a series of management presentations directly addressing Sears' deteriorating operational and financial performance (the **2013 Board Presentations**). Among other things, the 2013 Board Presentations reported that:

(a) sales continued to decline across Sears' business at a rate of 2.6% per year;

(b) based on year-to-date current trends (and without appropriately accounting for stores closed in connection with the Monetization Plan), Sears' projected EBITDA by 2016 would be negative $105 million; and

(c) Sears was struggling operationally: "Basics not fixed".

20 Earlier that month, Board presentations had also recognized that competition in the Canadian retail space was increasing with Target's entry into the market. Target had opened 68 stores in Canada in the second quarter of 2013, and planned to open a further 124 stores in Canada by year end.

21 Following the 2013 Board Presentations, the Board knew or ought to have known that Sears' business was in decline and that its long term viability was at risk.

Continued Disposition of Real Estate Assets

22 In accordance with the Monetization Plan, Sears pursued an agreement with Cadillac Fairview Corporation Limited (**Cadillac Fairview**) to terminate five additional high-value leases (Toronto Eaton Centre, Sherway Gardens, Markville Shopping Centre, Masonville Place and Richmond Centre) (the **Cadillac Terminations**).

23 Lampert directed the negotiating strategy in connection with the Cadillac Terminations with a view to ensuring a dividend of the proceeds before the end of 2013. Crowley and Stollenwerck negotiated directly with Cadillac Fairview, including with respect to the final price of $400 million.

24 On October 28, 2013, the Board approved the Cadillac Terminations. The Board was not advised of the role that Lampert, Crowley or Stollenwerk had played in negotiating the Cadillac Terminations. The Cadillac Terminations closed on November 12, 2013.

25 In the same period, Sears and Stollenwerck negotiated the sale of Sears' 50% interest in eight properties jointly owned with The Westcliff Group of Companies. Sears' 50% interest was sold to Montez Income Properties Corporation in exchange for approximately $315 million (the **Montez Sale**).

26 The Sears Board approved the Montez Sale on November 8, 2013. The approval was made by written resolution and without an in-person board meeting.

27 The Montez Sale closed in January 2014.

28 The assets disposed of by Sears were its "crown jewels". It was plain that the divestment of these key assets in 2013, while Sears was struggling in the face of stiffer retail competition from Target and others, would have a dramatic negative impact on Sears. The negative impact in fact unfolded:

Year	Total Revenues ($ million)	Operating Profit (Loss) ($ millions)	Gross Margin Rate
2012	4,300.7	(82.9)	36.7%
2013	3,991.8	(187.8)	36.2%
2014	3,424.5	(407.3)	32.6%
2015	3,145.5	(298.3)	31.8%
2016	2,613.6	(422.4)	27.3%

29 Lampert directed Sears to complete each of the Oxford Terminations, the Cadillac Terminations and the Montez Sale. These dispositions were part of the Monetization Plan, and completed in order to provide ESL Investments with funds to address its redemption obligations.

The 2013 Dividend

30 On November 12, 2013, the same day Sears received $400 million in proceeds from the Cadillac Terminations, Crowley directed Bird to move forward with an extraordinary dividend of between $5.00 and $8.00 per share.

31 On November 18 and 19, 2013, six days after the closing of the Cadillac Terminations, the Board held an in-person meeting (the **November Meeting**). Although Sears had no business operations in the United States, the November Meeting was held in New York City at the offices of Wachtell, Lipton, Rosen & Katz (**Wachtell**), legal counsel to Holdings.

32 The November Meeting began with a short pre-dinner discussion on November 18 and continued with a full day session on November 19, 2013.

33 During the short pre-dinner discussion on November 18, 2013, the Board unanimously resolved to declare the 2013 Dividend, an extraordinary dividend of $5.00 per common share, for an aggregate dividend payment of approximately $509 million.

34 The circumstances surrounding the 2013 Dividend raise a series of red flags.

Lack of Notice to the Board

35 The Board had no advance notice that it would be asked to consider an extraordinary dividend at the November Meeting.

36 On Friday November 15, 2013, the Board was provided with a package of material for the November Meeting (the **Board Materials**). The Board Materials included a detailed agenda with 15 separate items for the Board to consider during the November Meeting.

37 Neither the agenda nor any of the other Board Materials made any reference to the fact that the Board would be asked to consider an extraordinary dividend or any dividend at all. Moreover, the possible payment of a dividend had not been tabled in any prior Board meeting in 2013.

Lack of Information

38 The Board was not provided with the information necessary to assess the appropriateness of an extraordinary dividend.

39 Unlike past instances in which the Board was asked to consider an extraordinary dividend, the Board Materials did not contain any financial or operational information regarding the payment of a proposed dividend. The Board did not receive:

(a) any written materials regarding a proposed dividend or possible dividend structures;

(b) any written presentation analyzing the impact the proposed dividend would have on Sears' business, including taking into account possible downside scenarios; or

(c) any *pro forma* assessment of Sears' liquidity and cash flows following the payment of a dividend. Rather, the *pro forma* cash flows included in the Board Materials assumed that no dividend would be paid in either 2013 or 2014.

40 While Sears' management had identified the need to provide the Board with various cash flow analyses covering various dividend scenarios, the limited analysis that was done by management was incomplete and never presented to the Board.

41 Moreover, and unlike past meetings in which the Board had considered extraordinary dividends:

(a) management did not prepare a written presentation to the Board on the proposed dividend and there was no written recommendation or proposal from management to the Board; and

(b) the directors were not provided with legal advice with respect to their duties in connection with the declaration of a dividend.

Financial Uncertainty

42 On November 12, 2013, prior to the November Meeting, the Board received a financial update on the performance of Sears. Management reported that throughout the first

three quarters of the year, Sears had negative net income of $49 million ($27 million worse than the same period in 2012) and negative total cash flow of $26.3 million.

43 On November 14, 2013, the Investment Committee of Sears' Board was presented with material showing an estimated pension plan deficiency of $313 million at December 2013. The members of the Investment Committee were Crowley, Harker and Bird. This fact was not presented to the Board at the November Meeting.

44 In advance of the November Meeting, the Board was provided with only high level *pro forma* cash flows for 2014. The cash flows were based on a 2014 Plan EBITDA of $135 million, of which $118 million was based on aspirational changes to the business that management hoped would result in financial improvement but that management and the Board should have known were unreasonably optimistic. Moreover, the *pro forma* cash flows presented to the Board assumed the receipt of proceeds of the Montez Sale even though the transaction had not closed. Again, no information was provided to the Board on the impact an extraordinary dividend would have on future investment opportunities and future cash flows.

45 The Board Materials did however include two analyst reports, both of which reviewed the financial circumstances of Sears and predicted its eventual failure:

> **Desjardins Capital Markets Report (October 30, 2013)**
>
> As long as consumers do not perceive that Sears Canada is going out of business and desert it, Sears may be able to manage its demise slowly over time, selling prime and non-core assets, and waiting for the elusive purchaser of 60–80 store locations to appear.

CIBC Report (November 4, 2013)

> It is possible that SCC will simply operate its way into irrelevance, gradually selling off stores to stem the cash drain. That strategy would likely result in Sears occasionally cutting a special dividend cheque to all shareholders, not the worst way to create shareholder value. But that is dangerous to the operations, particularly as the primary, and most profitably flagship stores are vended.

A Conflicted Board

46 The 2013 Dividend was approved by the Board unanimously and without any abstentions.

47 Crowley and Harker participated in the Board's deliberations to pay the 2013 Dividend and approved the payment of the 2013 Dividend despite the fact that Sears had specifically determined that:

(a) Crowley and Harker were not "independent" directors; and

(b) pursuant to National Instrument 52-110, Crowley and Harker had a material relationship with Holdings and/or ESL that could "be reasonably expected to interfere with the exercise of [their] independent judgment."

48 Further, Crowley did not disclose to the Board that he, Lampert and Stollenwerck were personally involved in the 2013 real estate divestitures or that the timetable and size of the proposed dividend was dictated by ESL Investment's need for funds. Rather, the Board was led to believe that Sears' management was responsible for the 2013 real estate divestures. For example, Crowley expressly advised the independent members of the Board: "I do not think that the Board or the independents should attempt to insert themselves in the negotiations [of real estate transactions]. Bill [Harker] and I did not and do not do that."

49 Crowley and Harker in particular were focused on the interests of ESL and Lampert. Crowley and Harker failed to disclose the motivations of ESL and Lampert to the Board and the fact that both the real estate dispositions and 2013 Dividend were driven by the needs of ESL and Lampert, and not the best interests of Sears.

Departure from Past Governance Practices

50 The Board process for the 2013 Dividend represented a sharp departure from past practice of the Sears Board and ordinary standards of good corporate governance.

51 For example, in December 2005, the Board approved an extraordinary dividend. The process for approving that dividend included:

(a) multiple Board meetings on September 7, 2005, September 14, 2005, and December 2, 2005 to discuss the merits and risks of a potential dividend in light of the company's operational needs;

(b) multiple oral presentations from management and a dividend recommendation by the Chief Financial Officer;

(c) separate meetings between the independent directors of Sears and the Chief Financial Officer to assess the company's financial state;

(d) legal advice from both in-house and external counsel to the Board; and

(e) review by the Board of draft press releases and an officer's certificate with respect to the dividend.

52 In May 2010, the Board approved another extraordinary dividend, again with the benefit of a robust process:

(a) multiple meetings of the Board on April 23, 2010, May 7, 2010, and May 18, 2010 to discuss the merits and risks of a potential dividend in light of the company's operational needs;

(b) separate meetings of the independent directors on May 7, 2010 and May 12, 2010, with their own counsel present, to discuss the options available to Sears with respect to its excess cash and the amount of the potential dividend in light of the company's operational needs;

(c) multiple presentations by management, including a 40-page presentation dated April 23, 2010 and a subsequent 20-page presentation dated May 7, 2010, providing detailed analyses of excess cash and financial forecasts (with downside scenarios) for multiple dividend options;

(d) a dialogue between management and the Board continuing over several meetings with respect to various options for a potential dividend;

(e) consideration of multiple potential uses for excess cash, including cash dividends in various amounts, a substantial issuer bid and a normal course issuer bid; and

(f) a deferral of half the proposed dividend pending a full assessment of the company's operational needs.

53 In September 2010, the Board approved a second extraordinary dividend for 2010. The process for approving that dividend included:

(a) multiple meetings of the Board on or around August 23, 2010 and September 10, 2010 to discuss the capital structure of the company and the merits and risks of a potential dividend in light of the company's operational needs;

(b) multiple presentations by management, including a "capital structure update" dated August 3, 2010 and a 32-page presentation assessing the capital structure of the company and potential dividend options, including financial forecasts and downside scenarios, which the Board reviewed in advance of approving the dividend; and

(c) a separate meeting of the independent directors on or around September 8, 2010, with their own counsel present, to discuss the options available to Sears with respect to its excess cash and the amount of the potential dividend in light of the company's operational needs.

54 In December 2012, the Board approved a smaller extraordinary dividend. While not as fulsome as previous governance processes, the process for approving the 2012 dividend nonetheless included:

(a) a meeting on December 12, 2012 which included thorough discussion and analysis of the impact of a potential dividend on available cash, EBITDA and total debt, the company's need to retain cash for operational uses, and downside scenarios in respect of a possible dividend;

(b) a report entitled "Dividend Discussion" which was prepared by Sears' Chief Financial Officer and which the Board reviewed in advance of approving the dividend; and

(c) a review of the draft officer's certificate with respect to the dividend by external counsel to the independent directors, and a dialogue with the Chief Financial Officer of Sears addressing counsel's comments.

55 In stark contrast, the 2013 Dividend was the first item of business at a pre-dinner discussion at the outset of the November Meeting and was declared without any adequate financial, operational or cash flow information upon which to exercise proper business judgment. It was dealt with before any of the planned presentations to the Board, which addressed Sears' financial results, or the reports on management priorities, asset valuations, operating efficiency and Sears' 2014 financial plan and without the benefit of any independent legal advice regarding the directors' duties in the circumstances.

56 The Board's inability to make a proper business decision in respect of the 2013 Dividend was apparent from the fact that one of the Board members, Ronald Weissman, had been appointed to the Board that day. Weissman, a resident of Texas, had no material prior dealings with Sears or knowledge of Sears' financial or operational circumstances upon which to base his decision to approve the 2013 Dividend.

The 2013 Dividend is a Transfer at Undervalue and Void

A Transfer at Undervalue

57 The 2013 Dividend provided no value to Sears and solely benefited its direct and indirect shareholders, including the Defendants Holdings, ESL, Lampert and Harker. The amounts of the gratuitous benefit received by the Defendants were:

(a) Holdings: $259,811,955;

(b) ESL: $88,626,400;

(c) Lampert: $52,165,440; and

(d) Harker: $23,020.

~~58 The Defendants also caused approximately $259 million to be paid to Holdings through the 2013 Dividend.~~

Non-Arm's Length Dealings

59 At all materials times:

(a) Holdings was the controlling shareholder of Sears, was a related entity to Sears, and was not dealing at arm's length with Sears;

(b) ESL and Lampert exercised both *de facto* and *de jure* control over Holdings. As Holdings stated in its 2013 Annual Report, Mr. Lampert had "substantial influence over many, if not all, actions to be taken or approved by our stockholders"; and

(c) ESL and Lampert were not dealing at arm's length with Sears as a result of their direct and indirect beneficial control position in Holdings, which in turn held a controlling interest in Sears. Further, Holdings, ESL and Lampert collectively held more than 75% of Sears' shares. ESL, Lampert and Holdings (at the direction of ESL and Lampert) acted in concert with respect to the control of Sears, and specifically acted in concert and with a single mind to exercise influence over Sears in connection with the 2013 Dividend and the Monetization Plan.

60 As a result of these relationships, each of Holdings, ESL, Lampert, and Sears are related entities who are presumed not to have acted at arm's length in respect of the 2013 Dividend. ESL and Lampert used their position of control over Sears to direct and/or influence Sears and its directors to carry out the Monetization Plan and the 2013 Dividend.

Intention to defraud, defeat or delay Sears' creditors

61 The 2013 Dividend was effected by Sears for the sole purpose of satisfying the immediate financial needs of ESL Investments and Lampert, and in reckless disregard of the interests of Sears' creditors. The 2013 Dividend was made with the specific intention to prioritize the interests of Lampert and ESL over Sears' creditors and other stakeholders.

62 In particular, considering the surrounding circumstances, Sears knew but recklessly disregarded the fact that the 2013 Dividend would have a material adverse impact on its ability to continue as a viable business and pay its creditors. In particular, the 2013 Dividend was:

(a) a non-arm's length transaction made outside the usual course of business;

(b) paid in the face of significant outstanding indebtedness to Sears' creditors, including pensioners, in circumstances in which:

(i) Sears had no operating income to repay its debts, including to its pensioners and other creditors;

(ii) applying reasonable assumptions, the Board could only reasonably have expected Sears to be significantly cash flow negative from 2014 onwards; and

(iii) the Board had no real plan to repay such indebtedness;

(c) paid in circumstances that raise a series of "red flags", including as a result of the following facts:

(i) the 2013 Dividend was declared with unusual haste and with no advance notice to the Board;

(ii) the 2013 Dividend was declared in the absence of proper Board materials and with a deficient corporate governance process;

(iii) the Board received no independent legal advice to properly discharge its duties with respect to a material transaction involving related parties: Holdings, ESL and Lampert;

(iv) the divestiture of Sears' crown jewel assets had an obvious negative impact on its business;

(v) Sears had not addressed its negative cash flows or operational challenges despite years of effort;

(vi) there were clear conflicts of interest within the Board and management at the time the 2013 Dividend was declared; and

(vii) the 2013 Dividend was driven by Lampert, Bird as Chief Financial Officer of Sears, and Crowley and Harker as non-independent directors of Sears, in order to satisfy ESL Investments' urgent need for funds.

63 In March of 2014, the Board was presented with a proposal for a further, more modest dividend on short notice. The proposed dividend was not approved by the Board due to concerns about Sears' financial position, only three months after the payment of the 2013 Dividend.

64 Sears knew or recklessly disregarded the fact that the 2013 Dividend would defraud, defeat or delay Sears' creditors. Shortly after the 2013 Dividend, Crowley supported further dividends in an email to Harker, stating:

> "... we cannot hold cash because we may watch the business spiral down and do nothing.... Keeping the cash to fund a dying business does not make sense."

65 The Transfer at Undervalue effected by means of the 2013 Dividend is therefore void as against the Monitor within the meaning of section 96 of the BIA.

ESL, Lampert, Crowley and Harker are Liable as Privies

66 The Defendants ESL, Lampert, Crowley and Harker were privies to the Transfer at Undervalue and are liable to Sears.

67 None of ESL, Lampert, Crowley or Harker was dealing at arm's length with Holdings or Sears. Each of them knew that the 2013 Dividend would benefit ESL and Lampert, and each of them sought to cause or confer that benefit. Further, each of them received either a direct or indirect benefit from the 2013 Dividend.

Director Indemnities

68 In order to preserve any indemnity rights Harker or Crowley may have against Sears, the Monitor will agree that any recoveries received from Harker or Crowley in connection with this claim will be reduced by the amount of any distribution that Harker or Crowley, respectively, would have received on account of an unsecured indemnity claim from the Sears estate. The purpose of this adjustment is to make Harker and Crowley whole for any such indemnity claims while not requiring the Sears estate to reserve funds for such indemnity claims.

Service Ex Juris, Statutes Relied Upon, and Location of Trial

69 The Monitor is entitled to serve Holdings, SPE I Partners, LP, SPE Master I, LP, and ESL Institutional Partners, LP without a court order pursuant to rule 17 of the Rules of Civil Procedure, R.R.O. 1990, Reg. 194, because the claim is authorized by statute to be made against a person outside Ontario by a proceeding commenced in Ontario (Rule 17.02(n)).

70 The Monitor pleads and relies on the BIA and the CCAA.

71 The Monitor proposes that the trial of this matter be heard in Toronto, Ontario.

December 19, 2018

~~December 19, 2018~~
~~July 5, 2019~~

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Lawyers for FTI Consulting Canada Inc.,
as Court-Appointed Monitor

FTI Consulting Canada Inc., in its capacity as Court-appointed monitor	and	ESL Investments Inc. *et al.*	Court File No.: CV-18-00611219-00CL
Plaintiff		Defendants	

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

Proceeding commenced at TORONTO

AMENDED STATEMENT OF CLAIM

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Court File No. CV-18-00611214-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

B E T W E E N:

SEARS CANADA INC., by its Court-appointed Litigation Trustee,
J. DOUGLAS CUNNINGHAM, Q.C.

Plaintiff

and

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

Defendants

AMENDED AMENDED STATEMENT OF CLAIM

TO THE DEFENDANTS

A LEGAL PROCEEDING HAS BEEN COMMENCED AGAINST YOU by the Plaintiff. The Claim made against you is set out in the following pages.

IF YOU WISH TO DEFEND THIS PROCEEDING, you or an Ontario lawyer acting for you must prepare a Statement of Defence in Form 18A prescribed by the Rules of Civil Procedure, serve it on the Plaintiff's lawyer or, where the Plaintiff does not have a lawyer, serve it on the Plaintiff, and file it, with proof of service in this court office, WITHIN TWENTY DAYS after this Statement of Claim is served on you, if you are served in Ontario.

If you are served in another province or territory of Canada or in the United States of America, the period for serving and filing your Statement of Defence is forty days. If you are served outside Canada and the United States of America, the period is sixty days.

Instead of serving and filing a Statement of Defence, you may serve and file a Notice of Intent to Defend in Form 18B prescribed by the Rules of Civil Procedure. This will entitle you to ten more days within which to serve and file your Statement of Defence.

IF YOU FAIL TO DEFEND THIS PROCEEDING, JUDGMENT MAY BE GIVEN AGAINST YOU IN YOUR ABSENCE AND WITHOUT FURTHER NOTICE TO YOU. IF YOU WISH TO DEFEND THIS PROCEEDING BUT ARE UNABLE TO PAY LEGAL FEES, LEGAL AID MAY BE AVAILABLE TO YOU BY CONTACTING A LOCAL LEGAL AID OFFICE.

TAKE NOTICE: THIS ACTION WILL AUTOMATICALLY BE DISMISSED if it has not been set down for trial or terminated by any means within five years after the action was commenced unless otherwise ordered by the court.

Date December 19, 2018 Issued by "Ray Williams"
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CLAIM

1. The Plaintiff claims:

(a) damages on a joint and several basis in the amount of $509 million,

(i) as against the Former Directors (as defined below) and Ephraim J. Bird ("**Bird**") for breach of fiduciary duty, breach of the duty of care, and conspiracy;

(ii) as against the ~~ESL Parties~~ Significant Shareholders (as defined below), for inducing the Former Directors and Bird to breach their duties owed to Sears Canada Inc. ("**Sears Canada**"), knowing assistance, and conspiracy;

(b) in the alternative to paragraph (a) (ii) above, damages against the ~~ESL Parties~~ Significant Shareholders on a joint and several basis in the amount of $402 million for inducing the Former Directors and Bird to breach their duties owed to Sears Canada, knowing assistance, and conspiracy;

(c) a declaration that the ~~ESL Parties~~ Significant Shareholders knowingly received the proceeds of a breach of fiduciary duty and/or were unjustly enriched, hold the proceeds of the Dividend (as defined below) in trust for Sears Canada (except with respect to Sears Holdings Corp.) and must disgorge the proceeds they received on account of the Dividend to Sears Canada;

(d) a declaration that the authorization and payment of the Dividend was oppressive and unfairly disregarded and was prejudicial to the interests of Sears Canada and its stakeholders and an Order setting aside the Dividend;

(e) except with respect to Sears Holdings Corp., punitive and exemplary damages;

(f) pre-judgment and post-judgment interest in accordance with sections 128 and 129 of the *Courts of Justice Act*, R.S.O. 1990, c. C.43, as amended;

(g) the costs of this proceeding, plus all applicable taxes; and

(h) such further and other relief as to this Honourable Court may seem just.

Overview

2. In the early 2010s, Sears Canada was one of Canada's largest retailers. It operated more than 100 of its own full-line department stores, and had more than 25,000 employees.

3. However, Sears Canada was facing serious financial and operational challenges. Since 2007, its revenues and EBITDA had declined each year. In 2011, its management recognized that Sears Canada was falling behind its peers and identified a need to modernize its business in order to keep pace in an increasingly competitive retail environment. This required significant capital investment in order to refresh Sears Canada's stores and improve its e-commerce platform.

4. Despite these warnings, Sears Canada's board of directors ("**Board**") failed to authorize capital investments in the business. Instead, between 2005 and 2012, the company sold assets worth approximately $2.86 billion and distributed approximately $2.97 billion in capital to its shareholders.

5. The primary recipients of these distributions were Sears Canada's majority shareholders: Sears Holdings Corp. ("**Sears Holdings**"), the hedge fund ESL Investments, Inc. ~~("ESL")~~ and its affiliates ("**ESL**"), and ESL's founder and proprietor, the billionaire investor Edward S. Lampert (collectively, the "**Significant Shareholders**").

6. In late 2013, Sears Canada was in the midst of its worst year yet. Its revenues declined by more than $300 million year-over-year and its operating losses reached almost $188 million. In September, its CEO resigned in frustration at the refusal of the Board to allocate sufficient capital to implement a turnaround strategy.

7. At the same time, ESL was experiencing a liquidity crisis. Its investors had submitted billions of dollars in redemption requests, which it was having difficulty funding.

8. Over the course of the year, Sears Canada sold off a number of its most important assets (the "**Key Asset Sales**"): the leases underlying some of its largest and most lucrative stores. The Sears Canada directors involved in the Key Asset Sales included a number of former ESL and Sears Holdings employees who had been selected for their roles by Lampert. In addition, even though he was not an officer or director of Sears Canada, Lampert was personally involved in the negotiations concerning these transactions.

9. The Key Asset Sales generated extraordinary proceeds of approximately $591 million. At a November 2013 meeting of the Board held at the offices of Sears Holdings' lawyers in New York City, less than a week after the final sale closed (the "**November 2013 Meeting**"), Sears Canada's management proposed a plan to distribute more than $509 million to its shareholders through an extraordinary dividend (the "**Dividend**").

10. The Board was not given any advance notice of the proposed Dividend: it did not even appear on the agenda for the November 2013 Meeting. Although the Board was given extensive materials by management, those materials did not address the proposed Dividend or any analysis of its potential impacts on Sears Canada's business. Nor did the Board receive legal or financial advice in relation to it. Nevertheless, the Board authorized the payment of the Dividend.

11. Lampert, ~~and~~ ESL, and Sears Holdings improperly used their influence with the Board to procure the Dividend, for the purpose of providing funds to themselves ~~Significant Shareholders~~. In accordance with their shareholdings in Sears Canada, 79% of the Dividend was paid to the Significant Shareholders.

12. The payment of the Dividend diverted funds from Sears Canada at a time when the Defendants knew, or ought to have known, that it would be in the best interests of Sears Canada to reinvest the funds in the business or to preserve liquidity to satisfy increasing losses and creditor claims. By mid-2017, Sears Canada had become insolvent, and, on June 22, 2017, it was granted protection under the *Companies' Creditors Arrangement Act* (the "***CCAA***"). Sears Canada has since liquidated its remaining assets and ceased operations, leaving massive unsatisfied debts owed to its unsecured creditors, including former employees and pensioners.

13. It was not until after the *CCAA* Proceeding (defined below) commenced that it was discovered that the declaration of the Dividend had taken place in improper circumstances.

14. The Plaintiff seeks to set aside the Dividend and seeks damages to compensate Sears Canada and therefore its creditors for the losses they have suffered as a result of the Dividend.

The Parties

15. The Plaintiff, Sears Canada, is a corporation incorporated under the laws of Canada, with its headquarters in Toronto.

16. Sears Canada is insolvent. It is an applicant in a *CCAA* proceeding commenced on June 22, 2017 (the "***CCAA* Proceeding**"). By order dated December 3, 2018, the presiding court in that proceeding (the "***CCAA* Court**") appointed the Honourable J. Douglas Cunningham, Q.C., as Litigation Trustee for Sears Canada to pursue claims on behalf of Sears Canada and its creditors against third parties, including the Defendants.

16.1. The Defendant Sears Holdings is a corporation incorporated under the laws of Delaware, in the United States of America, with its headquarters in Hoffman Estates, Illinois, in the United States of America. Sears Holdings was Sears Canada's majority shareholder in 2013. Sears Holdings filed for bankruptcy protection under Chapter 11 of the U.S. Bankruptcy Code on October 15, 2018.

17. The Defendant, ESL Investments Inc., is a corporation incorporated under the laws of Delaware, in the United States of America, with its headquarters in Bay Harbor Islands, Florida, in the United States of America. It is a hedge fund which operates through a number of subsidiary entities, namely: ESL Partners, LP, SPE I Partners, LP, SPE Master I, LP, and ESL Institutional Partners, LP. These entities are collectively referred to herein as "**ESL**". As a whole, ESL was at all relevant times the largest shareholder of Sears Holdings.

18. The Defendant, Edward S. Lampert, is an individual residing in Indian Creek, Florida, in the United States of America. Lampert was the CEO of Sears Holdings from May 2013 to October 2018. Lampert owns and controls ESL, and has served as ESL Investments Inc.'s Chairman and

Chief Executive Officer since he founded it in 1988. Collectively, ESL and Lampert are referred to herein as the "**ESL Parties**".

19. The Defendant Ephraim J. Bird is an individual residing in Salado, Texas, in the United States of America. Bird was a director of Sears Canada between May 2006 and November 13, 2013, and its interim CFO, and later permanent CFO, from March 2013 until June 2016.

20. The Defendant Douglas Campbell ("**Campbell**") is an individual residing in Toronto. Campbell was Sears Canada's COO from November 2012 until September 24, 2013, and its CEO and a director from that date until October 2014.

21. The Defendant William Crowley ("**Crowley**") is an individual residing in New York, New York, in the United States of America. Crowley was the Chairman of Sears Canada's Board in late 2013, and was a director of Sears from May 2005 to April 2015.

22. The Defendant William Harker ("**Harker**") is an individual residing in New York, New York, in the United States of America. Harker was a director of Sears Canada from November 2008 to April 2015.

23. The Defendant R. Raja Khanna ("**Khanna**") is an individual residing in Toronto. Khanna was a director of Sears Canada from October 2007 to August 2018.

24. The Defendant James McBurney ("**McBurney**") is an individual residing in London, in the United Kingdom. McBurney was a director of Sears Canada from April 2010 until 2015.

25. The Defendant Deborah Rosati ("**Rosati**") is an individual residing in Wainfleet, Ontario. Rosati was a director of Sears Canada from April 2007 to August 2018.

26. The Defendant Donald Ross ("**Ross**") is an individual residing in New York, New York, in the United States of America. Ross was a director of Sears Canada from May 2012 until 2014.

27. The Defendants, other than the ~~ESL Parties~~ Significant Shareholders and Bird, are referred to herein as the "**Former Directors**". All of the Former Directors were members of the Board during the November 2013 Meeting.

Lampert's Purchase of Sears Holdings

28. In early 2005, the ESL Parties acquired a controlling share in the American retailer Sears, Roebuck & Co. ("**Sears Roebuck**"), the then-parent company of Sears Canada. After the acquisition, the ESL Parties established Sears Holdings to hold their stakes in Sears Roebuck and Kmart, another retailer.

29. Lampert appointed himself Chairman of Sears Holdings, and later made himself CEO. From 2005 onwards, he played a direct role in the formulation of Sears Holdings' business strategy.

30. Soon after the acquisition, Lampert replaced the existing senior management of Sears Roebuck, in many cases with former ESL executives. Appointments to key positions at Sears Holdings made by Lampert included:

(a) Crowley, the President and COO of ESL, who became Sears Holdings' CFO;

(b) Harker, the former General Counsel of ESL, who became Sears Holdings' General Counsel and Corporate Secretary;

(c) Bird, the CFO of ESL from 1991 to 2002, who became a board member and the CFO of Sears Hometown and Outlet Stores, Inc., an important Sears Holdings subsidiary; and

(d) Jeffrey Stollenwerck ("**Stollenwerck**"), a Vice President at ESL, who became Senior Vice President and then President of Sears Holdings' real estate business.

31. Over the last several years, Sears Holdings has closed hundreds of Kmart and Sears stores and laid off thousands of employees. ~~On October 15, 2018, Sears Holdings filed for bankruptcy protection under Chapter 11 of the U.S. Bankruptcy Code.~~ Sears Holdings is now bankrupt.

32. By 2013, Sears Canada was an independent public company and was no longer a Canadian operating subsidiary of Sears Holdings. Nevertheless, Sears Holdings still owned 51% of the shares of Sears Canada at the time.

Lampert's Involvement in the Operations of Sears Canada

33. As he had at Sears Holdings, Lampert took a direct role in developing Sears Canada's business strategy.

34. The ESL Parties had significant direct shareholdings in Sears Canada. As of November 2013, the ESL Parties beneficially owned more than 28.1 million Sears Canada shares, amounting to 27.6% of its outstanding shares.

34.1. As a whole, the Significant Shareholders owned almost four fifths of Sears Canada's shares. At the time, the ESL Parties were the controlling shareholders of Sears Holdings and Lampert was its CEO. Lampert used his position at Sears Holdings, along with his and ESL's

direct shareholdings in Sears Canada, to cause Sears Canada to act in a way that would benefit him and ESL.

35. Lampert influenced the appointment of Sears Canada's management, including its chief executive officers. This included the appointment of Bird, a former ESL executive, as Sears Canada's interim, and later permanent, CFO in March 2013.

36. Crowley was appointed as the Chairman of the Board of Sears Canada in 2006, and Harker became a director in 2008. Bird was appointed as a Sears Canada director from 2006 to November 13, 2013, when he resigned from the Board but stayed on as the company's CFO.

37.1 By early 2013, Crowley and Harker, with the assistance of Bird, exercised extensive control over Sears Canada. They were instrumental in both management of day-to-day operations and high-level strategic planning. Crowley and Harker also played a major role in the appointment of Douglas Campbell as Sears Canada's CEO in September 2013, as well as the appointment of new directors to the Board.

37.2 Crowley and Harker communicated with Lampert and took direction from him regarding the management of Sears Canada.

Sears Canada's Financial and Operational Problems

37. Between 2011 and 2013, Sears Canada suffered aggregate operating losses of more than $310 million.

38. As early as September 2011, the company's 2011-2014 Strategic Plan (the "**Strategic Plan**") explained that "Sears Canada requires a full transformation to be able to compete and win in the increasingly competitive Canadian retail environment."

39. Management provided the Board with regular updates on Sears Canada's operations, including the progress of the Strategic Plan. A March 2012 presentation to the Board noted that: "Customer and employee perceptions have been in decline, yet to find bottom", "Sears is ... failing to connect with the next generation", and "[we h]ave underinvested recently in stores".

40. In September 2013, Sears Canada's CEO, Calvin McDonald ("**McDonald**"), resigned. McDonald later told the press that he had left in frustration at not being able to take the steps necessary to save the company, as a result of Lampert's refusal to authorize investments in Sears Canada's business. McDonald stated that "there was not a real long term commitment to save this business".

41. The minutes of Sears Canada's September 23, 2013 Board meeting summarize a presentation given by Douglas Campbell, Sears Canada's then-COO, which noted that "At current trends, the projection for 2016 EBITDA will be -$105 million", and that sales "continue to decline across the business at 2.6%". Campbell joined the Board the following day.

42. At the same meeting, the Board received a presentation on the Strategic Plan, which explained that the company's e-commerce system was "seriously substandard", and advised that "To catch competitors, significant investment and transformation is required."

43. By October 2013, the Board was well aware of the problems facing Sears Canada and that its long term viability was at risk. In the circumstances, it was obvious to the Board that Sears Canada urgently needed capital to invest in its business or to preserve value to satisfy its rapidly growing losses and liabilities.

44. However, instead of investing in Sears Canada's business or preserving value to fund liabilities and increasing losses, the Former Directors authorized a plan under which the company sold off its most lucrative assets and sent the proceeds directly to its shareholders.

The Dividend Plan

ESL's Need for Liquidity to Satisfy Redemptions

45. In 2012, ESL received a large number of redemption requests from its investors. These requests totaled approximately $3.5 billion (US), an amount equal to more than half of ESL's total assets under management at the time. The redemptions were payable in 2013.

46. ESL did not have sufficient cash on hand to satisfy its investors' demands. As a result, it was forced to liquidate significant portions of its portfolio and to pay in-kind redemptions, made up of shares of the companies it owned.

47. To help ESL fund the redemptions, Lampert devised a plan to cause Sears Canada to make a large dividend payment, the majority of which would go to the Significant Shareholders. ESL would use the cash it received to fund redemptions, or distribute its Sears Holdings shares, which would be increased in value as a result of the Dividend, to its own investors as in-kind redemptions.

47.1 Lampert, at the time the CEO of Sears Holdings, planned to use Sears Holdings as a conduit to direct the proceeds of the Key Asset Sales to ESL and himself.

Sale of Sears Canada's Assets

48. As a result of its large operating losses, Sears Canada did not have sufficient cash on hand to fund a large dividend payment. The only way it could raise the necessary funds was to liquidate a number of its "crown jewels": the long-term under-market-value leases for its largest and most lucrative stores.

48.1 In late 2012 or early 2013, Lampert enlisted the assistance and agreement of Crowley, Harker, and Bird to effect a scheme whereby Sears Canada would sell certain of its important assets and then declare a dividend to distribute the proceeds from the sale to Sears Canada's shareholders. Crowley, Harker, and Bird agreed with Lampert to use their respective positions at Sears Canada to execute the plan. These agreements were concluded through telephone calls, correspondence or at in-person meetings in New York City, Sears Holdings's headquarters in Hoffman Estates, Illinois, or ESL's offices in Miami, Florida.

49. Sears Canada had liquidated many of its assets since being acquired by the ESL Parties in 2005. However, in that context, the 2013 Key Asset Sales were notable for their size and impact on Sears Canada's operations.

50. Over the course of 2013, Sears Canada sold seven of its most valuable leases for approximately $591 million. The sales were carried out in two transactions:

(a) the sale of two leases – at the Yorkdale Shopping Centre in Toronto and the Square One Mall in Mississauga – to Oxford Properties Group in June 2013 for $191 million; and

(b) the sale of five leases – its flagship store in the Toronto Eaton Centre and four other large stores (two in the Greater Toronto Area, and one each in London, Ontario and Richmond, BC) – in November 2013 to Cadillac Fairview Corporation Limited for $400 million (the "**Cadillac Fairview Sale**").

51. Sears Canada also reached an agreement, in early November 2013, to sell its 50% interest in a group of eight Quebec shopping centres to Montez Income Properties Corporation for $315 million. That transaction closed in January 2014.

52. With the agreement of Crawley, Harker, and Bird, Lampert played a direct role in negotiating the Key Asset Sales, even though he was not a director or an officer of Sears Canada. He provided direct instructions to Sears Canada on the price sought by Sears for the Key Asset Sales. Among other things, Lampert personally directed the negotiation strategy in connection with the Cadillac Fairview Sale. Stollenwerck, a senior executive at Sears Holdings' real estate division and a former ESL employee, was the primary negotiator for Sears Canada, even though he was not a Sears Canada employee.

52.1 As part of the scheme, Crowley, Harker, and Bird also played a key role in the organization of the Key Asset Sales. They assisted in the identification of the assets to be sold, and the direction of negotiations. They also liaised with the other Former Directors to ensure that the Board would approve of the Key Assets Sales and the distribution of the proceeds through the declaration of the Dividend.

53. The Former Directors and Bird knew that the Key Asset Sales would significantly reduce Sears Canada's earnings capacity, since the stores being closed were some of the company's most valuable locations. A presentation to the Board (which at the time included Bird) at its September 2013 meeting projected a significant loss in earnings as a result of the liquidation of four of the large stores that were ultimately included in the Cadillac Fairview Sale.

The Dividend Proposal

54. At the same time the Cadillac Fairview Sale was closing in November 2013, ~~three former ESL employees~~ —Bird, Crowley, and Harker worked to finalize the proposal for a large extraordinary dividend. Over the course of the ten-day period from November 8 to 18, 2013, Bird, Crowley and Harker settled on a proposed dividend payment of $5 per share, or more than $509 million in total.

55. At the time, the Significant Shareholders owned more than 79% of Sears Canada's outstanding shares, and therefore stood to receive a total of approximately $402 million from a $5 per share Dividend.

Lack of Notice and Undue Haste

56. The Cadillac Fairview Sale closed on Tuesday, November 12, 2013. The Dividend was approved at a board meeting held less than a week later, on the following Monday and Tuesday, November 18-19, 2013.

57. No information about or notice of the proposed Dividend was provided to the Board by Sears Canada's management in the lead-up to the meeting. Indeed, the Dividend was not even referred to in the agenda for the November 2013 Meeting.

58. Approval of the Dividend was treated as a foregone conclusion by Bird, Crowley and Harker. Although, as discussed below, the Board was not presented with any financial analysis of the Dividend, the minutes of the November 2013 Meeting note that the Board was "presented [with] a draft press release relating to the dividend" at the beginning of their discussion.

59. Notwithstanding the fact they did not receive adequate notice of the proposed Dividend before being asked to vote on it, the Former Directors did not seek any information or advice about the proposal before they approved it.

Insufficient Information Provided to the Board

60. The Board was not given sufficient information to understand the impact of the Dividend, nor did they seek additional information from management.

61. Extensive background materials (the "**Materials**") were prepared by management and given to the Board before the November 2013 Meeting. However, the Materials did not contain any analysis of the Dividend. In fact, the Materials contained no references to the Dividend at all. The financial and operational plans included with the Materials also omitted any reference to the Dividend and failed to account for the Dividend in their calculations.

62. Even though Crowley, Bird, and Harker had previously undertaken a financial analysis of various Dividend scenarios in the weeks leading up to the declaration of the Dividend, none of their findings were presented to the Board.

63. Without even basic financial information or any professional advice, the Board was not in a position to properly assess the Dividend, even if it had tried or wanted to do so, which it did not.

Lack of Governance Procedures

64. The procedures adopted by Sears Canada's Board at the November 2013 Meeting were manifestly insufficient for a transaction as large as the Dividend, particularly in light of Sears Canada's precarious financial and operational position at the time.

65. The Board did not, *inter alia*:

(a) seek advice from outside legal counsel;

(b) commission any analysis from financial, accounting, or other advisors; or

(c) convene an *in camera* session of the independent directors to discuss the Dividend prior to its approval.

66. The failure to take any of these steps before approving the Dividend differed from the Board's conduct with respect to previous dividends and failed to comply with proper governance procedures.

67. For example, before authorizing the payment of two smaller dividends in 2010, the Board implemented a number of significant governance procedures.

68. In 2010, Sears Canada's management provided the Board with a series of capital structure presentations, which were updated several times. These presentations explained the benefits and risks of returning capital to the Company's shareholders and included both extensive financial analysis and in-depth discussions of potential alternatives.

69. The proposed 2010 dividends were discussed during at least five separate board meetings between April and September 2010. The independent directors held an *in camera* meeting to discuss the dividend, and asked outside counsel to attend and provide information on the implications of the payment of an extraordinary dividend, as well as other potential options for use of the company's capital.

70. In November 2013, despite Sears Canada's far worse financial and operational situation, the Board did not conduct *any* of this due diligence. Instead, it approved the Dividend proposed

by Lampert's representatives in management and on the Board without any analysis of the implications to the company itself, or its minority shareholders, employees, creditors, or other stakeholders.

Sears Canada's Board Rubber-Stamps the Dividend Payment

71. After authorizing the liquidation of its most valuable assets, the Board failed to ensure that the proceeds were used for Sears Canada's benefit or to ensure that sufficient value would be available to satisfy creditor claims that would continue to accumulate as losses increased.

72. To the contrary, the Former Directors, almost immediately and without scrutiny or evaluation, decided to dividend out almost all of the money that Sears Canada earned from the Key Asset Sales.

73. The Former Directors could not have reasonably concluded that the Dividend was in Sears Canada's best interest based on the extremely limited information available to them at the time they approved the Dividend. Indeed, the Dividend was not in Sears Canada's best interest. By approving the Dividend, the Former Directors breached their common law and statutory obligations to Sears Canada.

Effects of the Dividend

74. Payment of the Dividend caused serious harm to Sears Canada and its stakeholders.

75. The funds used to pay the Dividend were derived from the sale of leases for some of Sears Canada's largest and best-performing stores, which were located in some of Canada's most densely populated areas. These divestments brought about a significant decline in Sears Canada's revenue-generation capacity without any corresponding long-term investment in its operations.

76. The main beneficiaries of the Dividend were Sears Holdings, ESL, and Lampert. Sears Canada did not receive any benefit from the Dividend.

77. After three more years of enormous losses, Sears Canada became insolvent in 2017. It has since liquidated all of its remaining inventory and assets and closed all of its stores. Sears Canada's liquidation has cost more than 15,000 employees their jobs, and has left its creditors with hundreds of millions of dollars in uncollectable debts.

The *CCAA* Proceeding

78. On June 22, 2017, Sears Canada and a number of its affiliates commenced the *CCAA* Proceeding.

79. Although the existence of the Dividend was known at the time it was paid, prior to the commencement of the *CCAA* Proceeding, the circumstances surrounding the Board's authorization of and the ~~ESL Parties'~~ Significant Shareholders' involvement in the Dividend were not known to anyone other than Sears Canada's senior management and directors, and the Significant Shareholders.

80. These facts, including Lampert's involvement in the sale of the real estate assets, the non-independent Directors' role in the plan to declare the Dividend, and the absence of information and manifestly inadequate governance procedure at the November 2013 Meeting, were not known and were only uncovered after the *CCAA* Proceeding commenced.

The Claims

81. The facts surrounding the authorization and payment of the Dividend give rise to a number of claims by Sears Canada against the Former Directors, Bird, and the ~~ESL Parties~~ Significant Shareholders.

The Former Directors and Bird: Breaches of Duties and Oppression

82. The Former Directors breached their common law and statutory duties of care and fiduciary duties by:

(a) authorizing the Dividend in circumstances where it was not in the best interests of Sears Canada, thereby favouring the interests of the Significant Shareholders over those of the company and its other stakeholders; and

(b) failing to exercise the care, diligence and skill that a reasonably prudent person would have exercised in comparable circumstances by, among other things, neglecting to obtain any information or professional advice about the impact on the business of Sears Canada in paying the Dividend, or in the alternative investing the $509 million into its business or preserving this value to satisfy liabilities, before agreeing to authorize it.

83. Although Bird was not a director of Sears Canada at the time the November 2013 Meeting was held, he had been a director until immediately prior to the meeting. Bird attended the November 2013 Meeting in his capacity as chief financial officer of Sears Canada, and as such, he continued to owe fiduciary duties and a duty of care and loyalty to Sears Canada after his resignation from the Board.

84. Bird breached the duties he owed to Sears Canada by:

(a) proposing the Dividend in circumstances where the Dividend was not in the best interests of Sears Canada;

(b) proposing the Dividend for the benefit of the Significant Shareholders;

(c) preparing and planning for the distribution of the Dividend without providing adequate information to the Board, in the hope that the Dividend would be declared by the Board;

(d) withholding relevant financial information from the Former Directors that they required to properly analyze the merits of the Dividend, including information about Sears Canada's pension deficit; and

(e) proposing and recommending the Dividend and then resigning from the Board before the November 2013 Meeting.

85. As a result of the breaches referred to in paragraphs 82 to 84 above, Sears Canada seeks to unwind the Dividend and seeks damages against the Former Directors and Bird in the amount of $509 million.

86. Further, the Former Directors and Bird acted in an oppressive manner towards Sears Canada by:

(a) disregarding the reasonable expectation of Sears Canada that their powers would be used for the benefit of the company, rather than for that of third parties like the Significant Shareholders; and

(b) using their powers to authorize the Dividend, which was unfairly prejudicial to and disregarded the interests of Sears Canada and its creditors.

87. It is appropriate for Sears Canada, by way of its Litigation Trustee, to be the complainant for an oppression claim on its own behalf and on behalf of its creditors, who are all similarly affected by the oppressive conduct described above.

88. As a result of the Former Directors' and Bird's oppression Sears Canada seeks an Order:

(a) declaring that the Former Directors and Bird, breached their duties owed to Sears Canada;

(b) setting aside the Dividend; and

(c) ordering the Former Directors and Bird to pay damages to Sears Canada on a joint and several basis in the amount of $509 million.

89. An order setting aside the Dividend, imposing a constructive trust over those funds (except with respect to Sears Holdings), and/or ordering compensatory payments in the same amount would remedy the Former Directors' and Bird's oppression and return to Sears Canada the funds that rightly belong to it, for the ultimate benefit of its creditors.

The ~~ESL Parties~~ Significant Shareholders: Inducing Breaches of Duties; Knowing Assistance, Knowing Receipt, and Unjust Enrichment

90. The ~~ESL Parties~~ Significant Shareholders knowingly induced, encouraged, assisted and participated in the Former Directors' and Bird's breaches of fiduciary duty. They knew of the fiduciary duties the Former Directors and Bird owed to Sears Canada, and that the Dividend would

harm Sears Canada. The ~~ESL Parties~~ Significant Shareholders nonetheless influenced and encouraged the Former Directors to authorize the Dividend for ~~the ESL Parties'~~ their own benefit.

91. But for the ~~ESL Parties'~~ Significant Shareholders' inducement of and their assistance given to the Formers Directors' and Bird's breaches of their fiduciary duties to Sears Canada, those defendants would not have been put in circumstances where the breach of their duties in this manner was possible.

92. The ~~ESL Parties~~ Significant Shareholders knowingly assisted the Former Directors and Bird to take the wrongful step of authorizing and encouraging the Dividend, which resulted in prejudice to Sears Canada's rights, in circumstances where there was no right in the circumstances for the Former Directors and Bird to take such steps.

93. The ~~ESL Parties~~ Significant Shareholders are liable to Sears Canada for damages in the amount of $509 million for inducing breaches of fiduciary duties and knowing assistance in the Former Directors' and Bird's breaches of their duties.

94. In the alternative, the ~~ESL Parties~~ Significant Shareholders are liable for disgorgement in the amount of ~~$140.8~~402 million for knowingly receiving the proceeds of the Former Directors' and Bird's breaches of fiduciary duty.

95. In addition, or in the further alternative, the ~~ESL Parties~~ Significant Shareholders were unjustly enriched by receiving ~~$140.8~~402 million by way of the Dividend in circumstances where it should not have been approved. The Dividend was paid gratuitously as a benefit to the ~~ESL Parties~~ Significant Shareholders, and caused a corresponding deprivation to Sears Canada. There was no juristic reason for the ~~ESL Parties~~ Significant Shareholders to receive the Dividend.

96. The appropriate remedy for the ESL Parties' unjust enrichment is the imposition of a constructive trust in favour of Sears Canada over the portion of the Dividend received by them. The appropriate remedy for Sears Holdings' unjust enrichment is disgorgement of the portion of the Dividend received by it.

Conspiracy By All Defendants

97. All of the Defendants acted together to generate the funds for and authorize the Dividend to the benefit of the Significant Shareholders and to the detriment of Sears Canada. This was unlawfully carried out through the Former Directors' and Bird's breaches of the duty of care, fiduciary duties, and oppressive conduct, as planned and directed by the ~~ESL Parties~~ Significant Shareholders. This conduct was directed at Sears Canada in circumstances where the Defendants knew, or ought to have known, that damage to Sears Canada would result.

97.1 This course of action involved an agreement in late 2012 and early 2013 amongst Lampert, acting in his personal capacity and as the CEO of Sears Holdings and the directing mind of ESL, Crowley, Harker, and Bird, to develop and execute the plan to sell the Key Assets and distribute the bulk of the proceeds to Sears Holdings and ESL, for the ultimate benefit of ESL and Lampert. The conspiracy occurred primarily via email and telephone conversations. At all material times, the conspiracy took place in the co-conspirators' places of residence, namely Florida, Texas, Toronto and New York.

97.2 In fall 2013, the conspiracy expanded to an agreement between Lampert (again, acting in his personal capacity and as the CEO of Sears Holdings and the directing mind of ESL), the Former Directors, and Bird, for the Former Directors to authorize the payment of the Dividend by Sears Canada for the benefit of Sears Holdings, ESL, and Lampert. The conspiracy occurred between

October and December 2013, primarily via email and telephone conversations. At all material times, the conspiracy took place in the co-conspirators' places of residence, namely Florida, Texas, Toronto and New York, and at a meeting in November 2013 in New York City.

98. The Defendants knew, or ought to have known, that it was not in the best interests of Sears Canada to distribute over half a billion dollars to its shareholders at a time when capital needed to be re-invested in the corporation to arrest its decline or to preserve value to satisfy liabilities. Instead, the distribution of the extraordinary revenues generated by the Key Asset Sales to shareholders accelerated Sears Canada's decline, thereby damaging its interests in the short-, medium-, and long-term, and ensured that $509 million did not remain to satisfy increasing liabilities.

99. The Defendants are liable to Sears Canada for damages in the amount of $509 million for conspiracy.

Service *Ex Juris*, Statutes Relied Upon, and Location of Trial

100. The Plaintiff is entitled to serve any Defendants who reside outside Ontario without a court order because this claim relates to a tort committed in Ontario, and because the Defendants carried on business in Ontario.

101. The plaintiff pleads and relies upon the *Canada Business Corporations Act*, R.S.C. 1985, c. C-44, sections 122, 238, and 241 and Rules 17.02(g) and 17.02(p) of the *Rules of Civil Procedure*, R.R.O. 1990, Reg. 194.

102. The plaintiff proposes that this action be tried in the City of Toronto.

~~December 19, 2018~~
~~July 2, 2019~~
July 19, 2019

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J. DOUGLAS CUNNINGHAM, Q.C.

Plaintiff

-and-

ESL INVESTMENTS INC., *et al.*

Defendants

Court File No. CV-18-00611214-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

PROCEEDING COMMENCED AT
TORONTO

AMENDED AMENDED STATEMENT OF CLAIM

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AMENDED THIS 05 July 2019 PURSUANT TO
MODIFIÉ CE CONFORMÉMENT À
☐ RULE/LA RÈGLE 26 02 (
☒ THE ORDER OF Justice McEwen
L'ORDONNANCE DE
DATED / FAIT LE 18 June 2019

Cardoso
REGISTRAR GREFFIER
SUPERIOR COURT OF JUSTICE COUR SUPÉRIEURE DE JUSTICE
Alexandra Medeiros Cardoso
Registrar, Superior Court of Justice

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

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

BETWEEN:

MORNEAU SHEPELL LTD. in its capacity as administrator of the Sears Canada Inc. Registered Retirement ~~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 and SEARS HOLDINGS CORPORATION

Defendants

AMENDED STATEMENT OF CLAIM

A LEGAL PROCEEDING HAS BEEN COMMENCED AGAINST YOU by the plaintiff. The claim made against you is set out in the following pages.

IF YOU WISH TO DEFEND THIS PROCEEDING, you or an Ontario lawyer acting for you must prepare a statement of defence in Form 18A prescribed by the *Rules of Civil Procedure*, serve it on the plaintiff's lawyer or, where the plaintiff does not have a lawyer, serve it on the plaintiff, and file it, with proof of service, in this court office, WITHIN TWENTY DAYS after this statement of claim is served on you, if you are served in Ontario.

If you are served in another province or territory of Canada or in the United States of America, the period for serving and filing your statement of defence is forty days. If you are served outside Canada and the United States of America, the period is sixty days.

Instead of serving and filing a statement of defence, you may serve and file a notice of intent to defend in Form 18B prescribed by the *Rules of Civil Procedure*. This will entitle you to ten more days within which to serve and file your statement of defence.

IF YOU FAIL TO DEFEND THIS PROCEEDING, JUDGMENT MAY BE GIVEN AGAINST YOU IN YOUR ABSENCE AND WITHOUT FURTHER NOTICE TO YOU. IF YOU WISH TO DEFEND THIS PROCEEDING BUT ARE UNABLE TO PAY LEGAL FEES, LEGAL AID MAY BE AVAILABLE TO YOU BY CONTACTING A LOCAL LEGAL AID OFFICE.

TAKE NOTICE: THIS ACTION WILL AUTOMATICALLY BE DISMISSED if it has not been set down for trial or terminated by any means within five years after the action was commenced unless otherwise ordered by the court.

Date: December 19, 2018

Issued by "Ray Williams"
Local registrar

Address of court office: 330 University Avenue
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AND A
COURTESY
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CLAIM

1. The Plaintiff, Morneau Shepell Ltd. ("**Morneau**") in its capacity as administrator of the Sears Canada Inc. Registered Retirement ~~Pension~~ Plan (the "**Plan**") claims:

(a) Damages at law and in equity payable jointly and severally in the amount of the deficiency in the Plan as determined in the actuarial wind up report, which at present is estimated at approximately $260 million:

(i) as against the Defendants William Harker, William Crowley, Donald Campbell Ross, Deborah E. Rosati, R. Raja Khanna, James McBurney and Douglas Campbell (collectively the "**Director Defendants**") and Ephraim J. Bird for breach of fiduciary duty and negligence;

(ii) as against the Director Defendants and Ephraim J. Bird for inducing Sears Canada Inc. ("**Sears Canada**") and the other Director Defendants to breach their fiduciary duties and/or for knowingly assisting Sears Canada and the other Director Defendants in breaching such fiduciary duties;

(iii) as against the Defendants ESL Investments Inc., ESL Partners, LP, SPE I Partners, LP, SPE Master I, LP, ESL Institutional Partners, LP, Sears Holdings Corporation and Edward S. Lampert for inducing Sears Canada, Ephraim J. Bird and/or the Director Defendants to breach their fiduciary duties and/or for knowingly assisting Sears Canada, Ephraim J. Bird and/or the Director Defendants in breaching such fiduciary duties;

(b) a declaration that the Defendants ESL Investments Inc., ESL Partners, LP, SPE I Partners, LP, SPE Master I, LP, ESL Institutional Partners, LP, Sears Holdings Corporation, Edward S. Lampert, William Harker, Deborah Rosati, R. Raja Khanna

and James McBurney (collectively the "**Shareholder Defendants**") received directly or indirectly the 2013 Dividend (as defined below) with knowledge that such payment was the result of a breach of fiduciary duty by Sears Canada, Ephraim J. Bird and/or the Director Defendants and an order imposing a constructive trust on the assets of each such Shareholder Defendant (other than Sears Holdings Corporation) equal to the value of the dividend payments directly or indirectly received by them and an order requiring such amount be remitted to the Plaintiff for the benefit of the Plan beneficiaries;

(c) a declaration that the authorization and payment of the 2013 Dividend was oppressive and unfairly prejudicial to the interests of the Plan and its beneficiaries and unfairly disregarded their interests and orders pursuant to section 241 of the *Canada Business Corporations Act* (the "**CBCA**") setting aside the declaration and payment of the 2013 Dividend and/or requiring the Defendants to pay to the Plaintiff as compensation or restitution the amount required to fully fund the benefits promised under the Plan;

(d) punitive and exemplary damages (except as against Sears Holdings Corporation);

(e) pre and post-judgment interest in accordance with the *Courts of Justice Act*; and

(f) costs of this action on a substantial indemnity basis.

The Parties

2. The Superintendent of Financial Services for Ontario (the "**Superintendent**") has declared that Ontario's Pension Benefits Guarantee Fund (the "**PBGF**") applies to the Plan in respect of Ontario Plan beneficiaries. As a result, to the extent of any payment out of the PBGF into the Plan, the Superintendent has rights of subrogation in respect of the claims outlined herein.

The PBGF is administered by the Superintendent. Subject to Plan recoveries from the Sears Canada estates, the PBGF expects its contribution to the Plan to be material. As a result, the PBGF expects its subrogation rights in respect of these claims to be material.

3. Sears Canada is a corporation incorporated pursuant to the CBCA. Sears Canada and its affiliate companies obtained protection under the *Companies' Creditors Arrangements Act* (the "**CCAA**") on June 22, 2017.

4. The Plaintiff was appointed administrator of the Plan by the Superintendent effective October 16, 2017.

5A. The Defendant Sears Holdings Corporation ("**Holdings**") is publicly-traded corporation incorporated under the laws of Delaware.

5. The Defendant ESL Investments Inc. ("**ESL Investments**") is a privately-owned hedge fund incorporated under the laws of Delaware. The Defendants ESL Partners, LP, SPE I Partners, LP, SPE Master I, LP, ESL Institutional Partners, LP (collectively, and together with ESL Investments, "**ESL**") are affiliates of ESL Investments.

6. The Defendant Edward S. Lampert ("**Lampert**") is an individual residing in Indian Creek, Florida. At all material times, Lampert controlled ESL, and has served as ESL Investments' Chairman and Chief Executive Officer since its creation in 1988. At all material times, Lampert was also a director, Chairman of the Board of Directors and Chief Executive Officer of Holdings.

7. The Director Defendants William Crowley, William Harker, Donald Campbell Ross, Deborah E. Rosati, R. Raja Khanna, James McBurney and Douglas Campbell were directors of Sears Canada at the time the 2013 Dividend was approved by the Sears Canada board of directors (the "**Board**").

8. The Defendant Ephraim J. Bird ("**Bird**") was a member of the Board until on or around November 13, 2013 and was at all material times the Chief Financial Officer of Sears Canada.

9. At all material times, including from November 18, 2013 through to December 6, 2013, Lampert and ESL held a controlling ownership interest in ~~Sears~~ Holdings ~~Corporation (**"Holdings"**)~~ and beneficially owned 55% of Holdings' outstanding shares. In turn, at all material times, Holdings held a controlling ownership interest in Sears Canada. On October 15, 2018, Holdings filed for Chapter 11 protection from creditors with the United States Bankruptcy Court. ~~Holdings is not a party to this action.~~

10. At all material times, including from November 18, 2013 through to December 6, 2013, ~~Holdings and~~ each of the Shareholder Defendants was a direct or beneficial shareholder of Sears Canada, and held the following ownership interests:

(a) Holdings beneficially owned 51,962,391 shares in Sears Canada, representing approximately 51% of the outstanding shares.

(b) ESL beneficially owned 17,725,280 shares in Sears Canada, representing approximately 17.4% of the outstanding shares, which were directly held as follows:

(i) ESL Partners, LP: 15,821,206 shares;

(ii) SPE I Partners, LP: 830,852 shares;

(iii) SPE Master I, LP: 1,068,522 shares;

(iv) ESL Institutional Partners, LP: 4,381 shares; and

(v) CRK Partners, LLC (an affiliate of ESL Investments that was voluntarily cancelled effective June 1, 2018 and is not a party to these proceedings): 319 shares;

(c) Lampert owned 10,433,088 shares in Sears Canada, representing approximately 10.2% of the outstanding shares;

(d) William Harker owned 4,604 shares in Sears Canada;

(e) Deborah E. Rosati owned 2,600 shares in Sears Canada;

(f) James McBurney owned 1,525 shares in Sears Canada; and

(g) R. Raja Khanna owned 2,620 shares in Sears Canada.

The Plan

11. The Plan is a registered pension plan under the *Pension Benefits Act* (Ontario) which contains a defined benefit component. Sears Canada is the principal participating employer in the Plan and is obliged to make contributions to the Plan fund sufficient to ensure that the Plan fund has enough assets to pay all promised defined benefits when due.

12. Until October 16, 2017, Sears Canada was the administrator of the Plan and, as such, owed fiduciary duties to the Plan and the Plan beneficiaries.

13. In administering the Plan, Sears Canada acted through its officers and Board. These individuals (including the Director Defendants and Bird) also owed fiduciary duties and a duty of care to the Plan and the Plan beneficiaries.

14. Since at least 2010, Sears Canada and its directors have been aware of actuarial valuations disclosing that the assets held in respect of the defined benefit component of the Plan

were insufficient to pay all of the promised defined benefits and that further employer contributions to the Plan fund were required in order to permit all promised benefits to be paid to Plan beneficiaries when due. To the knowledge of Sears Canada, Bird and the Director Defendants, as at December 31, 2010, the Plan had a funding deficit of $68,039,000, a solvency deficit of $205,788,000 and a wind-up deficit of $307,330,000.

15. During the period subsequent to December 31, 2010, Sears Canada made only the minimum contributions to the Plan fund permitted by law, even after Sears Canada, Bird and the Director Defendants knew or ought to have known that that the long-term viability of Sears Canada, and thus its ability to fully fund the Plan liabilities from future revenues, was at serious risk.

16. The Plan was wound up by order of the Superintendent effective October 1, 2017 and the Plan's wind-up deficit which crystalized on that date is currently estimated at approximately $260 million.

17. The assets available for distribution under the CCAA to meet all of Sears Canada outstanding obligations including its obligation to fully fund the Plan's wind-up deficit is estimated to be only approximately $155 million. Excluding claims relating to the Plan's wind-up deficit, the claims of unsecured creditors against Sears Canada total approximately $1.5 billion.

2013 Plan to Dispose of Real Estate Assets to Fund Dividends

18. Beginning in 2011, Sears Canada's financial performance began to decline sharply.

19. By 2013, ESL Investments and Lampert had an immediate need for cash from Sears Canada. ESL Investments had raised money from investors years earlier on terms that precluded these investors from redeeming their investment for a period of time. When this holding

period had expired in 2013, these investors were entitled to withdraw funds and ESL Investments faced significant redemptions.

20. In order to satisfy its redemption obligations, ESL, Holdings and Lampert devised a plan to extract cash from Sears Canada through (a) the disposition of its most valuable real estate assets, and (b) the payment of an extraordinary dividend for the benefit of ESL, Holdings and Lampert (collectively the "**Monetization Plan**").

21. To give effect to the Monetization Plan, Lampert personally directed the disposition of Sears Canada's real estate assets in 2013.

22. In accordance with the Monetization Plan:

(a) Sears Canada entered into an agreement with Oxford Properties Group on or about June 14, 2013 to terminate Sears Canada's leases at Yorkdale Shopping Centre and Square One Mississauga in exchange for a payment to Sears Canada of $191 million (the "**Oxford Terminations**"). The Oxford Terminations closed June 24, 2013.

(b) Sears Canada pursued an agreement with Cadillac Fairview Corporation Limited (Cadillac Fairview) to terminate five additional high-value leases (Toronto Eaton Centre, Sherway Gardens, Markville Shopping Centre, Masonville Place and Richmond Centre) (the "**Cadillac Terminations**") for a payment of $400 million. The Cadillac Terminations were approved by the Sears Canada Board on October 28, 2013 and closed on November 12, 2013.

(c) Sears Canada negotiated the sale of Sears Canada's 50% interest in eight properties jointly owned with The Westcliff Group of Companies. Sears Canada's 50% interest was sold to Montez Income Properties Corporation in exchange for

approximately $315 million (the "**Montez Sale**"). The Sears Canada Board approved the Montez Sale on November 8, 2013 and the sale closed in January 2014.

23. Lampert directed Sears Canada to complete each of the Oxford Terminations, the Cadillac Terminations and the Montez Sale. These dispositions were part of the Monetization Plan and completed in order to provide ESL Investments with funds to address its redemption obligations. The assets disposed of by Sears Canada were its "crown jewels".

24. By September 23, 2013, the Board including Bird had received management presentations directly addressing Sears Canada's deteriorating operational and financial performance which reported that:

(a) sales continued to decline across Sears Canada's business at a rate of 2.6% per year;

(b) based on year-to-date current trends (and without appropriately accounting for stores closed in connection with the Monetization Plan), Sears Canada's projected EBITDA by 2016 would be negative $105 million;

(c) Sears Canada was struggling operationally: "Basics not fixed"; and

(d) competition in the Canadian retail space was increasing with Target's entry into the market. Target had opened 68 stores in Canada in the second quarter of 2013 and planned to open a further 124 stores in Canada by year end.

25. By September 23, 2013, the Director Defendants and Bird knew or ought to have known that Sears Canada's business was in decline, that its long-term viability was at risk, and that the divestment of these key assets in 2013 would have a dramatic negative impact on Sears

Canada including its ability to fund the Plan. Despite such knowledge, neither Sears Canada nor the Director Defendants nor Bird took any steps to ensure that the Plan was fully funded and able to satisfy the pension promise made to Plan beneficiaries.

The 2013 Dividend

26. On November 18 and 19, 2013, the Board held an in-person meeting (the "**November Meeting**") which was attended by the Director Defendants and Bird.

27. On November 12, 2013, prior to the November Meeting, the Board including Bird received a financial update on the performance of Sears Canada. Management reported that throughout the first three quarters of the year, Sears Canada had negative net income of $49 million ($27 million worse than the same period in 2012) and negative total cash flow of $26.3 million.

28. On November 14, 2013, the Investment Committee of Sears Canada's Board was presented with material showing an estimated pension plan deficiency on a wind-up basis of $313 million as at December 2013.

29. The materials provided to the Board and Bird in advance of the November Meeting included two analyst reports which reviewed the financial circumstances of Sears Canada and predicted its eventual failure:

> **Desjardins Capital Markets Report (October 30, 2013)**
>
> As long as consumers do not perceive that Sears Canada is going out of business and desert it, Sears may be able to manage its demise slowly over time, selling prime and non-core assets, and waiting for the elusive purchaser of 60–80 store locations to appear.
>
> **CIBC Report (November 4, 2013)**
>
> It is possible that SCC will simply operate its way into irrelevance, gradually selling off stores to stem the cash drain. That strategy would likely result in Sears occasionally cutting a special dividend cheque to all shareholders,

> not the worst way to create shareholder value. But that is dangerous to the operations, particularly as the primary, and most profitably flagship stores are vended.

30. During the short pre-dinner discussion on November 18, 2013, the Director Defendants, at the instigation and urging of one or more of them and Bird, unanimously resolved to declare an extraordinary dividend of $5.00 per common share, for an aggregate dividend payment of approximately $509 million (the "**2013 Dividend**").

31. The Director Defendants approved the 2013 Dividend unanimously and without any abstentions despite the fact that they did not have:

(a) any advance notice that they would be asked to consider an extraordinary dividend at the November Meeting;

(b) any written materials regarding a proposed dividend or possible dividend structures;

(c) any written presentation analyzing the impact the proposed dividend would have on Sears Canada including its ability to meet its pension obligations;

(d) any pro forma assessment of Sears Canada's liquidity and cash flows following the payment of a dividend;

(e) any management presentation or recommendation on the proposed dividend; or

(f) any legal advice with respect to their duties in connection with the declaration of a dividend.

32. The Director Defendants approved and/or acquiesced to the 2013 Dividend and Sears Canada paid the 2013 Dividend to satisfy the immediate financial needs of ESL. The 2013

Dividend was directed by Lampert who was at all times acting in his personal capacity and as the directing mind of ESL and Holdings and who:

(a) knew that Sears Canada, Bird and the Director Defendants owed fiduciary duties to the Plan and the Plan beneficiaries;

(b) knew that the Plan had a large unfunded deficit and that approval and payment of the extraordinary dividend would be contrary to the interests of the Plan beneficiaries; and

(c) intended that the Director Defendants would approve and Sears Canada would pay the 2013 Dividend without regard to its impact on the Plan or the Plan beneficiaries.

33. The Director Defendants approved and/or acquiesced to the 2013 Dividend and Sears Canada paid said dividend fraudulently and dishonestly for the purpose of benefitting Lampert and ESL and in total disregard to the interests of the Plan and its beneficiaries. When they authorized the 2013 Dividend, the Director Defendants knew or should have known that the dividend would severely prejudice the ability of Sears Canada to satisfy its pension funding obligations.

34. Sears Canada paid the 2013 Dividend on December 6, 2013 and the Shareholder Defendants received the following dividend payments:

(a) ESL: $88,626,400;

(b) Lampert: $52,165,440;

(c) William Harker: $23,020;

(d) Deborah E. Rosati: $13,000;

(e) James McBurney: $7,625; ~~and~~

(f) R. Raja Khanna: $13,100; and

(g) Holdings: $259,811,955.

35. ESL and Lampert also benefited from approximately $259 million paid to Holdings through the 2013 Dividend.

36. When the Shareholder Defendants received the above payments directly or indirectly from Sears Canada they knew or ought to have known that such payments had been authorized by the Director Defendants and paid by Sears Canada in breach of the fiduciary duties owed by them to the Plan and its beneficiaries. The Shareholder Defendants specifically knew or ought to have known that Sears Canada and the Director Defendants owed fiduciary duties to the Plan fund and the Plan beneficiaries, that the Plan was then seriously underfunded, that the long term viability of Sears Canada was then at risk and that payment of the 2013 Dividend to the Shareholder Defendants would severely prejudice the ability of Sears Canada to satisfy its pension funding obligations.

37. As a result of the 2013 Dividend, Sears Canada has insufficient assets to satisfy its obligation to fully fund all benefits accrued under the Plan with the result that Plan beneficiaries will not receive full payment of the pensions promised in the Plan.

Liability of Defendants

38. In authorizing and/or acquiescing to the 2013 Dividend in the manner and circumstances set out above, without first considering the need of Sears Canada to take steps as Administrator to provide for the Plan to be funded ahead of payments to shareholders and acting

on such consideration, each Director Defendant (i) breached the fiduciary duties and duty of care he or she owed the Plan and the Plan beneficiaries and (ii) induced Sears Canada and the other Director Defendants to breach the fiduciary duties they owed the Plan and the Plan beneficiaries and/or knowingly assisted Sears Canada and the other Director Defendants in breaching such duties.

39. In instigating and urging the approval and payment of the 2013 Dividend in the manner and circumstances set out above, without first considering the need of Sears Canada to take steps as Administrator to provide for the Plan to be funded ahead of payments to shareholders and acting on such consideration, Bird (i) breached the fiduciary duties and duty of care he owed the Plan and the Plan beneficiaries and (ii) induced Sears Canada and the Director Defendants to breach the fiduciary duties they owed the Plan and the Plan beneficiaries and/or knowingly assisted Sears Canada and the Director Defendants in breaching such duties.

40. In causing the Director Defendants to authorize the 2013 Dividend and in causing Sears Canada to pay such dividend in the manner and circumstances set out above, without first considering and at that time providing for appropriate funding or security for the Plan, the Shareholder Defendants induced the Director Defendants, Bird and Sears Canada to breach the fiduciary duties they owed the Plan and the Plan beneficiaries and/or knowingly assisted the Director Defendants, Bird and Sears Canada in breaching such duties.

41. In receiving directly and indirectly the 2013 Dividend payments in the manner and circumstances set out above, the Shareholder Defendants are in knowing receipt of assets transferred to them in breach of fiduciary duty and were unjustly enriched at the expense of the Plan and its beneficiaries and the Shareholder Defendants are required to account for all amounts so received for the benefit of the Plan beneficiaries.

42. Authorization and payment of the 2013 Dividend in the circumstances set out above was oppressive and unfairly prejudicial to the interests of the Plan and its beneficiaries and unfairly disregarded their interests and require an order pursuant to section 241 of the CBCA setting aside the declaration and payment of the 2013 Dividend and requiring the Defendants to pay to the Plaintiff by way of compensation or restitution the amount required to fully fund the benefits promised under the Plan.

Service *Ex Juris*, Statutes Relied Upon, and Location of Trial

43. The Plaintiff relies upon paragraphs (g) and (n) and (p) of Rule 17.02 to serve this claim outside Ontario.

44. The Plaintiff relies upon the CBCA.

45. The Plaintiff proposes that the trial of this matter be heard in Toronto, Ontario.

December 19, 2018
(Amended: 05 July, 2019)

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MORNEAU SHEPELL LTD. in its capacity as administrator of the Sears Canada Inc. Registered Retirement ~~Pension~~ Plan	and	ESL INVESTMENTS INC. et al.	Court File No.: CV-18-00611217-00CL
Plaintiff		Defendants	

ONTARIO
SUPERIOR COURT OF JUSTICE

Proceeding commenced at Toronto

AMENDED STATEMENT OF CLAIM

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AMENDED THIS April 9/19 PURSUANT TO
MODIFIÉ CE CONFORMÉMENT À
☑ RULE/LA RÈGLE 26 02 (A)
☐ THE ORDER OF
L'ORDONNANCE DU
DATED / FAIT LE

REGISTRAR
SUPERIOR COURT OF JUSTICE
GREFFIER
COUR SUPÉRIEURE DE JUSTICE

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 HOLDINGS 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*

FRESH AS AMENDED STATEMENT OF CLAIM

TO THE DEFENDANTS:

A LEGAL PROCEEDING HAS BEEN COMMENCED AGAINST YOU by the Plaintiff. The claim made against you is set out in the following pages.

IF YOU WISH TO DEFEND THIS PROCEEDING, you or an Ontario lawyer acting for you must prepare a Statement of Defence in Form 18A prescribed by the Rules of Civil Procedure, serve it on the Plaintiff's lawyer or, where the Plaintiff does not have a lawyer, serve it on the Plaintiff, and file it, with proof of service in this court office, WITHIN TWENTY DAYS after this Statement of Claim is served on you, if you are served in Ontario.

If you are served in another province or territory of Canada or in the United States of America, the period for serving and filing your Statement of Defence is forty days. If you are served outside Canada and the United States of America, the period is sixty days.

Instead of serving and filing a Statement of Defence, you may serve and file a Notice of Intent to Defend in Form 18B prescribed by the Rules of Civil Procedure. This will entitle you to ten more days within which to serve and file your Statement of Defence.

IF YOU FAIL TO DEFEND THIS PROCEEDING, JUDGMENT MAY BE GIVEN AGAINST YOU IN YOUR ABSENCE AND WITHOUT FURTHER NOTICE TO YOU. IF YOU WISH TO DEFEND THIS PROCEEDING BUT ARE UNABLE TO PAY LEGAL FEES, LEGAL AID MAY BE AVAILABLE TO YOU BY CONTACTING A LOCAL LEGAL AID OFFICE.

TAKE NOTICE: THIS ACTION WILL AUTOMATICALLY BE DISMISSED if it has not been set down for trial or terminated by any means within five years after the action was commenced unless otherwise ordered by the court.

Date October 21, 2015 Issued by "Deborah Farquharson"
Local Registrar

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CLAIM

1. The plaintiff claims on behalf of itself and all members of the Proposed Class:

(a) a declaration that the plaintiff is a "complainant" under the *Canada Business Corporations Act,* R.S.C. 1985, c. C. 44 (the "**CBCA**");

(b) a declaration that the plaintiff has been oppressed by the defendants under the CBCA;

(c) compensation pursuant to s. 241(3)(j) of the CBCA in an amount not exceeding $80,000,000;

(d) pre-judgment and post-judgment interest pursuant to the *Courts of Justice Act*, R.S.O. 1990, c. C.43;

(e) costs of this action on a substantial-indemnity scale, plus applicable goods and services and harmonized sales taxes; and;

(f) such further and other relief as this Honourable Court deems just, including all further necessary or appropriate accounts, inquiries and directions.

Parties

2. The plaintiff, 1291079 Ontario Limited ("**129**"), is incorporated under the laws of Ontario. Until December, 2013, 129 carried on business in the Town of Woodstock, Ontario, as a retailer under the "Sears Hometown" store program. 129 is the class

representative in a certified class proceeding against Sears Canada Inc., bearing Court File No. CV- 3769 /13-CP (the "**Class Action**") commenced in Milton, Ontario

3. The defendant, Sears Canada Inc. ("**Sears**"), is incorporated under the laws of Canada and has its head office in the City of Toronto, Province of Ontario. Sears' stock is publicly traded on the Toronto Stock Exchange and on the NASDAQ.

4. The defendant, Sears Holdings Corporation ("**Holdings**"), is incorporated under the laws of the State of Delaware in the U.S.A. Until October, 2014, Holdings owned 51% of the common shares of Sears, at which time its shareholdings were reduced to approximately 12% following a sale of its shares. On October 15, 2018, Holdings filed for relief under Chapter 11 of the Bankruptcy Code in the U.S. Bankruptcy Court.

5. The defendant, ESL Investments Inc. ("**ESL**"), is incorporated under the laws of the State of Delaware in the U.S.A. ESL is a privately-owned hedge fund controlling over approximately $9 billion in assets. Until October, 2014, ESL was a 27% shareholder of Sears, at which time it increased its shareholdings in Sears to approximately 48% through the acquisition of shares previously held by Holdings.

6. The principal individual behind both Holdings and ESL is hedge-fund billionaire Edward Lampert ("**Lampert**"). Lampert is the chairman and CEO of Holdings and the founder, chairman and CEO of ESL. Lampert is also the largest individual shareholder of Holdings.

7. Holdings and ESL are affiliates of Sears as defined under section 2 of the CBCA.

8. The defendant, William C. Crowley ("**Crowley**"), is an individual residing in New York, New York in the United States of America. Crowley was a director of Sears in 2013.

9. The defendant, William R. Harker ("**Harker**"), is an individual residing in Brooklyn, New York in the United States of America. Harker was a director of Sears in 2013.

10. The defendant, Donald Campbell Ross ("**Ross**"), is an individual residing in Toronto, Ontario. Ross was a director of Sears in 2013.

11. The defendant, Ephraim J. Bird ("**Bird**"), is an individual residing in Salado, Texas in the United States of America. Bird was a director of Sears in 2013.

12. The defendant, Deborah E. Rosati ("**Rosati**"), is an individual residing in Wainfleet, Ontario. Rosati was a director of Sears in 2013.

13. The defendant, R. Raja Khanna ("**Khanna**"), is an individual residing in Toronto, Ontario. Khanna was a director of Sears in 2013.

14. The defendant, James McBurney ("**McBurney**"), is an individual residing in London, England. McBurney was a director of Sears in 2013.

15. The defendant, Douglas Campbell ("**Campbell**"), is an individual residing in Toronto, Ontario. Campbell was a director of Sears in 2013.

16. Crowley, Harker, Ross, Bird, Rosati, Khanna, McBurney and Campbell are hereinafter, collectively, referred to as the "**Directors**".

17. At all material times, including on November 18, 2013 through December 6, 2013, Holdings, ESL, Lampert, and Harker (collectively, the "**Primary Shareholders**") were a direct or beneficial shareholder of Sears, and held the following ownership interests:

(a) Holdings beneficially owned 51,962,391 shares in Sears, representing approximately 51% of the outstanding shares;

(b) ESL beneficially owned 17,725,280 shares in Sears, representing approximately 17.4% of the outstanding shares, which were directly held as follows:

i. ESL Partners, LP – 15,821,206 shares;

ii. SPE I Partners, LP – 830,852 shares;

iii. SPE Master I, LP – 1,068,522 shares;

iv. ESL Institutional Partners, LP – 4,381 shares; and

v. CRK Partners, LLC (an affiliate of ESL that was voluntarily cancelled effective June 1, 2018, and is not a party to these proceedings – 319 shares;

(c) Lampert owned 10,433,088 shares in Sears, representing approximately 10.2% of the outstanding shares; and

(d) Harker owned 4,604 shares in Sears.

Background

18. 129 is a Sears Hometown Store dealer. Hometown Store dealers, before they were all shut down, were small hardware and appliance stores operated by independent retailers pursuant to a Dealer Agreement with Sears. The Hometown Dealers operated under the "Sears" brand.

19. On July 5, 2013, 129 commenced a class proceeding against Sears on behalf of all Hometown Store dealer stores operating under a Dealer Agreement with Sears at any time on or after July 5, 2011 (hereinafter collectively referred to as the "**Class**" or "**Hometown Dealers**")). The Class Action seeks $100 million in damages on behalf of the Class for, *inter alia*, breach of contract and breaches of the *Arthur Wishart Act (Franchise Disclosure), 2000*, S.O. 2000, c. 3 ("**Wishart Act**").

20. The Class Action was certified as a class proceeding on September 8, 2014.

21. 129 proposes that the class in this action be defined in the same manner as the class in the Class Action, namely:

> all corporations, partnerships, and individuals carrying on business as a Sears Hometown Store under a Dealer Agreement with Sears at any time from July 5, 2011 to June 22, 2017

Overview of the Claim

22. ESL—acting at all times at founder and namesake Lampert's direction—engaged in serial asset stripping, taking Sears's best assets out of the enterprise and away from the

claims of creditors, including the Class, so as to monetize these assets and have those funds delivered to ESL and Holdings by way of dividend and before its inevitable insolvency proceedings. Over the course of Lampert's and ESL's reign, Sears closed hundreds of stores, cut thousands of jobs, and lost untold billions in value. In effect, Lampert and ESL managed Sears as if it were a private portfolio company that existed solely to provide the greatest returns on their investment, recklessly disregarding the damage to Sears, its employees, and its creditors, including the Class.

23. In November and December 2013, the Directors issued and paid an extraordinary dividend in the amount of approximately $509 million which was made possible by ESL and the Directors' asset stripping, conflict of interest, and self-dealing. The extraordinary dividend was oppressive and unfairly disregarded and prejudiced the interests of the Class.

The Beginning of the End for Sears

24. Sears is a retailer of home appliances, furnishings, mattresses, electronics and apparel, among other things. It has operated in Canada for over 60 years. Sears' retail network includes many different channels of retail, such as full-line department stores, furniture and appliance stores, Dealer Hometown stores, catalogue selling locations, and outlet stores. Sears also sells direct to customers through its website, www.sears.ca and its 1-800 telephone number.

25. Beginning in 2011, Sears' financial performance began to decline sharply. According to Sears' publicly-disclosed audited annual financial statements for 2010 – 2013

(as amended, in certain cases) Sears' revenues operating profits/losses and gross margin rates were as follows:

Year	Total Revenues ($ million)	Operating Profit (Loss) ($ millions)	Gross Margin Rate
2010	4,938.5	106.3	39.3%
2011	4,619.3	(50.9)	36.5%
2012	4,300.7	(82.9)	36.7%
2013	3,991.80	(187.8)	36.2%

26. As early as 2011, Sears' management recognized that drastic, transformative action would be required for Sears to re-establish a foothold in the Canadian retail market. In the 2011 strategic plan (the **2011 Strategic Plan**) prepared for Sears' board of directors (the **Board**), then-Chief Executive Officer Calvin McDonald ("**McDonald**") described the state of Sears as follows:

> Sears Canada is not a good retailer. Our business is broken; trading is awkward and inefficient, we lack product and merchandising focus and we are becoming irrelevant to customers while losing touch with our core.
>
> [...]
>
> We lack many of the fundamental processes, structures and culture of a strong retailer. In short, we lack "retail rhythm". However most of our challenges are self-induced, meaning we are in a position to fix them.

27. The 2011 Strategic Plan also made clear that if transformative action was not taken, Sears could not expect to re-emerge as a successful retailer: "If we do not innovate, we

will cease to be relevant." More directly, the 2011 Strategic Plan warned that "the current trajectory of growth and margin decline would take EBITDA into negative territory if we do not take drastic action."

28. Notwithstanding the concerning operational trends identified in the 2011 Strategic Plan, Sears failed to take the necessary action to reinvigorate its business. Between 2011 and 2013, Sears consistently invested fewer resources on growth and transformational initiatives relative to its industry peers. In particular, the Board of Directors for Sears rejected multiple attempts by management, including, in particular, McDonald, to use Sears' capital to revitalize its business.

2013 Plan to Dispose of Real Estate Assets to Fund Dividends (the Monetization Plan)

29. By 2013, ESL and Lampert had an immediate need for cash from Sears. ESL had raised money from investors years earlier on terms that precluded these investors from redeeming their investment for a period of time. In 2013, this holding period expired, investors were entitled to withdraw funds and ESL investors faced significant redemptions.

30. In order to satisfy its redemption obligations, ESL and Lampert devised a plan to extract cash from Sears through (a) the disposition of its most valuable real estate assets, and (b) the payment of an extraordinary dividend for the benefit of ESL and Lampert (collectively, the "**Monetization Plan**").

31. To give effect to the Monetization Plan, Lampert personally directed the disposition of Sears' real estate assets in 2013. Lampert provided specific instructions to Sears on the price sought by Sears for its dispositions.

32. At all material times, Lampert directed and acted in concert with officers and directors of Sears to implement the Monetization Plan, including, in particular, with Crowley (then Chair of the Sears Board), Harker (then a director of Sears) and E.J. Bird (then Chief Financial Officer of Sears). Jeffrey Stollenwerck (then President, Real Estate Business Unit of Holdings) was also engaged by ESL and Lampert on these matters. Lampert had a long standing professional and personal relationship with each of them:

(a) Crowley had acted as President and Chief Operating Officer of ESL from January 1999 to May 2012, Executive Vice-President and Chief Administrative Officer of Holdings from September 2005 to January 2011 and Chief Financial officer of Holdings for periods in 2005-2007;

(b) Harker was an Executive Vice-President and General Counsel of ESL from February 2011 to June 2012 and an officer of Holdings from September 2005 until August 2012, during which time he acted variously as General Counsel, Corporate Secretary and Senior Vice-President, among other roles;

(c) Bird was the Chief Financial Officer of ESL from 1991 to 2002; and

(d) Stollenwerck was the President of the Real Estate Business Unit of Holdings from February 2008 to April 2018 and a Senior Vice President, Real

Estate for Holdings from March 2005 to February 2008. Before joining Holdings, Stollenwerck had acted as Vice-President, Research at ESL.

33. In accordance with the Monetization Plan, Sears entered into an agreement with Oxford Properties Group on or about June 14, 2013, to terminate Sears' leases at Yorkdale Shopping Centre and Square One Mississauga in exchange for a payment to Sears of $191 million (the "**Oxford Terminations**"). The Oxford Terminations closed June 24, 2013.

September 2013 Board Presentations

34. On September 23, 2013, two years after the 2011 Strategic Plan, the Board of Directors for Sears received a series of management presentations directly addressing Sears' deteriorating operational and financial performance (the "**2013 Board Presentations**"). Among other things, the 2013 Board Presentations reported that:

(a) sales continued to decline across Sears' business at a rate of 2.6% per year;

(b) based on year-to-date current trends (and without appropriately accounting for stores closed in connection with the Monetization Plan), Sears' projected EBITDA by 2016 would be negative $105 million; and

(c) Sears was struggling operationally: "Basics not fixed".

35. Earlier that month, presentations to the Board had also recognized that competition in the Canadian retail space was increasing with Target's entry into the market. Target had

opened 68 stores in Canada in the second quarter of 2013 and planned to open a further 124 stores in Canada by year end.

36. On or about September 24, 2013, MacDonald (Sears then CEO) resigned from the company. MacDonald resigned because of disagreements with Lampert over commitment to MacDonald's turnaround plan for Sears. That same day, Sears announced that Campbell was appointed its CEO and President.

37. Following the 2013 Board Presentations, the Board knew or ought to have known that Sears' business was in decline and that its long term viability was at risk.

Continued Disposition of Real Estate Assets

38. Further to the Monetization Plan, Sears pursued an agreement with Cadillac Fairview Corporation Limited ("**Cadillac Fairview**") to terminate five additional high-value leases (Toronto Eaton Centre, Sherway Gardens, Markville Shopping Centre, Masonville Place and Richmond Centre) (the "**Cadillac Terminations**").

39. Lampert directed the negotiating strategy in connection with the Cadillac Terminations with a view to ensuring a dividend of the proceeds before the end of 2013. Rowley and Stollenwerck negotiated directly with Cadillac Fairview, including with respect to the final price of $400 million.

40. On October 28, 2013, the Board approved the Cadillac Terminations. The Board was not advised of the role that Lampert, Crowley or Stollenwerck had played in

negotiating the Cadillac Terminations. The Cadillac terminations closed on November 12, 2013.

41. In the same period, Sears and Stollenwerck negotiated the sale of Sears' 50% interest in eight properties jointly owned with The Westcliff Group of Companies. Sears' 50% interest was sold to Montez Income Properties Corporation in exchange for approximately $315 million (the "**Montez Sale**").

42. The Sears Board approved the Montez Sale on November 8, 2013. The approval was made by written resolution and without an in-person board meeting.

43. The Montez Sale closed in January 2014.

44. The assets disposed of by Sears were its "crown jewels". It was plain that the divestiture of these key assets in 2013, while Sears was struggling in the face of stiffer retail competition from Target and others, would have a dramatic negative impact on Sears. The negative impact, in fact, unfolded:

Year	Total Revenues ($ million)	Operating Profit (Loss) ($ millions)	Gross Margin Rate
2012	4,300.7	(82.9)	36.7%
2013	3,991.8	(187.8)	36.2%
2014	3,424.5	(407.3)	32.6%
2015	3,145.5	(298.3)	31.8%
2016	2,613.6	(422.4)	27.3%

45. Lampert directed Sears to complete each of the Oxford Terminations, the Cadillac Terminations and the Montez Sale. These dispositions were part of the Monetization Plan and completed in order to provide ESL with funds to address its redemption obligations.

The 2013 Dividend

46. On November 12, 2013, the same day Sears received $400 million in proceeds from the Cadillac Terminations, Crowley directed Bird to move forward with an extraordinary dividend of between $5.00 and $8.00 per share.

47. On November 18 and 19, 2013, six days after the closing of the Cadillac Terminations, the Board held an in-person meeting (the "**November Meeting**"). Although Sears had no business operations in the United States, the November Meeting was held in New York City at the Offices of Wachtel, Lipton, Rosen & Katz ("**Wachtel**").

48. The November Meeting began with a short pre-dinner discussion on November 18 and continued with a full day session on November 19, 2013.

49. During the short pre-dinner discussion on November 18, 2013, the Board unanimously resolved to declare the 2013 Dividend, an extraordinary dividend of $5.00 per common share, for an aggregate dividend payment of approximately $509 million (the "**2013 Dividend**").

50. The circumstances surrounding the 2013 Dividend raised a series of red flags.

Lack of Notice to the Board

51. The Board had no advance notice that it would be asked to consider an extraordinary dividend at the November Meeting.

52. On Friday, November 15, 2013, the Board was provided with a package of material for the November Meeting (the "**Board Materials**"). The Board Materials included a detailed agenda with 15 separate items for the Board to consider during the November Meeting.

53. Neither the agenda nor any of the other Board Materials made any reference to the fact that the Board would be asked to consider an extraordinary dividend or any dividend at all. Moreover, the possible payment of a dividend had not been tabled in any prior Board meeting in 2013.

Lack of Information

54. The Board was not provided with the information necessary to assess the appropriateness of an extraordinary dividend.

55. Unlike past instances in which the Board was asked to consider an extraordinary dividend, the Board Materials did not contain any financial or operational information regarding the payment of a proposed dividend. The Board did not receive:

(a) any written materials regarding a proposed dividend or possible dividend structures;

(b) any written presentation analyzing the impact of the proposed dividend would have on Sears' business, including taking into account possible downside scenarios;

(c) any *pro forma* assessment of Sears' liquidity and cash flows following the payment of a dividend. Rather, the *pro forma* cash flows included in the Board Materials assumed that no dividend would be paid in either 2013 or 2014; or

(d) no financial statement was available which addressed the outstanding liability created by the Class Action. No contingency reserve was set aside and no written description of the existence of the Class Action was provided to the Board.

56. While Sears' management had identified the need to provide the Board with various cash flow analyses covering various dividend scenarios, the limited analysis that was done by management was incomplete and never presented to the Board.

57. Moreover, and unlike past meetings in which the Board had considered extraordinary dividends:

(a) management did not prepare a written presentation to the Board on the proposed dividend and there was no written recommendation or proposal from management to the Board; and

(b) the Directors were not provided with legal advice with respect to their duties in connection with the declaration of a dividend.

Financial Uncertainty

58. On November 12, 2013, prior to the November Meeting, the Board received a financial update on the performance of Sears. Management reported that throughout the first three quarters of the year, Sears had negative net income of $49 million ($27 million worse than the same period in 2012) and negative total cash flow of $26.3 million.

59. On November 14, 2013, the Investment Committee of Sears' Board was presented with material showing an estimated pension plan deficiency of $313 million at December 2013. The members of the Investment Committee were Crowley, Harker and Bird. This fact was not presented to the Board at the November Meeting.

60. In advance of the November Meeting, the Board was provided with only high level *pro forma* cash flows for 2014. The cash flows were based on a 2014 Plan EBITDA of $135 million, of which $118 million was based on aspirational changes to the business that management hoped would result in financial improvement but that management and the Board should have known were unreasonably optimistic. Moreover, the *pro forma* cash flows presented to the Board assumed the receipt of proceeds of the Montez Sale even though the transaction had not closed. Again, no information was provided to the Board on the impact of an extraordinary dividend would have on future investment opportunities and future cash flows.

61. The Board Materials did, however, include two analyst reports, both of which reviewed the financial circumstances of Sears and predicted its eventual failure:

Desjardins Capital Markets Report (October 30, 2013)

> As long as consumers do not perceive that Sears Canada is going out of business and desert it, Sears may be able to manage its demise slowly over time, selling prime and non-core assets, and waiting for the elusive purchaser of 60-80 store locations to appear.

CIBC Report (November 4, 2013)

> It is possible that SCC will simply operate its way into irrelevance, gradually selling off stores to stem the cash drain. That strategy would likely result in Sears occasionally cutting a special dividend cheque to all shareholders, not the worst way to create shareholder value. But that is dangerous to the operations, particularly as the primary, and most profitably flagship stores are vended.

A Conflicted Board

62. The 2013 Dividend was approved by the Board unanimously and without any abstentions.

63. Crowley and Harker participated in the Board's deliberations to pay the 2013 Dividend and approved the payment of the 2013 Dividend despite the fact that Sears had specifically determined that:

(a) Crowley and Harker were not "independent" directors; and

(b) pursuant to National Instrument 52-110, Crowley and Harker had a material relationship with Holdings and/or ESL that could "be reasonably expected to interfere with the exercise of [their] independent judgment".

64. Further, Crowley did not disclose to the Board that he, Lampert and Stollenwerck were personally involved in the 2013 real estate divestitures or that the timetable and size

of the proposed dividend was dictated by ESL's need for funds. Rather, the Board was led to believe that Sears' management was responsible for the 2013 real estate divestures. For example, Crowley expressly advised the independent members of the Board: "I do not think that the Board or the independents should attempt to insert themselves in the negotiations [of real estate transactions]. Bill [Harker] and I did not and do not do that."

65. Crowley and Harker in particular were focused on the interests of ESL and Lampert. Crowley and Harker failed to disclose the motivations of ESL and Lampert to the Board and the fact that both the real estate dispositions and 2013 Dividend were driven by the needs of ESL and Lampert and not the best interests of Sears and its other stakeholders, including the Class.

Departure from Past Governance Practices

66. The Board process for the 2013 Dividend represented a sharp departure from past practice of the Sears Board and ordinary standards of good corporate governance.

67. For example, in December 2005, the Board approved an extraordinary dividend. The process for approving that dividend included:

(a) multiple Board meetings on September 7, 2005, September 14, 2005, and December 2, 2005, to discuss the merits and risks of a potential dividend in light of the company's operational needs;

(b) multiple oral presentations from management and a dividend recommendation by the Chief Financial Officer;

(c) separate meetings between the independent directors of Sears and the Chief Financial Officer to assess the company's financial state;

(d) legal advice from both in-house and external counsel to the Board; and

(e) review by the Board of draft press releases and an officer's certificate with respect to the dividend.

68. In May 2010, the Board approved another extraordinary dividend, again with the benefit of a robust process:

(a) multiple meetings of the Board on April 23, 2010, May 7, 2010, and May 18, 2010, to discuss the merits and risks of a potential dividend in light of the company's operational needs;

(b) separate meetings of the independent directors on May 7, 2010, and May 12, 2010, with their own counsel present, to discuss the options available to Sears with respect to its excess cash and the amount of the potential dividend in light of the company's operation needs;

(c) multiple presentations by management, including a 40-page presentation dated April 23, 2010, and a subsequent 20-page presentation dated May 7, 2010,

providing detailed analyses of excess cash and financial forecasts (with downside scenarios) for multiple dividend options;

(d) a dialogue between management and the Board continuing over several meetings with respect to various options for a potential dividend;

(e) consideration of multiple potential uses for excess cash, including cash dividends in various amounts, a substantial issuer bid and a normal course issuer bid; and

(f) a deferral of half of the proposed dividend pending a full assessment of the company's operational needs.

69. In September 2010, the Board approved a second extraordinary dividend for 2010. The process for approving that dividend included:

(a) multiple meetings of the Board on or around August 23, 2010, and September 10, 2010, to discuss the capital structure of the company and the merits and risks of a potential dividend in light of the company's operational needs;

(b) multiple presentations by management, including a "capital structure update" dated August 3, 2010, and a 32-page presentation assessing the capital structure of the company and potential dividend options, including financial forecasts and downside scenarios, which the Board reviewed in advance of approving the dividend; and

(c) a separate meeting of the independent directors on or around September 8, 2010, with their own counsel present, to discuss the options available to Sears with respect to its excess cash and the amount of the potential dividend in light of the company's operational needs.

70. In December 2012, the Board approved a smaller extraordinary dividend. While not as fulsome as previous governance processes, the process for approving the 2012 dividend nonetheless included:

(a) a meeting on December 12, 2012, which included thorough discussion and analysis of the impact of a potential dividend on available cash, EBITDA and total debt, the company's need to retain cash for operational uses and downside scenarios in respect of a possible dividend;

(b) a report entitled "Dividend Discussion" which was prepared by Sears' Chief Financial Officer and which the Board reviewed in advance of approving the dividend; and

(c) a review of the draft officer's certificate with respect to the dividend by external counsel to the independent directors and a dialogue with the Chief Financial Officer of Sears addressing counsel's comments.

71. In stark contrast, the 2013 Dividend was the first item of business at a pre-dinner discussion at the outset of the November Meeting and was declared without any adequate financial, operational or cash flow information upon which the exercise proper business

judgment. It was dealt with before any of the planned presentations to the Board, which addressed Sears' financial results or the reports on management priorities, asset valuations, operating efficiency and Sears' 2014 financial plan and without the benefit of any independent legal advice regarding the directors' duties in the circumstances.

72. The Board's inability to make a proper business decision in respect of the 2013 Dividend was apparent from the fact that one of the Board members, Weissman, had been appointed to the Board that day. Weissman, a resident of Texas, had no material prior dealings with Sears or knowledge of Sears' financial or operational circumstances upon which to base his decision to approve the 2013 Dividend.

The Hometown Dealers' Interest in the Affairs of Sears

73. The 2013 Dividend was declared by the Directors and paid by Sears with knowledge by the defendants of the substantial claim against Sears by the Hometown Dealers in the Class Action.

74. The defendants knew that by implementing and proceeding with the Monetization Plan, culminating in the 2013 Dividend, that Sears would likely be unable to pay the damages of the Class if and when the Class succeeded in the Class Action.

75. The Class' claim was sizeable when compared to the assets of Sears at the time of the 2013 Dividend, its overall liabilities in 2013, its grim financial outlook, and its increasingly rapid financial deterioration. As a result, the Class had a direct financial interest in how Sears was being managed.

76. The Class was in a position of inequality of power and knowledge vis-à-vis the defendants and was unable to exert any influence over their decisions. The Class had no legal right to influence or change conduct contrary to Sears' interests, and to the interests of its creditors and other stakeholders.

77. The Class, in good faith, attempted to protect its interests, but the defendants ignored the Class' attempts.

(a) On November 26, 2013, after the declaration of the 2013 Dividend but prior to its payment, counsel for the plaintiff in the Class Action wrote to counsel for Sears requesting assurances that, having regard to the assets, liabilities (existing and contingent) and actual and likely future operating losses of Sears, it had set aside a sufficient reserve to satisfy a judgment against Sears should the Class Action be certified and succeed on the merits. No answer was provided.

(b) On December 3, 2013, counsel for the plaintiff in the Class Action wrote to each Director to put them on notice that should Sears be unable to satisfy an eventual judgment against Sears in the Class Action, that each Director who authorized the 2013 Dividend may be jointly and severally liable with Sears for such damages. No answer was provided.

78. The defendants ignored the Class' letters and paid the 2013 Dividend on December 6, 2013.

The Hometown Dealers' Reasonable Expectations

79. At the time the Monetization Plan was being implemented and the 2013 Dividend was issued, the Hometown Dealers were creditors of Sears with a claim of up to $100 million. As creditors, the Hometown Dealers' reasonable expectations were as follows:

(a) the Directors would not cripple Sears' ability to pay the Hometown Dealers by implementing and continuing the Monetization Plan and declaring the 2013 Dividend.

(b) the Directors, the management of Sears, and the Primary Shareholders would factor in its ability to pay the Hometown Dealers, as creditors, before continuing with the Monetization Plan, and declaring and paying the 2013 Dividend;

(c) the Directors, the management of Sears, and the Primary Shareholders would not engage in the Monetization Plan by stripping Sears of its best assets and selling Sears' crown jewels, and significantly erode its capitalization to the disadvantage of Sears' creditors, including the Hometown Dealers;

(d) the affairs of Sears would be conducted by the Defendants honestly, fairly and in good faith, in relation to the interests of the Hometown Dealers, and in a manner that did not unfairly prejudice or affect the Hometown Dealers' interests as creditors; and,

(e) the Directors would exercise care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances before the Directors implemented, and continued with, the Monetization Plan and declared the 2013 Dividend.

The 2013 Dividend Provided No Value to Sears

80. The 2013 Dividend provided no value to Sears and solely benefited its direct and indirect shareholders, including ESL, Lampert and Harker. The amounts of the gratuitous benefit received by them were:

(a) ESL: $88,626,400;

(b) Lampert: $52,165,440; and

(c) Harker: $23,020.

81. The Defendants also caused approximately $259 million to be paid to Holdings through the 2013 Dividend.

Non-Arm's Length Dealings

82. At all material times:

(a) Holdings was the controlling shareholder of Sears, was a related entity to Sears and was not dealing at arm's length with Sears;

(b) ESL and Lampert exercised both *de facto* and *de jure* control over Holdings. As Holdings stated in its 2013 Annual Report, Lampert had "substantial influence over many, if not all, actions to be taken or approved by our stockholders"; and

(c) ESL and Lampert were not dealing at arm's length with Sears as a result of their direct and indirect beneficial control position in Holdings, which in turn held a controlling interest in Sears. Further, Holdings, ESL and Lampert collectively held more than 75% of Sears' shares. ESL, Lampert and Holdings (at the direction of ESL and Lampert) acted in concert with respect to the control of Sears and specifically acted in concern and with a single mind to exercise influence over Sears in connection with the 2013 Dividend and the Monetization Plan.

83. As a result of these relationships, each of Holdings, ESL, Lampert and Sears are related entities who are presumed not to have acted at arm's length in respect of the 2013 Dividend. ESL and Lampert used their position of control over Sears to direct and/or influence Sears and its directors to carry out the Monetization Plan and the 2013 Dividend.

The Defendants' Actions were Oppressive and Unfairly Prejudicial to and Unfairly Disregarded the interests of the Plaintiff

84. The Defendants' actions in implementing the Monetization Plan and paying the 2013 Dividend were done for the purpose of denuding Sears of its prime assets and reducing its capitalization, and paying the funds from the realization of the assets to the

primary benefit of Holdings and ESL to the detriment of the Class. These actions were oppressive and unfairly prejudicial to and unfairly disregarded the interests of the Class.

85. The 2013 Dividend was effected by the defendants for the primary purpose of satisfying the immediate financial needs of ESL and Lampert and in reckless disregard of the reasonable expectations of Sears' creditors, including the Class. The 2013 Dividend was made with the specific intention to prioritize the interests of Lampert, ESL, and Holdings over Sears' creditors, including the Class, and other stakeholders.

86. In particular, considering the surrounding circumstances, the defendants knew but unfairly disregarded the fact that the 2013 Dividend would have a material adverse impact on its ability to continue as a viable business and pay its creditors, including the Class. In particular, the 2013 Dividend was:

(a) a non-arm's length transaction made outside the usual course of business;

(b) paid in the face of significant outstanding indebtedness to Sears' creditors, including the Class, in circumstances where:

i. Sears had dwindling operating income to repay its debts, including to the Class and other creditors;

ii. applying reasonable assumptions, the Board could only reasonably have expected Sears to be significantly cash flow negative from 2014 onwards;

iii. the Board had no real plan to repay such indebtedness;

iv. Sears was aggressively liquidating its prime assets and would continue to do so in the future;

v. Sears was experiencing growing, unsustainable operating losses each quarter and would continue to do so in the future;

vi. the defendants Holdings and ESL were not prepared to allow Sears to commit the funds and resources necessary to implement a viable turnaround of Sears' operations, and that MacDonald and other executives had resigned as a result;

vii. Sears was slashing its operating budget which would deprive it of the ability to effect a turnaround of its operations and would continue to do so in the future;

viii. the Sears Hometown stores network was and would continue in the future to be abandoned by Sears. Every senior executive involved in the Sears Hometown store network either left the organization or would leave in the near future as a result of this abandonment and the growing despair of the independent dealer network; and

ix. the class members, which are independent owner operators of Sears Hometown stores, were experiencing and would continue to

experience massive, unsustainable losses which would lead to their financial demise.

(c) paid in circumstances that raise a series of "red flags", including as a result of the following facts:

i. the 2013 Dividend was declared with unusual haste and with no advance notice to the Board;

ii. the 2013 Dividend was declared in the absence of proper Board materials and with a deficient corporate governance process;

iii. the Board received no independent legal advice to properly discharge its duties with respect to a material transaction involving related parties: Holdings, ESL and Lampert;

iv. the divestiture of Sears' crown jewel assets had an obvious negative impact on its business;

v. Sears had not addressed its negative cash flows or operational challenges despite years of effort;

vi. there were clear conflicts of interest within the Board and management at the time the 2013 Dividend was declared; and

vii. the 2013 Dividend was driven by ESL, Lampert, Bird as Chief Financial Officer of Sears and Crowley and Harker as non-

independent directors of Sears in order to satisfy ESL's urgent need for funds.

87. In March of 2014, the Board was presented with a proposal for a further, more modest dividend on short notice. The proposed dividend was not approved by the Board due to concerns about Sears' financial position, only three months after the payment of the 2013 Dividend.

88. At all material times, Holdings and ESL controlled and directed Sears and directed the payment of the 2013 Dividend by Sears. The Directors voted for and consented to the resolution authorizing the payment of the 2013 Dividend. The defendants have interfered with the plaintiff's and the Class' rights as creditors of Sears.

89. Specifically, by directing and authorizing Sears to pay the 2013 Dividend and its other actions as described above, the defendants have:

(a) effected a result;

(b) carried on their business and affairs and those of Sears in a manner; and

(c) exercised their powers in a manner,

that was oppressive and unfairly prejudicial to and that unfairly disregarded the interests of the Class, contrary to section 241 of the CBCA.

90. The plaintiff and the Class are complainants under ss. 238(d) of the CBCA.

91. The plaintiff pleads and relies on the CBCA, and particularly Part XX thereof.

The Continuing Path Towards Insolvency

92. Following the payment of the 2013 Dividend on December 6, 2013, Sears continued aggressively down the path of winding-up operations in Canada and liquidating what remained of its valuable assets.

93. Having received the 2013 Dividend and facing its own financial issues, on May 14, 2014, Holdings announced that it was exploring strategic alternatives for its shareholding in Sears, including a possible divestiture of its shares. Holdings retained the firm of Bank of America Merrill Lynch for this purpose.

94. In May, 2014, Sears announced that it had sold its minority ownership interest in the Centre commercial Les Rivières shopping centre in Trois-Rivières, Quebec, for $33.5 million.

95. In August, 2014, Sears announced that it had entered into an agreement to sell its interest in Kildonan Place, a shopping centre located in Winnipeg, for $33.5 million.

96. In September, 2014, Sears announced that Campbell would resign as CEO by the end of the year.

97. In October, 2014, Ronald Boire ("**Boire**") was named as Campbell's replacement as CEO. Boire was Sears' third different CEO in just under two years.

98. In November, 2014, Sears and JPMorgan Chase Bank, N.A. announced that their agreement relating to the Sears-branded credit card would terminate on November 15, 2015.

99. In February, 2015, Sears released its financial results for the previous quarter and fiscal year. Sears suffered an operating loss of $154.7 million for the last quarter of 2014. For the 2014 fiscal year, Sears suffered an operating loss of $407.3 million.

100. In March 11, 2015, Sears announced that it had entered into an agreement to sell and lease back three of its properties for $140 million. The locations include store space and adjacent property located at the Metropolis at Metrotown in Burnaby, British Columbia, Cottonwood Mall in Chilliwack, British Columbia and North Hill Shopping Centre in Calgary, Alberta.

101. On May 20, 2015, Sears released its financial performance for the first quarter of 2015. Sears suffered a $59.1 million net loss for this quarter.

102. On July 2, 2015, Boire announced that he would be leaving his position as CEO of Sears by the end of the 2015 summer.

103. All of the Hometown Dealer stores have closed.

Sears Enter CCAA Proceedings

104. On June 22, 2017 Sears and a number of its operating subsidiaries sought and obtained an initial order (as amended and restated on July 13, 2017, the "**Initial Order**"),

under the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, as amended (the "**CCAA**") (collectively the "**CCAA Proceedings**").

105. On July 18, 2017, as part of the CCAA Proceedings, the Court issued an order approving an agreement and a process for the liquidation of inventory and FF&E at certain initial closing Sears locations, which liquidation process is now complete.

106. On October 13, 2017, as part of the CCAA Proceedings, the Court issued, among other orders, an order approving an agreement and a process for the liquidation and the inventory and FF&E at all remaining Sears retail locations, which liquidation commenced shortly thereafter and is now completed.

107. The liquidation of assets at Sears retail locations is now completed, all retail locations are closed, and leases in respect of such locations have been disclaimed or surrendered back to the landlord.

108. All of the Hometown Dealers stores have closed and there will be available to the creditors of Sears, including the Hometown Dealers, only pennies on the dollar after its liquidation, a fate which was materially exacerbated by the Monetization Plan and the issuance of the 2013 Dividend.

109. Effective as of December 14, 2018, the Monitor, which had run a claims process in the CCAA, entered into an amended and restated settlement agreement with the Class (the "**Agreement**"). In the Agreement, the Monitor agreed that, in the event a Plan of Arrangement to be filed by Sears in the CCAA Proceedings is implemented, the Class in

the Class Action would have a proven unaffected unsecured claim against Sears of $80,000,000.

110. The Agreement will form part of the Plan of Arrangement. The Directors and ESL have each filed an indemnity claim in the CCAA proceedings and will be bound to the Plan of Arrangement, including the Agreement, if the Plan of Arrangement is approved.

111. The plaintiff seeks to have this action proceed and be tried together with the following related actions:

(a) Sears Canada Inc., by its Court-appointed Litigation Trustee, J. Douglas Cunningham, Q.C. v. ESL Investments Inc., et al. bearing Court File No. CV-18-006111214-00CL;

(b) Morneau Shepell Ltd. in its capacity as administrator of the Sears Canada Inc. Registered Pension Plan v. ESL Investments Inc. et al., bearing Court File No. CV-18-00611217-00CL; and,

(c) FTI Consulting Canada Inc., in its capacity as Court-appointed monitor in proceedings to the Companies Creditors Arrangement Act, RSC 1985, c. c-36 v. ESL Investments Inc. et al., bearing Court File No. CV-18-00611219-00CL.

October 21, 2015

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1291079 ONTARIO LIMITED
Plaintiff

-and-

SEARS CANADA INC., et al.
Defendants

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

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

PROCEEDING COMMENCED AT MILTON

FRESH AS AMENDED STATEMENT OF CLAIM

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APPENDIX "B"

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, SEARS HOLDINGS CORPORATION, WILLIAM HARKER and WILLIAM CROWLEY

Defendants

AMENDED STATEMENT OF DEFENCE OF THE DEFENDANTS WILLIAM HARKER and WILLIAM CROWLEY

1. The Defendants William Harker and William Crowley deny each and every allegation in the Amended Statement of Claim, except where hereinafter expressly admitted, and deny that the Plaintiff FTI Consulting Canada Inc. is entitled to any of the relief sought in the Amended Statement of Claim.

OVERVIEW

2. The Plaintiff seeks to recover the full amount of a dividend paid to all shareholders of Sears Canada Inc. ("Sears Canada" or the "Company") almost six years ago (the "2013 Dividend"). This dividend was unanimously approved by the Company's experienced board of directors (the "Board"), the majority of which was independent, following comprehensive and

careful consideration of the best interests of the Company. Sears Canada remained financially sound following the payment of the 2013 Dividend, and indeed for the duration of the tenure of the Defendants William Harker and William Crowley as directors.

3. In 2011, in a challenging retail and economic environment, Sears Canada began a three-year strategic plan to transform the Company into a strong mid-market retailer with a renewed focus on suburban and smaller/rural centres (the "Transformation Plan"). As part of that strategic evolution, management recommended and the Board approved the divestiture of certain non-core real estate assets. These divestitures were expected to result in improvements to long-term financial and operational performance. As a result of these divestitures, as well as the financial and operational improvements consequent to the implementation of the strategic plan, Sears Canada had significant cash on hand – expected to be more than $1 billion at the end of fiscal 2013.

4. Consistent with corporate governance best practices, the Board's decision regarding the use of the significant excess cash involved careful consideration of the financial and operational position of Sears Canada in light of its strategic plan and capital requirements, market conditions, and the fact that the Company had virtually no debt. Among other things, the Board assessed the needs of the business based on the Transformation Plan and management's priorities and operating plans, including strategies aimed at long-term growth. Management did not request any funding in excess of what would be available following payment of the 2013 Dividend to pursue the Transformation Plan or its other priorities, and more than sufficient cash remained on hand.

5. The 2013 Dividend was paid *pro rata* to Sears Canada's shareholders, all of whom were treated equally and all of whose interests were aligned. After the 2013 Dividend was paid, Sears Canada's largest shareholders continued to have the largest investments – and strongest interests – in the ongoing operational success of the Company. Sears Canada was not insolvent

or near insolvent when the 2013 Dividend was declared or paid, and it was not rendered insolvent by that payment. On the contrary, following payment of the 2013 Dividend, approximately $513.8 million in cash still remained on Sears Canada's balance sheet, with virtually no debt, and its operations and plans for implementing management's strategic objectives remained fully funded.

6. Indeed, between 2011 and 2015, Sears Canada had no significant debt, maintained a significant cash position ($398 million in 2011 and $315 million in 2015) and, with availability under its credit facility, had significant total liquidity ranging from $434 million to $887 million in this period. Sears Canada was financially sound when the Board approved the 2013 Dividend and remained so in 2015 when Harker and Crowley left the Board.

7. There was nothing improper whatsoever about the Board's approval of the 2013 Dividend. It was not undertaken to defraud, defeat, or delay any of Sears Canada's creditors and none were in fact defrauded, defeated, delayed, or otherwise harmed by the 2013 Dividend. In fact, for many years thereafter, Sears Canada continued to implement its Transformation Plan, run its operations, pay its creditors in the ordinary course, maintain significant cash on hand, and reduce its overall debt.

8. The claim that Harker and Crowley should now pay $509 million – the amount of the 2013 Dividend – to benefit the current creditors of Sears Canada is factually baseless and without legal merit. This action should be dismissed.

THE PARTIES

The Former Directors – Harker and Crowley

9. The Defendant William Harker was a director of Sears Canada from November 2008 to April 2015. Harker was at all material times a highly experienced corporate lawyer, corporate director, and senior manager with significant experience in the retail sector and in investment fund strategy and management.

10. Prior to, and concurrent with part of, his tenure on the Board, Harker held management roles with Sears Holdings Corporation ("Sears Holdings"), including as chief counsel from September 2005, then as general counsel from April 2006 to May 2010, and then as an officer until August 2012, and with ESL Investments Inc. as general counsel from February 2011 to August 2012. Harker also co-founded an investment fund in 2013. He previously practised as a corporate lawyer with the law firm of Wachtell Lipton Rosen & Katz LLP in New York City and has a law degree from the University of Pennsylvania.

11. The Defendant William Crowley (together with Harker, the "Former Directors") was a director of Sears Canada from March 2005 to April 2015, and chair of the Board from December 2006 to April 2015. Crowley was at all material times a highly experienced executive and corporate director with extensive experience in the management of retail organizations, investment fund strategy and management, and finance.

12. Prior to, and concurrent with part of, his tenure on the Board, Crowley held management roles with Sears Holdings, as executive vice-president, chief financial officer, and chief administrative officer at various times from March 2005 to January 2011, and with ESL Investments Inc., as president and chief operating officer from January 1999 to May 2012. Crowley previously worked as a financial analyst with Merrill Lynch and as a managing director of Goldman Sachs and co-founded an investment fund in 2013. Crowley has an undergraduate degree and a law degree from Yale University and a master's degree in philosophy, politics, and economics from the University of Oxford.

Sears Holdings Corporation

12A. To the best of the Former Directors' knowledge, the Defendant Sears Holdings is a corporation incorporated under the laws of Delaware. On October 15, 2018, Sears Holdings filed for protection from its creditors under Chapter 11 of the *United States Bankruptcy Code*.

The ESL Defendants

13. To the best of the Former Directors' knowledge, the Defendant ESL Investments Inc. is an investment fund incorporated under the laws of Delaware. The Defendants ESL Partners LP, SPE I Partners, LP, SPE Master I LP, and ESL Institutional Partners, LP were at all material times controlled directly or indirectly by ESL Investments Inc. (these limited partnerships, together with ESL Investments Inc., "ESL").

14. To the best of the Former Directors' knowledge, the Defendant Edward S. Lampert is an individual residing in Florida who at all material times was the principal of ESL. Lampert was also, at all material times, the chair and chief executive officer of ESL Investments Inc., the chair of Sears Holdings, and beginning in February 2013 the chief executive officer of Sears Holdings.

15. To the best of the Former Directors' knowledge, at all material times, Sears Holdings held a 51% interest in Sears Canada, ESL held a 17.4% interest in Sears Canada, and Lampert held a 10.2% interest in Sears Canada.

The Plaintiff

16. On June 22, 2017, Sears Canada obtained protection under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 (the "CCAA"). The Plaintiff FTI Consulting Canada Inc. is the court-appointed monitor of Sears Canada and its debtor affiliates in the CCAA proceedings.

17. Prior to the CCAA proceedings, Sears Canada was a multi-format retailer focused on merchandising and sale of goods and services through its network of approximately 111 full-line department stores and 295 speciality stores, including Sears Home stores and Sears Hometown dealer stores, as well as its direct (catalogue/internet) channel.

BACKGROUND

18. The global economic recession in 2008 and 2009 negatively impacted Canadian retailers, including Sears Canada. Its business, like many retailers, was affected by various factors such as low consumer confidence (the lowest in almost 30 years), high unemployment, rising consumer debt, a strong Canadian dollar, and rising expenses, among others.

19. These factors, combined with the increasingly competitive retail marketplace, were major contributors to changes in Sears Canada's operational performance in 2010, including a 4% same store sales decline and a 41% decline in EBITDA as compared to 2009.

20. Sears Canada maintained a strong financial position despite economic and retail market conditions and operational challenges. In particular, in 2010, it reduced its debt profile with the repayment of $300 million of medium term notes and arranged access to an $800 million credit facility which it could draw on, if necessary, to fund working capital needs, capital expenditures, acquisitions, and for other general corporate purposes. Additionally, in 2010, Sears Canada declared total dividends of $753.4 million, or $7 per share, and repurchased approximately 2.2 million shares for approximately $43 million pursuant to a normal course issuer bid.

21. Nevertheless, given the changes in the retail landscape, and since Sears Canada's traditional customer base – older Canadians living in suburban and smaller/rural centres – was eroding, the Company initiated a process to redefine itself. This process was undertaken in the context of volatility in the retail industry, at a time when Sears Canada faced fierce competition from entry into the Canadian market by American retailers, the liquidation of other Canadian retailers, the advancement of consumer technologies and the increased use by Canadian consumers of e-commerce, increased cross border shopping, and shifting spending patterns in the baby boomer generation – a key target market for Sears Canada.

THE TRANSFORMATION PLAN

22. Beginning in 2011, under the guidance of its new CEO Calvin McDonald, Sears Canada undertook a full diagnostic review of all aspects of its business. The purpose of this review, which included an assessment of, among other things, merchandising and marketing, operations and logistics, direct sales (website and catalogue), and the nature and extent of the Company's "retail footprint", was (i) to focus the business on the Company's strengths and (ii) to determine how best to respond to changing market conditions.

23. This review culminated in a three-year strategic plan designed to transform the Company over time by renewing and improving its operational performance and re-focusing its retail business on its traditional core strengths. This Transformation Plan acknowledged that Sears Canada had strong performance in suburban and smaller centre/rural markets, had "lost its focus" by pursuing urban markets, and was "stuck" without a relevant value proposition for these three distinct markets: rural, suburban, and urban.

24. The Transformation Plan, which was carefully considered and approved by the Board, was a "compass" for the business transformation, with annual financial and operational plans functioning as "roadmaps" for the implementation of that transformation. The Transformation Plan and annual financial and operational plans included initiatives to improve Sears Canada's operational performance, enhance its core retail business, and unlock value, including through operational changes and capital investment to refresh a number of Sears Canada's stores and thereby improve the performance of the refreshed stores.

25. The Transformation Plan acknowledged the need for Sears Canada to focus on getting the basics of retail right before it could realize any benefit from investing significantly in its retail locations and provided for a disciplined approach to capital investment.

26. In connection with the store refreshes, management recommended a phased approach, with an initial limited phase of refreshes, and a demonstrated return on investment prior to any further or Company-wide implementation of store refreshes. The Board authorized the phased approach to capital investment to ensure adequate return for the benefit of the Company.

27. Sears Canada made significant investments in its business as part of the implementation of the Transformation Plan and operating plans in 2012 and 2013. Among other things, it:

(a) invested a total of $165 million in capital expenditures;

(b) invested approximately $40 million completing the refresh or reset of 58 full-line stores, with emphasis on merchandise presentation and standards; and

(c) invested $125 million in various other capital projects, including $8 million in its website, which drove e-commerce growth that exceeded the decline in catalogue.

28. As part of the Transformation Plan, management initiated a thorough assessment of the Company's real estate assets to identify unproductive stores and excess space that, in the context of the strategic review, had higher "real estate value" than "trading value", measured by a multiple of "four-wall" EBITDA.[1] Management called their initiative "Project Matrix".

29. Project Matrix was not initiated, as alleged, because Sears Holdings, ESL and Lampert "had an immediate need for cash" in early 2013. Nor was it devised, as alleged, by Sears Holdings, ESL or Lampert as a "plan to extract cash" from Sears Canada. In fact, the Former Directors were not aware of any cash liquidity issues or cash constraints for Sears Holdings, ESL or Lampert while they were directors of Sears Canada.

[1] EBITDA refers to earnings before interest, tax, depreciation and amortization. It is a key measure of a company's operating performance and in particular indicates the cash operating profit of a business. It is used by management and investors to assess a company's operational performance by eliminating the effects of financing decisions, accounting decisions, or tax environments.

30. In fact, Project Matrix was initiated by Sears Canada's management in early 2012. It was led by a steering committee composed of senior management from the real estate, legal, and finance departments of Sears Canada, not by the Former Directors. The assessment undertaken in connection with Project Matrix confirmed that the Company was not optimally positioned with its "real estate footprint", that certain locations (particularly in large urban centres) were more valuable to the Company as real estate assets than as operating stores, and that the divestiture of those assets could "right size" and re-focus the business by reducing major urban locations.

31. In particular, given economic conditions and the increasingly competitive retail landscape in Canada, management recognized that the sale of store leases for stores that did not generate meaningful operational returns would allow the Company to focus on its core retail business. At the same time, aggressive entry into the Canadian market by American retailers presented a unique and time-limited opportunity to Sears Canada by increasing demand for space that did not fit within the Company's business model.

32. The initiative became a key aspect of the ongoing implementation of the Transformation Plan to refocus operations on Sears Canada's core customer base in suburban, mid-market, and smaller/rural locations, and generate long-term value. Management provided detailed reports to the Board on the results of Project Matrix, including an assessment of each store, with rankings according to their respective real estate values and trading values, measured by a detailed "four-wall" EBITDA assessment, and the proposal to divest unproductive real estate assets to transition the Company to a mid-market retailer without major urban locations.

33. Management identified the top ten stores for which the real estate value far exceeded the trading value. Management presented various scenarios and proposed that Sears Canada pursue the sale of six to eight of these full-line stores, located in urban markets, and right-size an additional seven or eight full-line stores by subletting excess space in the near term.

34. The Board approved annual financial and operational plans presented by management relating to implementation of the Transformation Plan, which were designed to address changes in retail market conditions and the impact of the various initiatives on the Company's business. In addition to quarterly meetings, the Board met with management every month to review financial and operational performance and each fall, the Board attended a two-day strategic session prior to the review and approval of the annual financial and operational plan.

REAL ESTATE DIVESTITURES

35. Project Matrix culminated in Sears Canada entering into four transactions in 2013 for the sale or redevelopment of certain store locations. Management led the negotiations for each transaction with assistance from external advisors and input from various Board members. The Board was specifically aware of the assistance provided by the Former Directors and Jeffrey Stollenwerck, an executive with Sears Holdings, who had relevant expertise and relationships with Sears Canada's and other retail landlords. Sears Holdings, ESL, and Lampert did not direct the negotiating strategy in connection with these transactions.

36. Management recommended each transaction to the Board following comprehensive review and consideration and provided detailed presentations to the Board with its recommendations, which included an assessment of the transaction, an evaluation of store performance versus real estate value, accounting implications of a sale, and the impact of the proposed sale on operational and financial performance, EBITDA, and the balance sheet. Each of the four transactions was carefully reviewed and unanimously approved by the Board as being in the best interests of Sears Canada.[2]

[2] In light of a potential conflict in respect of outside business activities not related to Sears Canada, the Former Directors recused themselves from the review and approval of the Concord transaction, described below.

The Oxford Transaction

37. Sears Canada entered into a transaction with Oxford Properties Group ("Oxford") for the sale of leases for Yorkdale and Square One for total consideration of $191 million and a $1 million payment by Oxford in exchange for an option to purchase the Scarborough Town Centre lease for $53 million.

38. The transaction was not initiated by the Company. Rather, it was initiated by a proposal from Oxford and negotiations were led by Sears Canada's management with input as necessary from external advisors and various Board members.

39. Management had ranked the three stores in the Oxford transaction in the top ten stores with real estate value exceeding trading value, and the divestiture of these assets was consistent with the Company's plan to right-size and re-focus its business. The consideration of $191 million represented a value of more than 21 times the four-wall trading EBITDA for Yorkdale and the Square One locations, 10.6 times the four-wall trading EBITDA for Scarborough Town Centre, and greatly exceeded management's estimate of real estate value by approximately $55 million.

The Concord Transaction

40. Sears Canada entered into a transaction with Concord Kingsway Project Limited Partnership ("Concord") for the sale of a 50% beneficial interest in its property in Burnaby, British Columbia – except for the new Sears Canada store site – and the creation of a co-ownership joint venture for the redevelopment of a mixed-use residential office and retail shopping centre. The total consideration proposed was approximately $140 million.

41. Management recommended partnering with Concord over two other candidates that had been considered on the basis that Concord proposed the most favourable structure, was one of Canada's largest mixed-use developers, and offered the highest net present value.

The Cadillac Fairview Transaction

42. Sears Canada entered into a transaction with Cadillac Fairview Corporation Limited ("Cadillac Fairview") for the sale of leases for five stores: the Toronto Eaton Centre, Sherway Gardens, Markville Shopping Centre, Masonville Place, and Richmond Centre. The total consideration proposed was $400 million.

43. The transaction was not initiated by the Company. Rather, it was initiated by a proposal from Cadillac Fairview and negotiations were led by Sears Canada's management with input as necessary from external advisors and various Board members.

44. Management had ranked the five stores in the Cadillac Fairview transaction in the top seventeen stores with real estate value exceeding trading value, with three being in the top ten. The divestiture of these assets was consistent with the Company's plan to right-size and re-focus its business. The consideration of $400 million represented a value of more than 26.1 times the four-wall trading EBITDA and greatly exceeded management's estimate of real estate value by approximately $158 million.

The Montez Transaction

45. Sears Canada entered into a transaction with Montez Income Properties ("Montez") for the sale of Sears Canada's 50% joint venture interest with Westcliff Group of Companies in eight shopping centres in Quebec for consideration of approximately $315 million.

46. Management advised the Board that this amount represented fair market value for these non-core real estate assets. The transaction allowed the Company to refocus is business by exiting the joint venture arrangement while continuing to operate full-line stores in the eight shopping centres, with the leases being revised to account for Sears Canada being a tenant and not a landlord.

47. When announcing the transaction with Montez, the Company explained that "unlocking the value of assets is a lever we use as a way to help create total value. The joint venture assets we are selling to Montez impact neither our store operations nor our ability to serve customers. As such, our primary focus in creating long-term value remains on the basics of the business and continuing to become more relevant with Canadians coast to coast."

The Board Rejected Transactions Inconsistent with the Transformation Plan

48. Transactions proposed by management that were inconsistent with the Transformation Plan were not authorized by the Board. In particular, in late 2013 management proposed a transaction with Ivanhoe Cambridge to sell five store leases and its 15% joint venture interest in a shopping centre in Quebec. As with all potential real estate divestitures presented by management, the Board conducted a thorough review and consideration of this transaction to determine whether it was consistent with Sears Canada's strategy and long-term interests.

49. After careful consideration, the Board decided that the proposed transaction was not consistent with the objectives of the Transformation Plan, including the right-sizing of the retail footprint since most of these locations were too valuable as operating stores to be divested. Accordingly, the Board declined to authorize management to pursue the proposed transaction.

All Transactions Were Driven by the Transformation Plan

50. These transactions did not represent a sale of the Company's "crown jewels", as alleged. In fact, the opposite is true. All of these transactions related to store locations where value as real estate assets far exceeded their trading value as operating stores. The sale of these assets was consistent with the Transformation Plan – the strategy approved by the Board to right-size the Company's full-line store network and refocus Sears Canada's retail operations on its core customer base in suburban and smaller/rural locations while growing that business.

51. The Former Directors deny that any of these transactions was entered into for an improper purpose and deny that the divestment of these real estate assets in 2013 had any negative short term or long-term impact on the Company, or in the alternative, could be foreseen to have a long-term negative impact.

52. In fact, these transactions were expected to generate positive results. In September 2013, management presented the 2014 financial and operating plan, with a focus on improving earnings through further cost savings, right-sizing, and targeted capital expenditures. The plan outlined various financial and operational improvements from the implementation of the Transformation Plan in the first half of 2013, including improvements in EBITDA of approximately $19 million (on a comparable basis) and in gross margin rate of approximately 66 basis points year over year.

53. The plan outlined a path, in light of retail market conditions, to achieve EBITDA ranging from 3.9% to 5% of total revenue with more moderate sales growth and projected cost savings initiatives totalling approximately $200 million in various areas of the business, including logistics and cost of goods sold over the next three years. It also incorporated the impact of the divestiture of full-line locations as part of the Company's continued right-sizing. Through the continued implementation of these initiatives, Sears Canada's EBITDA was projected to be $196 million by 2016 rather than the projected negative $105 million without such initiatives.

54. In late September 2013, McDonald resigned as CEO of Sears Canada to take a senior leadership position with a global retailer. He was replaced by Douglas Campbell, the Company's COO, who had particular expertise in retail turnaround and other turnaround projects, including in the manufacturing, consumer packaged goods, chemicals, and pharmaceuticals industries. Sears Canada continued to implement the Transformation Plan and the Project Matrix strategies developed under McDonald's leadership, with necessary adjustments as recommended by Campbell – particularly those focused on cost savings.

APPROVAL OF THE 2013 DIVIDEND

55. The four real estate transactions resulted in total cash consideration of $906 million, and management anticipated that Sears Canada would have cash on hand of approximately $1 billion at the end of fiscal year 2013. As a result, the Board determined in early November 2013 to consider the use of the proceeds, which would include consideration of the financial and operational position of the Company, as well as future needs of the business, as Sears Canada implemented its strategic plan, at the Board meeting scheduled for November 18 and 19, 2013.

56. The process undertaken by the Board leading up to the approval of the 2013 Dividend was robust and consistent with good corporate governance practices. The approval of the 2013 Dividend by the Board was an exercise of informed business judgment.

The Board Was Aware of the Requirements for Declaring Extraordinary Dividends

57. Approximately one year earlier, on December 12, 2012, in the midst of implementing the Transformation Plan, Sears Canada declared an extraordinary dividend of $102 million (the "2012 Dividend"). Prior to the declaration of the 2012 Dividend, Sears Canada had anticipated cash and cash equivalents of approximately $400 million. As of year-end 2012, after paying the 2012 Dividend, Sears Canada had approximately $240 million in cash and cash equivalents.

58. Prior to approving the 2012 Dividend, the Board received a presentation which included an analysis of the impact of a dividend on the Company's financial position, including its liquidity position, cash, EBITDA and total debt, the anticipated cash requirements for operations, and a sensitivity assessment. This presentation reviewed the Board's governance considerations, and summarized the statutory solvency and process requirements, under the *Canada Business Corporations Act*, R.S.C. 1985, c. C-44 (the "CBCA").

59. The Board also received confirmation from the chief financial officer, following consultation with the Company's auditor, Deloitte, that statutory solvency requirements were met,

and was provided with an officer's certificate certifying that, among other things, there were no reasonable grounds for believing that Sears Canada was, or would be after the payment of the 2012 Dividend, unable to pay its liabilities as they became due.

60. In light of the Board's ongoing dialogue and consideration of the Company's business and operations throughout 2012, including at numerous Board meetings and otherwise, much of the information contained within this presentation was already known to the Board when the presentation was provided.

61. The process undertaken by management and the Board leading up to the declaration of the 2012 Dividend was robust and consistent with corporate best practices. The decision to declare the 2012 Dividend was an exercise of informed business judgment by the Board acting in the best interests of Sears Canada.

The Board Was Fully Informed and Engaged

62. The Board was provided with the information necessary for the consideration of a dividend in 2013, and the decision by the Board to approve the 2013 Dividend was informed by the analyses, presentations, and discussions that occurred during the November 18, 2013 meetings and the informal and formal meetings of the Board and the audit committee of the Board (the "Audit Committee"), which took place leading up to those meetings, and in the course of extensive dialogue among members of the Board.

63. In particular, in advance of the declaration of the 2013 Dividend, the Audit Committee, composed entirely of independent directors, met on February 26, March 14, May 21, August 20, and November 18, 2013. Additionally, in advance of the declaration of the 2013 Dividend, the Board met on January 30, March 14, April 24, April 25, April 29, May 21, June 13, July 16, September 4, September 5, September 23, October 11, October 28, and November 18, 2013.

64. Aside from formal meetings, members of the Board were in frequent contact not only around the scheduled meetings but also on an as-needed basis, and at least once per month. The Board was also informed by the analyses and discussions that occurred at such meetings in advance of the Company declaring the 2013 Dividend and their experience and knowledge regarding practices and processes relating to a decision to declare a dividend.

65. In 2013, the Former Directors received, among other things:

(a) annual operating plans which included detailed cash flow analyses, operating cash requirements, and capital expenditures relating to the ongoing business and the implementation of the Transformation Plan;

(b) regular updates on the financial and operational position of the Company, the status of the implementation of the Transformation Plan – including capital needs required to drive long-term growth in a manner consistent with this strategy, cash flow analyses and cash requirements, debt, and the status of pension funding, including at quarterly Board meetings and on monthly financial update calls; and

(c) regular updates on the implementation of Project Matrix, the divestiture of real estate assets, including at quarterly board meetings, at special purpose board meetings, by e-mail, and at informal Board meetings.

66. In light of the significant amount of information provided to the Board by management, in the summer of 2013 the Board was aware of the cash needs and operational requirements of the Company. In particular, from ongoing monthly and, at times, weekly discussions with management, the Board was aware that all transformation and operating plan projects were adequately funded and that no additional capital could be usefully deployed to enhance these projects and drive long-term growth for the Company.

67. In September, October, and early November 2013, over multiple meetings of the Board, management provided analyses and other details relating to the business and operations of the Company, cash flows, and pending real estate transactions, all of which were discussed and considered by the Board. The financial performance updates in respect of the implementation of the Transformation Plan and annual operating plan provided by management to the Board in that period advised that the Company's EBITDA was improving as compared to the prior year as follows:

(a) regarding the September 2013 financial results, that EBITDA had improved by $2 million compared to September 2012;

(b) regarding the October 2013 financial results, that EBITDA had improved by $5.6 million compared to October 2012; and

(c) regarding the third quarter 2013 financial results, that EBITDA had improved $11.7 million compared to October 2012 on a year-to-date basis and by $19.6 million on a comparable year-to-date basis.

68. As part of the preparation for the Board meeting scheduled for November 18 and 19, 2013, management prepared *pro forma* balance sheet, income statement, and cash flow analyses for the remainder of 2013 and 2014, and analyzed the impact of potential dividend scenarios. Based on these analyses, management determined that the difference between Sears Canada's cash on hand and cash needs to implement its strategic plan resulted in significant excess cash and would allow for a dividend of between $7 and $8 per share, assuming no debt.

69. Crowley did not at that time, or ever, direct management to "move forward" with a dividend. To the contrary, Crowley confirmed that the determination regarding the use of the proceeds would be made by the Board once it had an opportunity to consider and discuss

alternatives for the use of the proceeds at the November Board meeting. Indeed, the Board had previously agreed to consider the appropriate use of excess cash at its meeting in November.

70. In advance of that Board meeting, the Board received and reviewed voluminous materials. In particular, the materials provided to the Board in advance of the Audit Committee meeting, which was attended by the entire Board, included:

(a) the draft third quarter results, MD&A and draft press release, as well as an analysis prepared by management relating to the Company's financial performance, factors relating to the retail sector, and accounting implications of divestiture of real estate assets;

(b) an analysis prepared by Deloitte relating to third quarter 2013 results; and

(c) an analysis regarding pending litigation.

71. In addition, the materials provided to the Board in advance of the Board meeting included:

(a) an analysis outlining management's immediate priorities, including:

(i) building a long term growth strategy by focusing on sustainable growth on a smaller asset base; and

(ii) generating cash from investing activities to create value and fund growth by selling assets deemed to be non-core;

(b) an analysis of asset valuation, which confirmed that there was a substantial core business remaining after the real estate divestitures;

(c) an analysis of operating efficiency, which included a plan to drive excess cost out of the business, allowing Sears Canada to meet 70% of its $200 million savings

target in 2014 and an update on a "90 Day Program", advising that top opportunities were being pursued that would yield $106 million in annual savings;

(d) an analysis of merchandising value, which included a category performance review, strategies to address gaps in operational performance and strategies to re-build Sears Canada's value proposition with the goal of clearly and consistently standing for something in the minds of Canadian consumers; and

(e) a financial analysis prepared by the CFO together with the Company's 2014 Financial Plan, which provided management's view of the Company's financial position and cash needs for 2014.

72. Sears Canada's investment committee also received presentations prepared by Towers Watson and management relating to the registered pension plan (the "Plan") in advance of the Board meeting, which were relayed to the Board at the meeting, and confirmed:

(a) that the year-to-date return for the Plan was 8.3% and for the third quarter was 2.54%, both of which were above the benchmark for the Plan, while during the third quarter Plan assets had increased on a net basis by $10.2 million; and

(b) that on a going concern basis, the Plan was forecasted to achieve a surplus of $77 million, and that the Plan's solvency was forecasted to improve by more than 50%.

Declaration of 2013 Dividend: Exercise of Business Judgment

73. On November 18 and 19, 2013, the Board met to review and consider a number of items, including the possible declaration of a dividend. This meeting was held in New York, consistent with the Board's practice to have periodic meetings in both Toronto and New York.

74. The Board did not decide to authorize the 2013 Dividend at a "short pre-dinner discussion on November 18, 2013", or without receiving any financial analyses or information from management, as alleged. In fact, in advance of the Board meeting, on November 18, 2013, the Audit Committee met to consider a number of matters. All of the members of the Audit Committee were independent directors. Consistent with past practice, all of the Board members attended the Audit Committee meeting. The Company's auditor, Deloitte, also participated in the meeting and an *in-camera* session with the committee members.

75. The presentation provided by management at this meeting indicated that the Company's balance sheet and liquidity position remained strong, with significant cash on hand and no draw downs on the credit facility. The presentation also indicated that Sears Canada had approximately $1.66 billion in current assets, and provided information on real estate transactions completed, including the Oxford, Concord, Montez, and Cadillac Fairview transactions.

76. Additionally, Deloitte delivered a report on November 18, 2013 which noted that it had discussed a number of matters with management, including pending litigation, changes to pension discount rates and the required reserve, and the recent real estate transactions completed by the Company.

77. The real estate divestiture transactions, cash position, capital requirements and funding for turnaround projects, long-term growth, and possibility of declaring a dividend, including the potential amount of the dividend, were discussed by management and the Board during the Audit Committee meeting, with the benefit of the information provided to the Board in advance of and at the Audit Committee meeting.

78. The Board then discussed the potential dividend during the Board meeting held on November 18, 2013, following the Audit Committee meeting. At the Board meeting, the Board, among other things:

(a) received and considered a detailed presentation on management's priorities and asset valuation, including strategies aimed at long-term growth for the Company – all of which were fully funded;

(b) received a sensitivity analysis with respect to the payment of a potential dividend, and discussed and considered the timing and quantum of a dividend in light of the Company's operational and cash position, and the cash that would remain following payment, including in the event that:

(i) the Montez transaction entered into by Sears Canada, which was expected to close in January 2014, did not close; or

(ii) projected revenues and earnings were not achieved;

(c) received and considered a detailed presentation from the CFO regarding the financial and operational position of the Company, future cash requirements, cash flow and liquidity, and the impact of the payment of a dividend of $5 per share on the Company's financial and liquidity position in 2013 and 2014;

(d) received and considered a presentation from the chair of the Board's investment committee regarding the Plan; and

(e) received confirmation from management, following consultation with Deloitte, that the statutory solvency requirements were met and received a certificate of solvency from the CFO prior to approving the 2013 Dividend.

79. All but two of the directors, Campbell and Ron Weissman, were members of the Board when Sears Canada had declared an extraordinary dividend less than one year earlier, after receiving legal advice about their duties in relation to declaring dividends. The Board, which was

composed of highly skilled and experienced corporate directors with expertise in retail, finance, accounting, and law, had significant and specific experience relating to these duties. In addition, the Board had the benefit of the participation of both the general counsel and the assistant general counsel at the Audit Committee and Board meetings.

80. The two directors who were not members of the Board when it approved the 2012 Dividend were, like the other directors, satisfied that the 2013 Dividend was in the best interest of Sears Canada on the basis of the information provided to them in advance of and at the Audit Committee and Board meetings, their discussions with other members of the Board, and the information presented to the Board by management on November 18, 2013.

81. The Former Directors did not have a material relationship with Sears Holdings, ESL, or Lampert which could reasonably have been expected to interfere with their independent judgment in supporting the 2013 Dividend. At all material times, and in particular on November 18, 2013, the Former Directors were not conflicted and exercised their independent judgment with a view to the best interests of Sears Canada in voting to approve the 2013 Dividend.[3] Their historic relationships with Sears Holdings, ESL, and Lampert did not motivate any decisions whatsoever in which they participated as directors of Sears Canada.

82. Additionally, and in any event, the interests of all shareholders with respect to the Company's declaration of the 2013 Dividend were aligned, all shareholders were treated the same, and Sears Holdings, ESL and Lampert had the strongest interest in (and investment in) the ongoing financial and operational success of Sears Canada.

83. The 2013 Dividend was not approved by the Board with undue haste, in an ill-considered manner, or "in concert" with Sears Holdings, Lampert or ESL. Nor was the timing or quantum of

[3] Although the Former Directors were not considered to be independent under National Instrument 52-110, which relates to independence for the purpose of audit committee membership only, the Former Directors were not members of the Audit Committee.

the 2013 Dividend driven or dictated by Sears Holdings, Lampert or ESL, or their need for funds. The circumstances surrounding the approval of the 2013 Dividend did not raise “red flags”.

84. Indeed, none of the decisions regarding Project Matrix, the divestiture of real estate assets, any other aspect of the Company’s financial and operational plans, or the 2013 Dividend were in any way directed by or related to the financial needs of Sears Holdings, ESL or Lampert. There was no “plan to extract cash from Sears Canada” through the sale of real estate assets devised by Sears Holdings, ESL or Lampert, or at all. Even if there were such a plan, which is denied, the Former Directors were not generally or specifically aware of it, and they were certainly not participants.

85. Rather, the process undertaken by management and the Board leading up to the declaration of the 2013 Dividend was robust and consistent with corporate best practices. Moreover, the decision was an exercise of informed business judgment by the Board acting in the best interests of Sears Canada.

86. On December 6, 2013, the 2013 Dividend was paid *pro rata* to Sears Canada’s shareholders. Sears Canada was not insolvent or near insolvent when the 2013 Dividend was declared or paid and was not rendered insolvent by that payment. On the contrary, following that payment, approximately $513.8 million in cash still remained on Sears Canada’s balance sheet, with virtually no debt, and its operations and plans for the future remained fully funded.

No Dividend in 2014: Exercise of Business Judgment

87. In March 2014, the Board considered the Company’s cash position following the completion of the Montez transaction and the possibility of a further dividend. In particular, the Board reviewed two further dividend scenarios presented by management, valued at $1.50 per share and $2.50 per share, respectively.

88. At that time, the Board received a detailed presentation from management regarding the financial and operating results for the fourth quarter of 2013, the drivers for such results, and various initiatives being undertaken by management to improve performance.

89. Consistent with its approach to the consideration of the 2012 Dividend and the 2013 Dividend, the Board undertook a comprehensive review and consideration of the financial position and the potential impact of various dividend scenarios.

90. Ultimately, the Board decided not to declare a dividend. This decision was not the result of concerns about Sears Canada's long-term viability. Rather, the Board decided not to declare a dividend in early 2014 in light of Sears Canada's unexpected poor performance in the fourth quarter of 2013 and its resulting cash position, which was lower than expected.

91. As with the decision to declare the 2013 Dividend, the decision not to declare a dividend in 2014 was an exercise of informed business judgment by the Board acting in the best interests of Sears Canada.

NO TRANSFER AT UNDERVALUE

92. The 2013 Dividend was not a transfer at undervalue within the meaning of section 96 of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 (the "BIA"). In any event, neither Sears Canada nor the Former Directors intended to defraud, defeat, or delay any of Sears Canada's creditors, and none were in fact defrauded, defeated, or delayed in connection with the approval or payment of the 2013 Dividend.

Section 96 Does Not Apply

93. Dividends are a return on the investment made by shareholders. Dividends are not by their nature "reviewable transactions" under section 96 of the BIA because the definition of "transfer at undervalue" contemplates a *transaction* where there is no consideration, or where the

consideration received by the debtor is “conspicuously” less than the fair market value of the consideration given by the debtor.

94. Dividends are not transactions of that kind because they are not, and not intended to be by design, an exchange for value at all. Since a corporation never receives consideration (*i.e.* “value”) from a shareholder for payment of a dividend, the payment of a dividend cannot take place at “undervalue”.

95. Additionally, the concept of “fair market value” required for the application of section 96 of the BIA cannot apply to the declaration and payment of a dividend. The decision as to the amount of a dividend is within the discretion of a corporation’s board of directors. There is no “market” for dividends and, therefore, they have no “market value”, whether fair or otherwise.

96. Instead, dividends are reviewable pursuant to section 101 of the BIA – titled “Inquiries into Dividends” – which provides that a trustee in bankruptcy (or a monitor in CCAA proceedings) may review and inquire into such dividends where the corporation was insolvent or rendered insolvent by the payment of a dividend within one year of the date of the initial bankruptcy event.

97. Section 101 is the only provision of the BIA that would permit the Plaintiff (as monitor of Sears Canada) to seek to review a dividend declared by the Board in light of Sears Canada seeking protection under the CCAA. However, Sears Canada was not insolvent or rendered insolvent by the payment of the 2013 Dividend and, in any event, such a claim is now statute-barred because the 2013 Dividend was declared more than three and a half years prior to the date of the initial bankruptcy event.

Requirements of Section 96 Not Met

98. Even if dividends could be considered “transfers at undervalue”, which is unprecedented and denied, the requirements of paragraph 96(1)(b) are not met.

99. Paragraph 96(1)(b) requires that the "party was not dealing at arm's length with the debtor". The 2013 Dividend was declared pursuant to the discretion of the Board acting in the best interests of Sears Canada, without negotiation or other dealings with shareholders, and each of Sears Canada's shareholders received the same per share dividend. Shareholders were not "dealing" with Sears Canada at all, let alone in a manner that was non-arm's length.

100. Moreover, even if the concept of "dealing at arm's length" has applicability to the declaration of a dividend, which is denied, then Sears Canada and the Board dealt at arm's length with the Company's shareholders, including Lampert, ESL, and Sears Holdings, in connection with the approval and payment of the 2013 Dividend.

101. Paragraph 96(1)(b) also requires that the debtor – Sears Canada – intend to defraud, defeat, or delay a creditor. In declaring the 2013 Dividend, Sears Canada did not intend to defraud, defeat, or delay its creditors, and did not in fact do so.

102. Although it was not the Former Directors who caused Sears Canada to declare the 2013 Dividend – but instead the Board acting unanimously – the Former Directors did not in any event intend to defraud, defeat, or delay Sears Canada's creditors in connection with the approval of the 2013 Dividend or otherwise. In fact, in approving the 2013 Dividend, it was the Former Directors' intention to act in the best interests of Sears Canada, and they did so.

103. Neither the Former Directors, nor the Board generally, had reason to believe in November 2013 that payment of the 2013 Dividend could negatively impact Sears Canada's creditors. The Company's creditors continued to be paid for many years thereafter.

104. Additionally, Sears Canada was not insolvent at the time at which the 2013 Dividend was declared or paid, nor was it rendered insolvent by the 2013 Dividend. Rather, the solvency of Sears Canada was specifically confirmed when the 2013 Dividend was declared and it had no

significant debt at that time. In fact, Sears Canada ended fiscal 2013 (the year ending February 1, 2014) in a strong financial position, with:

(a) approximately $514 million in cash and only $35.9 million in debt;

(b) over $1 billion in shareholder equity;

(c) net earnings of $446.5 million (an improvement of approximately $300 million compared to fiscal 2012);

(d) working capital of $567 million ($150 million more than in fiscal 2012), and the generation of $73.3 million in cash through better use of working capital;

(e) $76.8 million less in year-end inventory as compared to the end of fiscal 2012;

(f) $98 million lower operating expenses than in fiscal 2012 (after removing "transformation expenses" which relate primarily to severance); and

(g) $129.7 million lower retirement benefit plan obligations.

105. Indeed, according to Sears Canada's 2013 Annual Report:

> Our financial position as we ended 2013 was strong. We had $513.8 million of cash with no significant debt. In addition, we were undrawn on our credit facility at year-end. Based on our borrowing base and net of outstanding letters of credit of $24.0 million, we had availability under our senior secured revolving credit facility of approximately $374.0 [million] bringing our total liquidity to $887.8 million.

106. It was neither foreseeable nor a "foregone conclusion" on November 18, 2013, as alleged, that Sears Canada would become insolvent nearly four years later. When the Board authorized the 2013 Dividend on November 18, 2013, it was specifically looking to the future of the Company as a going concern by directing the ongoing implementation of the Transformation Plan.

107. At that time, Sears Canada intended to focus on increasing revenue in four priority categories (major appliances, women's apparel, children's wear, and footwear), and to continue to make progress toward its target of cutting $200 million in costs. The materials before the Board in November 2013 indicated that Sears Canada anticipated EBITDA of $135 million in 2014, an increase of $29 million from 2013.

SUBSEQUENT EVENTS

108. Following the approval and payment of the 2013 Dividend, Sears Canada continued to obtain and rely on financial, strategic, and other advice from third party professionals and continued to carry on business in the normal course for three and a half years – until at least June 21, 2017. During that time, management and other employees of Sears Canada operated stores, sold goods, undertook marketing efforts, implemented new initiatives, and made strategic, business, financial, operational, and other decisions.

109. However, after the Former Directors left Sears Canada, the Canadian retail market faced increasingly significant and unpredictable changes and stresses which posed new challenges for the continued successful operation of retailers, including Sears Canada. These events affected all segments of the retail market in Canada, including apparel, house wares, kitchen wares, office supplies, electronics, furnishings, toys, department stores, and jewellery. Numerous prominent retailers operating in Canada became insolvent, ceased operations, restructured, or reduced their footprint in the period immediately preceding Sears Canada's application for CCAA protection.

110. After payment of the 2013 Dividend, while the Former Directors remained on the Board, Sears Canada's Board and management worked to implement strategies in the best interests of Sears Canada and the Company's share price and financial position remained strong. In 2014, the Company's shares traded as high as $17.12 per share and not lower than $8.56 per share.

111. However, after the Former Directors ceased to hold positions on the Board, new management ushered in and oversaw significant shifts in the Company's strategic direction, including with a plan known as "Sears 2.0". In 2016, the Company's shares never traded higher than $7 per share (lower than the low in 2014) and the average trading price was only $3.68 per share. By early 2017, Sears Canada was in a difficult financial position.

112. As late as January 28, 2017, Sears Canada operated 95 full-line department stores, 830 catalogue and on-line merchandise pick-up locations, and 14 outlet stores. At that time, it had current assets of over $1 billion, of which $235.8 million was cash, with shareholder equity in the amount of $222.2 million. However, Sears Canada suffered a sudden, significant, and unexpected decline in early and mid-2017. In that period, cash on hand had fallen to $125.3 million and inventory on hand had increased to $648.1 million from $598.5 million. In addition, as of April 2017, the Company had incurred debt of $125 million under a term loan. By June 5, 2017 it had incurred additional debt of $33 million under a revolving credit facility.

113. Upon filing for CCAA protection, Sears Canada confirmed that the decline in financial performance was the result of market factors causing the decline of other retailers, as well as, among other things:

(a) unsustainable fixed costs from an overly broad retail footprint;

(b) the decline of the catalogue business and lower than expected conversion of catalogue customers to online customers; and

(c) the inability to secure an agreement for the management of credit and financial services operations.

THE ACTION SHOULD BE DISMISSED

114. Sears Canada continued to pay its creditors in the ordinary course, while reducing its overall debt, for many years after the 2013 Dividend was approved. It was not intended to defraud, defeat, or delay Sears Canada's creditors, and it did not do so.

115. The insolvency of Sears Canada, or any harm to its creditors as a result of the insolvency, which harm is denied, did not result from the decisions, actions, or omissions of the Former Directors in 2013. There is no basis in fact or in law for the Plaintiff's claim against the Former Directors, nor any basis for the relief sought against them.

116. The Former Directors claim the right, at law and in equity, to set off against the Plaintiff's claim the full amount of each of their unsecured claims against the estate of Sears Canada filed in the Company's CCAA proceeding.

117. The Former Directors plead and rely on the CBCA, the BIA, the CCAA, and the *Courts of Justice Act*, R.S.O. 1990, c. C.43, and request that this action be dismissed with costs on a substantial indemnity basis.

May 10, 2019

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

FTI CONSULTING CANADA INC. -and- Plaintiff	ESL INVESTMENTS INC. *et al.* Defendants

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

PROCEEDING COMMENCED AT TORONTO

AMENDED STATEMENT OF DEFENCE OF THE DEFENDANTS WILLIAM HARKER and WILLIAM CROWLEY

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Court File No. CV-18-00611214-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

B E T W E E N:

SEARS CANADA INC., by its Court-appointed Litigation Trustee,
J. DOUGLAS CUNNINGHAM, Q.C.

Plaintiff

- and -

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

Defendants

STATEMENT OF DEFENCE OF THE DEFENDANTS
EPHRAIM J. BIRD, DOUGLAS CAMPBELL, WILLIAM CROWLEY,
WILLIAM HARKER, JAMES MCBURNEY, and DONALD ROSS

1. The Defendants Ephraim J. Bird, Douglas Campbell, William Crowley, William Harker, James McBurney, and Donald Ross deny each and every allegation in the Amended Amended Statement of Claim, except where hereinafter expressly admitted, and deny that the Plaintiff Sears Canada Inc. is entitled to any of the relief sought in the Amended Amended Statement of Claim.

OVERVIEW

2. The Plaintiff seeks to recover the full amount of a dividend paid to all shareholders of Sears Canada Inc. (“Sears Canada” or the “Company”) almost six years ago (the “2013 Dividend”). This dividend was unanimously approved by the Company’s experienced board of

directors (the "Board"), the majority of which was independent, following comprehensive and careful consideration of the best interests of the Company. Sears Canada remained financially sound following the payment of the 2013 Dividend, and indeed for the duration of the tenure of the Defendants Douglas Campbell, William Crowley, William Harker, James McBurney, Donald Ross, and Ephraim J. Bird (the "Former Directors").

3. In 2011, in a challenging retail and economic environment, Sears Canada began a three-year strategic plan to transform the Company into a strong mid-market retailer with a renewed focus on suburban and smaller/rural centres (the "Transformation Plan"). As part of that strategic evolution, management recommended, and the Board approved, the divestiture of certain non-core real estate assets. These divestitures were expected to result in improvements to long-term financial and operational performance.

4. As a result of these divestitures, as well as the financial and operational improvements consequent to the implementation of the strategic plan, Sears Canada had significant cash on hand—expected to be more than $1 billion at the end of fiscal 2013.

5. Consistent with corporate governance best practices, the Board's decision regarding the use of the significant excess cash involved careful consideration of the financial and operational position of Sears Canada in light of its strategic plan and capital requirements, market conditions, and the fact that the Company had virtually no debt. Among other things, the Board assessed the needs of the business based on the Transformation Plan and management's priorities and operating plans, including strategies aimed at long-term growth. Management did not request any funding in excess of what would be available following payment of the 2013 Dividend to pursue the Transformation Plan or its other priorities, and more than sufficient cash remained on hand.

6. The 2013 Dividend was paid *pro rata* to Sears Canada's shareholders, all of whom were treated equally and all of whose interests were aligned. After the 2013 Dividend was paid, Sears

Canada's largest shareholders continued to have the largest investments—and strongest interests—in the ongoing operational success of the Company. Sears Canada was not insolvent or near insolvent when the 2013 Dividend was declared or paid, and it was not rendered insolvent by that payment. On the contrary, following payment of the 2013 Dividend, approximately $513.8 million in cash remained on Sears Canada's balance sheet, with virtually no debt, and its operations and plans for implementing management's strategic objectives remained fully funded.

7. Indeed, between 2011 and 2015, Sears Canada had no significant debt, maintained a significant cash position ($398 million in 2011 and $315 million in 2015) and, with availability under its credit facility, had significant total liquidity ranging from $434 million to $887 million in this period. Sears Canada was financially sound when the Board approved the 2013 Dividend and remained so during the Former Directors' respective terms on the Board.

8. The Former Directors complied with their duties and acted in the best interest of Sears Canada in approving the 2013 Dividend. The claim that the Former Directors should now pay $509 million—the amount of the 2013 Dividend—or any other amount to benefit the current creditors of Sears Canada, many of which were not even creditors when the 2013 Dividend was declared, is factually baseless and without legal merit. This action should be dismissed.

THE PARTIES

The Former Directors

9. The Defendant, Ephraim J. Bird, was a director of Sears Canada from May 2006 until November 18, 2013 and was the lead director of Sears Canada from May 2007 to March 2013. Bird resigned from the Board prior to the approval of the 2013 Dividend (for reasons related to overall Board composition). Bird was also the executive vice-president and chief financial officer of Sears Canada from March 2013 to June 2016. Bird was at all material times a highly

experienced director and officer with significant expertise in the management of retail organizations, investment fund strategy and management, and finance.

10. From 1991 to 2002, Bird was the chief financial officer of ESL Investments Inc. Bird is currently senior vice president and chief financial officer of Sears Hometown and Outlet Stores, Inc. Bird has a Master of Business Administration degree from the Stanford University Graduate School of Business, and he is licensed as a certified public accountant.

11. The Defendant, Douglas Campbell, was a director of Sears Canada from September 2013 to October 2014. In 2011, Campbell joined Sears Canada as an executive vice-president. In 2012, Campbell was promoted to the position of chief operating officer. In September 2013, Campbell succeeded Calvin McDonald as president and chief executive officer of Sears Canada, a position that he held until he resigned in the fall of 2014 for family reasons. Campbell was at all material times a highly experienced director and officer with significant expertise in the management of retail organizations and turnaround strategy.

12. Prior to joining Sears Canada, Campbell was a principal at Boston Consulting Group, where he focused on turnaround matters. Campbell is currently a partner with Harvest Partners, LP, a private equity firm focused on leveraged buyout and growth capital investments in mid-market companies. He has a Master of Business Administration degree in finance from The Wharton School at the University of Pennsylvania. Campbell has never held any position with the Defendant Sears Holdings Corporation (“Sears Holdings”) or ESL Investments Inc.

13. The Defendant, William Crowley, was a director of Sears Canada from March 2005 to April 2015, and chair of the Board from December 2006 to April 2015. Crowley was at all material times a highly experienced executive and corporate director with extensive experience in the management of retail organizations, investment fund strategy and management, and finance.

14. Prior to, and concurrent with part of, his tenure on the Board, Crowley held management roles with Sears Holdings, as executive vice-president, chief financial officer, and chief administrative officer at various times from March 2005 to January 2011, and with ESL Investments Inc., as president and chief operating officer from January 1999 to May 2012. Crowley previously worked as a financial analyst with Merrill Lynch and as a managing director of Goldman Sachs and co-founded an investment fund in 2013. Crowley has an undergraduate degree and a law degree from Yale University and a master's degree in philosophy, politics, and economics from the University of Oxford.

15. The Defendant, William Harker, was a director of Sears Canada from November 2008 to April 2015. Harker was at all material times a highly experienced corporate lawyer, corporate director, and senior manager with significant experience in the retail sector and in investment fund strategy and management.

16. Prior to, and concurrent with part of, his tenure on the Board, Harker held management roles with Sears Holdings, including as chief counsel from September 2005, then as general counsel from April 2006 to May 2010, and then as an officer until August 2012, and with ESL Investments Inc. as general counsel from February 2011 to August 2012. Harker also co-founded an investment fund in 2013. He previously practised as a corporate lawyer with the law firm of Wachtell Lipton Rosen & Katz LLP in New York City and has a law degree from the University of Pennsylvania.

17. The Defendant, James McBurney, was a director of Sears Canada from April 2010 to April 2015. McBurney was at all material times a highly experienced executive and corporate director with extensive experience in mergers and acquisitions and corporate strategy.

18. Prior to joining the Board, McBurney was the chief executive officer of HCF International Advisers in London, where he focused on strategic advisory and mergers and acquisitions

matters. Prior to that position, he was employed by Goldman Sachs in New York, where he focused on mergers and acquisitions. McBurney is currently an executive in the technology industry. McBurney has a Master of Business Administration degree from the Harvard Business School. McBurney has never held any position with Sears Holdings or ESL Investments Inc.

19. The Defendant, Donald Ross, was a director of Sears Canada from May 2012 to April 2014. Ross was at all material times a highly experienced lawyer with extensive experience in corporate law and corporate governance. From 1988 to August 2013, Ross was a partner at Osler, Hoskin & Harcourt LLP, where he focused on domestic and cross-border mergers and acquisitions and corporate finance and advised senior management and boards of directors on corporate governance matters. Since September 2013, he has held a senior counsel position with the New York office of Covington & Burling LLP.

20. Ross has been recognized for his work by numerous legal publications and organizations including Chambers Global, the Best Lawyers in Canada, the Lexpert/American Lawyer Guide to the Leading 500 Lawyers in Canada, and the IFLR 1000. He has an undergraduate degree from the University of Toronto, a law degree from Osgoode Hall Law School, and a master's degree from the London School of Economics. He is a member of Ontario and New York bars. Ross has never held any position at Sears Holdings or ESL Investments Inc.

Rosati and Khanna

21. To the best of the Former Directors' knowledge, the Defendant, Deborah E. Rosati, was a director of Sears Canada from April 2007 to August 2018 and the Defendant, R. Raja Khanna, was a director of Sears Canada from October 2007 to August 2018.

Sears Holdings Corporation

22. To the best of the Former Directors' knowledge, the Defendant, Sears Holdings, is a corporation incorporated under the laws of Delaware. On October 15, 2018, Sears Holdings filed for protection from its creditors pursuant to Chapter 11 of the *United States Bankruptcy Code*.

The ESL Defendants

23. To the best of the Former Directors' knowledge, the Defendant, ESL Investments Inc., is an investment fund incorporated under the laws of Delaware. The Defendants, ESL Partners LP, SPE I Partners, LP, SPE Master I LP, and ESL Institutional Partners, LP, were at all material times controlled directly or indirectly by ESL Investments Inc. (these limited partnerships, together with ESL Investments Inc., "ESL").

24. To the best of the Former Directors' knowledge, the Defendant, Edward Lampert, is an individual residing in Florida who at all material times was the principal of ESL. Lampert was also, at all material times, the chair and chief executive officer of ESL Investments Inc., the chair of Sears Holdings, and, beginning in February 2013, the chief executive officer of Sears Holdings.

25. To the best of the Former Directors' knowledge, at all material times, Sears Holdings held a 51% interest in Sears Canada, ESL held a 17.4% interest in Sears Canada, and Lampert held a 10.2% interest in Sears Canada.

The Plaintiff

26. Sears Canada is a corporation incorporated under the laws of Canada, with its headquarters in Toronto, Ontario. On June 22, 2017, Sears Canada obtained protection under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 (the "CCAA").

27. Prior to the CCAA proceedings, Sears Canada was a multi-format retailer focused on merchandising and sale of goods and services through its network of approximately 111 full-line

department stores and 295 speciality stores, including Sears Home stores and Sears Hometown dealer stores, as well as its direct (catalogue/internet) channel.

BACKGROUND

28. The global economic recession in 2008 and 2009 negatively impacted Canadian retailers, including Sears Canada. Its business, like many retailers, was affected by various factors such as low consumer confidence (the lowest in almost 30 years), high unemployment, rising consumer debt, a strong Canadian dollar, and rising expenses, among others.

29. These factors, combined with the increasingly competitive retail marketplace, were major contributors to changes in Sears Canada's operational performance in 2010, including a 4% same store sales decline and a 41% decline in EBITDA as compared to 2009.

30. Sears Canada maintained a strong financial position despite economic and retail market conditions and operational challenges. In particular, in 2010, it reduced its debt exposure through the repayment of $300 million of medium-term notes and arranged access to an $800 million credit facility on which it could draw, if necessary, to fund working capital needs, capital expenditures, acquisitions, and for other general corporate purposes. Additionally, in 2010, Sears Canada declared total dividends of $753.4 million, or $7 per share, and repurchased approximately 2.2 million shares for approximately $43 million pursuant to a normal course issuer bid.

31. Nevertheless, given the changes in the retail landscape, and since Sears Canada's traditional customer base—older Canadians living in suburban and smaller/rural centres—was eroding, the Company initiated a process to redefine itself. This process was undertaken in the context of volatility in the retail industry, at a time when Sears Canada faced fierce competition from entry into the Canadian market by American retailers, the liquidation of other Canadian retailers, the advancement of consumer technologies, increased e-commerce and cross-border

shopping, and shifting spending patterns in the baby boomer generation, a key target market for Sears Canada.

THE TRANSFORMATION PLAN

32. Beginning in 2011, under the guidance of its new chief executive officer, Calvin McDonald, Sears Canada undertook a full diagnostic review of all aspects of its business. The purpose of this review, which included an assessment of, among other things, merchandising and marketing, operations and logistics, direct sales (website and catalogue), and the nature and extent of the Company's "retail footprint", was (i) to focus the business on the Company's strengths and (ii) to determine how best to respond to changing market conditions.

33. This review culminated in a three-year strategic plan designed to transform the Company over time by renewing and improving its operational performance and re-focusing its retail business on its traditional core strengths. This Transformation Plan acknowledged that Sears Canada had strong performance in suburban and smaller centre/rural markets, had "lost its focus" by pursuing urban markets, and was "stuck" without a relevant value proposition for these three distinct markets: rural, suburban, and urban.

34. The Transformation Plan, which was carefully considered and approved by the Board, was a "compass" for the business transformation, with annual financial and operational plans functioning as "roadmaps" for the implementation of that transformation. The Transformation Plan and annual financial and operational plans included initiatives to improve Sears Canada's operational performance, enhance its core retail business, and unlock value, including through operational changes and capital investment to refresh a number of Sears Canada's stores and thereby improve the performance of the refreshed stores. Sears Holdings, Lampert, and ESL did not take a direct role in developing Sears Canada's business strategy.

35. The Transformation Plan acknowledged the need for Sears Canada to focus on getting the basics of retail right before it could realize any benefit from investing significantly in its retail locations and provided for a disciplined approach to capital investment.

36. In connection with the store refreshes, management recommended a phased approach, with an initial limited phase of refreshes, and a demonstrated return on investment prior to any further or Company-wide implementation of store refreshes. The Board authorized the phased approach to capital investment to ensure adequate return for the benefit of the Company.

37. Sears Canada made significant investments in its business as part of the implementation of the Transformation Plan and operating plans in 2012 and 2013. Among other things, it invested

(a) a total of $165 million in capital expenditures;

(b) approximately $40 million completing the refresh or reset of 58 full-line stores, with emphasis on merchandise presentation and standards; and

(c) $125 million in various other capital projects, including $8 million in its website, which drove e-commerce growth that exceeded the decline in catalogue.

38. As part of the Transformation Plan, management initiated a thorough assessment of the Company's real estate assets to identify unproductive stores and excess space that, in the context of the strategic review, had higher "real estate value" than "trading value", measured by a multiple of "four-wall" EBITDA.[1] Management called the initiative "Project Matrix".

39. Project Matrix was not initiated, as alleged, because Sears Holdings, ESL and Lampert "had an immediate need for cash" in early 2013. Nor was it devised, as alleged, by Sears

[1] EBITDA refers to earnings before interest, tax, depreciation and amortization. It is a key measure of a company's operating performance and, in particular, indicates the cash operating profit of a business. It is used by management and investors to assess a company's operational performance by eliminating the effects of financing decisions, accounting decisions, or tax environments.

Holdings, ESL or Lampert as a “plan to extract cash” from Sears Canada. The Former Directors were not aware of any cash liquidity issues or cash constraints for Sears Holdings, ESL or Lampert while they were directors of Sears Canada.

40. Project Matrix was initiated by Sears Canada’s management in early 2012. It was led by a steering committee composed of senior management from the real estate, legal, and finance departments of Sears Canada, not by the Board. The assessment undertaken in connection with Project Matrix confirmed that the Company was not optimally positioned with its “real estate footprint”, that certain locations (particularly in large urban centres) were more valuable to the Company as real estate assets than as operating stores, and that the divestiture of those assets could “right-size” and re-focus the business by reducing major urban locations.

41. In particular, given economic conditions and the increasingly competitive retail landscape in Canada, management recognized that the sale of store leases for stores that did not generate meaningful operational returns would allow the Company to focus on its core retail business. At the same time, aggressive entry into the Canadian market by American retailers presented a unique and time-limited opportunity for Sears Canada by increasing demand for space that did not fit within the Company’s business model.

42. The initiative became a key aspect of the ongoing implementation of the Transformation Plan to refocus operations on Sears Canada’s core customer base in suburban, mid-market, and smaller/rural locations, and generate long-term value. Management provided detailed reports to the Board on the results of Project Matrix (including an assessment of each store, with rankings according to their respective real estate values and trading values, measured by a detailed “four-wall” EBITDA assessment) and the proposal to divest unproductive real estate assets to transition the Company to a mid-market retailer without major urban locations.

43. Management identified the top ten stores for which the real estate value far exceeded the trading value. Management presented various scenarios and proposed that Sears Canada pursue the sale of six to eight of these full-line stores, located in urban markets, and right-size an additional seven or eight full-line stores by subletting excess space in the near term.

44. The Board approved annual financial and operational plans presented by management relating to implementation of the Transformation Plan, which were designed to address changes in retail market conditions and the impact of the various initiatives on the Company's business. In addition to quarterly meetings, the Board met with management every month to review financial and operational performance and each fall, the Board attended a two-day strategic session prior to the review and approval of the annual financial and operational plan.

REAL ESTATE DIVESTITURES

45. Project Matrix culminated in Sears Canada entering into four transactions in 2013 for the sale or redevelopment of certain store locations. Management led the negotiations for each transaction with assistance from external advisors and input from various Board members. The Board was specifically aware of the assistance provided by the Former Directors and Jeffrey Stollenwerck, an executive with Sears Holdings, who had relevant expertise and relationships with Sears Canada's and other retail landlords. Lampert did not direct the negotiating strategy in connection with these transactions.

46. Management recommended each transaction to the Board following comprehensive review and consideration and provided detailed presentations to the Board with its recommendations, which included an assessment of the transaction, an evaluation of store performance versus real estate value, accounting implications of a sale, and the impact of the proposed sale on operational and financial performance, EBITDA, and the balance sheet. Each of

the four transactions was carefully reviewed and unanimously approved by the Board as being in the best interests of Sears Canada.[2]

The Oxford Transaction

47. Sears Canada entered into a transaction with Oxford Properties Group ("Oxford") for the sale of leases for Yorkdale and Square One for total consideration of $191 million and a $1 million payment by Oxford in exchange for an option to purchase the Scarborough Town Centre lease for $53 million.

48. The transaction was not initiated by the Company. Rather, it was initiated by a proposal from Oxford and negotiations were led by Sears Canada's management with input as necessary from external advisors and various Board members.

49. Management had ranked the three stores in the Oxford transaction in the top ten stores with real estate value exceeding trading value, and the divestiture of these assets was consistent with the Company's plan to right-size and re-focus its business. The consideration of $191 million represented more than 21 times the four-wall trading EBITDA for Yorkdale and the Square One locations, 10.6 times the four-wall trading EBITDA for Scarborough Town Centre, and exceeded management's estimate of real estate value by approximately $55 million.

The Concord Transaction

50. Sears Canada entered into a transaction with Concord Kingsway Project Limited Partnership ("Concord") for the sale of a 50% beneficial interest in its property in Burnaby, British Columbia—except for the new Sears Canada store site—and the creation of a co-ownership joint venture for the redevelopment of a mixed-use residential office and retail shopping centre. The total consideration proposed was approximately $140 million.

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[2] In light of a potential conflict related to outside business activities not related to Sears Canada, Harker and Crowley recused themselves from the review and approval of the Concord transaction, described below.

51. Management recommended partnering with Concord, in preference to two other candidates that had been considered, on the basis that Concord proposed the most favourable structure, was one of Canada's largest mixed-use developers, and offered the highest net present value.

The Cadillac Fairview Transaction

52. Sears Canada entered into a transaction with Cadillac Fairview Corporation Limited ("Cadillac Fairview") for the sale of leases for five stores: the Toronto Eaton Centre, Sherway Gardens, Markville Shopping Centre, Masonville Place, and Richmond Centre. The total consideration proposed was $400 million.

53. The transaction was not initiated by the Company. Rather, it was initiated by a proposal from Cadillac Fairview and negotiations were led by Sears Canada's management with input as necessary from external advisors and various Board members.

54. Management had determined that the five stores that were the subject of the Cadillac Fairview transaction were among the seventeen stores whose real estate value most significantly exceeded trading value, and three of the stores were in the top ten. The divestiture of these assets was consistent with the Company's plan to right-size and re-focus its business. The consideration of $400 million represented more than 26.1 times the four-wall trading EBITDA and exceeded management's estimate of real estate value by approximately $158 million.

The Montez Transaction

55. Sears Canada entered into a transaction with Montez Income Properties ("Montez") for the sale of Sears Canada's 50% joint venture interest with Westcliff Group of Companies in eight shopping centres in Quebec for consideration of approximately $315 million.

56. Management advised the Board that this amount represented fair market value for these non-core real estate assets. The transaction allowed the Company to refocus is business by exiting the joint venture arrangement while continuing to operate full-line stores in the eight shopping centres, with the leases being amended to show Sears Canada as a tenant and not a landlord.

57. When announcing the transaction with Montez, the Company explained that "unlocking the value of assets is a lever we use as a way to help create total value. The joint venture assets we are selling to Montez impact neither our store operations nor our ability to serve customers. As such, our primary focus in creating long-term value remains on the basics of the business and continuing to become more relevant with Canadians coast to coast."

The Board Rejected Transactions Inconsistent with the Transformation Plan

58. The Board did not approve transactions proposed by management that were inconsistent with the Transformation Plan. In particular, in late 2013 management proposed a transaction with Ivanhoe Cambridge to sell five store leases and its 15% joint venture interest in a shopping centre in Quebec. As with all potential real estate divestitures presented by management, the Board conducted a thorough review and consideration of this transaction to determine whether it was consistent with Sears Canada's strategy and long-term interests.

59. After careful consideration, the Board decided that the proposed transaction was not consistent with the objectives of the Transformation Plan, including the right-sizing of the retail footprint since most of these locations were too valuable as operating stores to be divested. Accordingly, the Board did not authorize management to pursue the proposed transaction.

All Transactions Were Driven by the Transformation Plan

60. These transactions did not represent a sale of the Company's "crown jewels", as alleged. In fact, the opposite is true. All of these transactions related to store locations whose value as real

estate assets far exceeded their trading value as operating stores. The sale of these assets was consistent with the Transformation Plan—the strategy approved by the Board to right-size the Company's full-line store network and refocus Sears Canada's retail operations on its core customer base in suburban and smaller/rural locations while growing that business.

61. The Former Directors deny that any of these transactions was entered into for an improper purpose and deny that the divestment of these real estate assets in 2013 had any negative short-term or long-term impact on the Company, or in the alternative, could be foreseen to have a long-term negative impact.

62. In fact, these transactions were expected to generate positive results. In September 2013, management presented the 2014 financial and operating plan, with a focus on improving earnings through further cost savings, right-sizing, and targeted capital expenditures. The plan outlined various financial and operational improvements from the implementation of the Transformation Plan in the first half of 2013, including improvements in EBITDA of approximately $19 million (on a comparable basis) and in gross margin rate of approximately 66 basis points year over year.

63. The plan outlined a path, in light of retail market conditions, to achieve EBITDA ranging from 3.9% to 5% of total revenue with more moderate sales growth and projected cost savings initiatives totalling approximately $200 million in various areas of the business, including logistics and cost of goods sold over the next three years. It also incorporated the impact of the divestiture of full-line locations as part of the Company's continued right-sizing. Through the continued implementation of these initiatives, Sears Canada's EBITDA was projected to be $196 million by 2016 rather than the projected negative $105 million without such initiatives.

64. In late September 2013, McDonald resigned as chief executive officer of Sears Canada to take a senior leadership position with a global retailer. He was replaced by Douglas Campbell, the Company's chief operating officer, who had particular expertise in retail turnaround and other

turnaround projects, including in the manufacturing, consumer packaged goods, chemicals, and pharmaceuticals industries. Sears Canada continued to implement the Transformation Plan and the Project Matrix strategies developed under McDonald's leadership, with necessary adjustments as recommended by Campbell—particularly those focused on cost savings.

APPROVAL OF THE 2013 DIVIDEND

65. The four real estate transactions resulted in total cash consideration of $906 million, and management anticipated that Sears Canada would have cash on hand of approximately $1 billion at the end of fiscal year 2013.

66. In early November 2013, the Board decided that, at its November 18 and 19, 2013 meeting, it would evaluate possible uses of the proceeds while taking into account the financial and operational position of the Company and the future needs of the business, as Sears Canada implemented its strategic plan. Bird, Crowley, Harker and the other Former Directors never treated approval of the 2013 Dividend as a "foregone conclusion".

67. The Board's process leading up to the approval of the 2013 Dividend was robust and consistent with good corporate governance practices. The approval of the 2013 Dividend by the Board was an exercise of informed business judgment.

The Board Was Aware of the Requirements for Declaring Extraordinary Dividends

68. Approximately one year earlier, on December 12, 2012, in the midst of implementing the Transformation Plan, Sears Canada declared an extraordinary dividend of $102 million (the "2012 Dividend"). Prior to the declaration of the 2012 Dividend, Sears Canada expected to have on hand cash and cash equivalents of approximately $400 million. At the end of 2012, after paying the 2012 Dividend, Sears Canada had approximately $240 million in cash and cash equivalents.

69. Prior to approving the 2012 Dividend, the Board received a presentation which included both (i) an analysis of the impact of a dividend on the Company's financial position, including its liquidity position, cash, EBITDA, total debt, and the anticipated cash requirements for operations and (ii) a sensitivity analysis. This presentation reviewed the Board's governance considerations, and summarized the statutory solvency and process requirements, under the *Canada Business Corporations Act*, R.S.C. 1985, c. C-44 (the "CBCA").

70. The Board also received confirmation from the chief financial officer, following consultation with the Company's auditor, Deloitte, that statutory solvency requirements were met, and was provided with an officer's certificate certifying that, among other things, there were no reasonable grounds for believing that Sears Canada was, or would be after the payment of the 2012 Dividend, unable to pay its liabilities as they became due.

71. In light of the Board's ongoing dialogue and consideration of the Company's business and operations throughout 2012, including at numerous Board meetings and otherwise, much of the information contained within this presentation was already known to the Board when the presentation was provided.

72. The process undertaken by management and the Board leading up to the declaration of the 2012 Dividend was robust and consistent with corporate best practices. The decision to declare the 2012 Dividend was an exercise of informed business judgment by the Board acting in the best interests of Sears Canada.

The Board Was Fully Informed and Engaged

73. The Board was provided with the information necessary for the consideration of a dividend in 2013, and the decision by the Board to approve the 2013 Dividend was informed by the analyses, presentations, and discussions that occurred during the November 18, 2013 meetings and the informal and formal meetings of the Board and the audit committee of the Board (the

"Audit Committee"), which took place leading up to those meetings, and in the course of extensive dialogue among members of the Board.

74. In particular, in advance of the declaration of the 2013 Dividend, the Audit Committee, composed entirely of independent directors, met on February 26, March 14, May 21, August 20, and November 18, 2013. Additionally, in advance of the declaration of the 2013 Dividend, the Board met on January 30, March 14, April 24, April 25, April 29, May 21, June 13, July 16, September 4, September 5, September 23, October 11, October 28, and November 18, 2013.

75. Aside from formal meetings, members of the Board were in frequent contact not only around the time of scheduled meetings but also on an as-needed basis, and at least once per month. The Board was also informed by the analyses and discussions that occurred at such meetings in advance of the Company declaring the 2013 Dividend and their experience and knowledge regarding practices and processes relating to a decision to declare a dividend.

76. In 2013, the Board received, among other things, the following:

(a) annual operating plans which included detailed cash flow analyses, operating cash requirements, and capital expenditures relating to the ongoing business and the implementation of the Transformation Plan;

(b) regular updates on the financial and operational position of the Company, the status of the implementation of the Transformation Plan—including capital needs required to drive long-term growth in a manner consistent with this strategy, cash flow analyses and cash requirements, debt, and the status of pension funding, including at quarterly Board meetings and on monthly financial update calls; and

(c) regular updates at quarterly, special-purpose, and informal Board meetings and by e-mail about the implementation of Project Matrix and the divestiture of real estate assets.

77. In light of the significant amount of information provided to the Board by management, in the summer of 2013 the Board was aware of the cash needs and operational requirements of the Company. In particular, from ongoing monthly and sometime weekly discussions with management, the Board was aware that all transformation and operating plan projects were adequately funded and that no additional capital could be usefully deployed to enhance these projects and drive long-term growth for the Company.

78. In September, October, and early November 2013, during multiple meetings of the Board, management provided analyses and other details relating to the business and operations of the Company, cash flows, and pending real estate transactions, all of which were discussed and considered by the Board. The financial performance updates that management provided to the Board about the implementation of the Transformation Plan and annual operating plan demonstrated that the Company's EBITDA was improving as compared to the prior year:

(a) regarding the September 2013 financial results, that EBITDA had improved by $2 million compared to September 2012;

(b) regarding the October 2013 financial results, that EBITDA had improved by $5.6 million compared to October 2012; and

(c) regarding the third quarter 2013 financial results, that EBITDA had improved $11.7 million compared to October 2012 on a year-to-date basis and by $19.6 million on a comparable year-to-date basis.

79. As part of the preparation for the Board meeting scheduled for November 18 and 19, 2013, management prepared *pro forma* balance sheet, income statement, and cash flow analyses for the remainder of 2013 and 2014, and analyzed the impact of potential dividend scenarios. Based on these analyses, management determined that Sears Canada's cash-on-hand substantially exceeded the cash needed to implement its strategic plan, and thus there was sufficient excess cash to permit a dividend of between $7 and $8 per share, assuming no debt.

80. In advance of that Board meeting, the Board received and reviewed voluminous materials. In particular, the materials provided to the Board in advance of the Audit Committee meeting, which the entire Board attended, included the following:

(a) the draft third quarter results, management discussion and analysis, and draft press release, as well as an analysis prepared by management relating to the Company's financial performance, factors relating to the retail sector, and accounting implications of divestiture of real estate assets;

(b) an analysis prepared by Deloitte relating to third quarter 2013 results; and

(c) an analysis of pending litigation.

81. In addition, the materials provided to the Board in advance of the Board meeting included the following:

(a) an analysis outlining management's immediate priorities, including

(i) building a long-term growth strategy by focusing on sustainable growth on a smaller asset base; and

(ii) generating cash from investing activities to create value and fund growth by selling assets deemed to be non-core;

(b) an analysis of asset valuation, which confirmed that there was a substantial core business remaining after the real estate divestitures;

(c) an analysis of operating efficiency, which included a plan to drive excess cost out of the business so that Sears Canada could achieve 70% of its $200 million savings target in 2014 and an update on a "90 Day Program" stating that top opportunities were being pursued that would yield $106 million in annual savings;

(d) an analysis of merchandising value, which included a category performance review, strategies to address gaps in operational performance, and strategies to re-build Sears Canada's value proposition with the goal of clearly and consistently standing for something in the minds of Canadian consumers; and

(e) a financial analysis prepared by the chief financial officer together with the Company's 2014 Financial Plan, which provided management's view of the Company's financial position and cash needs for 2014.

82. Sears Canada's investment committee also received presentations prepared by Towers Watson and management relating to the registered pension plan (the "Plan") in advance of the Board meeting, which were relayed to the Board at the meeting, and confirmed that

(a) the year-to-date return for the Plan was 8.3% and for the third quarter was 2.54%, both of which were above the benchmark, and that during the third quarter Plan assets had increased on a net basis by $10.2 million; and

(b) on a going-concern basis, the Plan was forecasted to achieve a surplus of $77 million and to improve its solvency by more than 50%.

Declaration of 2013 Dividend: Exercise of Business Judgment

83. On November 18 and 19, 2013, the Board met to review and consider a number of items, including the possible declaration of a dividend. This meeting was held in New York, consistent with the Board's practice to have periodic meetings in both Toronto and New York.

84. The Board did not decide to authorize the 2013 Dividend at a "short pre-dinner discussion on November 18, 2013", or without receiving any financial analyses or information from management, as alleged. In fact, on November 18, 2013 before the Board meeting, the Audit Committee met to consider a number of matters. All of the members of the Audit Committee were independent directors. Consistent with past practice, all of the Board members attended the Audit Committee meeting. The Company's auditor, Deloitte, also participated in the meeting and an *in-camera* session with the committee members.

85. The presentation provided by management at this meeting indicated that the Company's balance sheet and liquidity position remained strong, with significant cash on hand and no draws on the credit facility. The presentation also indicated that Sears Canada had approximately $1.66 billion in current assets, and provided information on real estate transactions completed, including the Oxford, Concord, Montez, and Cadillac Fairview transactions.

86. Additionally, Deloitte delivered a report on November 18, 2013 which noted that it had discussed a number of matters with management, including pending litigation, changes to pension discount rates and the required reserve, and the recent real estate transactions completed by the Company.

87. During the Board meeting, with the benefit of information that had been provided to them in advance and at the Audit Committee meeting, management and the Board discussed the real estate divestiture transactions, cash position, capital requirements, funding for turnaround projects, long-term growth, and possibility and amount of a potential dividend.

88. At this meeting, the Board also

(a) received and considered a detailed presentation on management's priorities and asset valuation, including strategies aimed at long-term growth for the Company—all of which were fully funded;

(b) received and considered a dividend sensitivity analysis and discussed and considered the timing and quantum of a dividend in light of the Company's operational and cash position, and the cash that would remain following payment, including in the event that

(i) the Montez transaction, which was expected to close in January 2014, did not close; or

(ii) projected revenues and earnings were not achieved;

(c) received and considered a detailed presentation from the chief financial officer regarding the financial and operational position of the Company, future cash requirements, cash flow and liquidity, and the impact of the payment of a dividend of $5 per share on the Company's financial and liquidity position in 2013 and 2014;

(d) received and considered a presentation from the chair of the Board's investment committee regarding the Plan; and

(e) received confirmation from management, following consultation with Deloitte, that the statutory solvency requirements were met and received a certificate of solvency from the chief financial officer prior to approving the 2013 Dividend.

89. All but two of the directors, Campbell and Ron Weissman, were members of the Board when Sears Canada had declared an extraordinary dividend less than one year earlier, after receiving legal advice about their duties in relation to declaring dividends. The Board, which was composed of highly skilled and experienced corporate directors with expertise in retail, finance, accounting, and law, had significant and specific experience relating to these duties. In addition, the Board had the input and advice of both the general counsel and the assistant general counsel, who attended the Audit Committee and Board meetings.

90. The two directors who were not members of the Board when it approved the 2012 Dividend were, like the other directors, satisfied that the 2013 Dividend was in the best interests of Sears Canada on the basis of the information provided to them in advance of and at the Audit Committee and Board meetings, their discussions with other members of the Board, and the information presented to the Board by management on November 18, 2013.

91. None of the Former Directors had a material relationship with Sears Holdings, ESL, or Lampert which could reasonably have been expected to interfere with their independent judgment in supporting the 2013 Dividend. At all material times, and in particular on November 18, 2013, the Former Directors were not conflicted and exercised their independent judgment with a view to the best interests of Sears Canada when they voted to approve the 2013 Dividend.[3] Any historic relationships between some of the Former Directors and Sears Holdings, ESL, or Lampert did not in any way affect their decisions as directors of Sears Canada.

[3] Harker and Crowley were not considered to be independent under National Instrument 52-110, which relates to independence for the purpose of audit committee membership only. They were not members of the Audit Committee.

92. Additionally, and in any event, the interests of all shareholders with respect to the Company's declaration of the 2013 Dividend were aligned, all shareholders were treated the same, and Sears Holdings, ESL, and Lampert had the strongest interest in (and investment in) the ongoing financial and operational success of Sears Canada.

93. Contrary to the allegations in the Amended Amended Statement of Claim, the 2013 Dividend was not approved by the Board with "undue haste", in an ill-considered manner, or in concert with Sears Holdings, Lampert or ESL. Nor was the timing or quantum of the 2013 Dividend driven or dictated by Sears Holdings, Lampert, or ESL, or their need for funds.

94. Indeed, none of the decisions regarding Project Matrix, the divestiture of real estate assets, any other aspect of the Company's financial and operational plans, or the 2013 Dividend was in any way directed by or related to the financial needs of Sears Holdings, ESL, or Lampert. There was no "plan to extract cash from Sears Canada" through the sale of real estate assets devised by Sears Holdings, ESL or Lampert, or at all. Even if there were such a plan, which is denied, the Former Directors were not generally or specifically aware of it, and they were certainly not participants in such a plan.

95. Rather, the process undertaken by management and the Board leading up to the declaration of the 2013 Dividend was robust and consistent with corporate best practices. Moreover, the decision was an exercise of informed business judgment by the Board acting in the best interests of Sears Canada.

96. On December 6, 2013, the 2013 Dividend was paid *pro rata* to Sears Canada's shareholders. Sears Canada was not insolvent or nearly insolvent when the 2013 Dividend was declared or paid and was not rendered insolvent by that payment. On the contrary, following that payment, approximately $513.8 million in cash still remained on Sears Canada's balance sheet, with virtually no debt, and its operations and plans for the future remained fully funded.

No Dividend in 2014: Exercise of Business Judgment

97. In March 2014, the Board considered the Company's cash position following the completion of the Montez transaction and the possibility of a further dividend. In particular, the Board reviewed two further dividend scenarios presented by management valued, respectively, at $1.50 and $2.50 per share.

98. At that time, the Board received a detailed presentation from management regarding the financial and operating results for the fourth quarter of 2013, the drivers for such results, and various initiatives being undertaken by management to improve performance.

99. Consistent with its approach to the consideration of the 2012 Dividend and the 2013 Dividend, the Board undertook a comprehensive review and consideration of the financial position and the potential impact of various dividend scenarios.

100. Ultimately, the Board decided not to declare a dividend because of Sears Canada's unexpected poor performance in the fourth quarter of 2013 and its resulting cash position, which was lower than expected. As with the decision to declare the 2013 Dividend, the decision not to declare a dividend in 2014 was an exercise of informed business judgment by the Board acting in the best interests of Sears Canada.

DEFENCES TO CLAIMS

No Breach of Duty

101. At all material times, and in particular, in approving the 2013 Dividend, the Former Directors acted honestly and in good faith with a view to the best interests of Sears Canada. They also exercised the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances in approving the 2013 Dividend.

102. The Former Directors complied with their statutory fiduciary duties and their duty of care set out in paragraphs 122(1)(a) and (b) of the CBCA, as well as any common law duties they owed.

103. The Former Directors (and the Board as a whole) were entitled to determine that it was in the best interests of Sears Canada to distribute to shareholders, by declaring a dividend, some or all of the net proceeds of previous divestitures of unneeded real estate assets.

104. The Former Directors (and the Board as a whole) properly discharged their statutory duties in relation to the 2013 Dividend, including by ensuring that the solvency test set out section 42 of the CBCA was met. In particular, in addition to considering the solvency test, the Former Directors (and the Board as a whole)

(a) received and considered extensive information about the performance of Sears Canada and its progress in achieving the goals set out in Project Matrix;

(b) knew that as a result of the divestitures of real estate assets Sears Canada had cash on hand that exceeded its contemplated requirements and, as a result, that the business of Sears Canada would not be impaired by the payment of a dividend; and

(c) specifically obtained a solvency certificate from management confirming the solvency of Sears Canada both before and after the payment of the 2013 Dividend.

105. The Board's decision to approve the 2013 Dividend, based on the information that was available at that time, was an informed exercise of business judgment by the Board, including the Former Directors.

106. Bird was not a director of Sears Canada at the time the 2013 Dividend was approved and did not propose or approve the 2013 Dividend. Bird provided sufficient and adequate information to the Board before it considered and approved the 2013 Dividend.

No Oppression

107. The Former Directors did not act in a manner that was oppressive toward Sears Canada or its creditors, or at all. In any event, the Former Directors deny that there is any basis in fact or in law for Sears Canada to claim oppression based upon its own interests and expectations or on behalf of any of its creditors whatsoever.

108. The Former Directors did not owe any duties to existing or future creditors of Sears Canada in the circumstances of the 2013 Dividend, including because the solvency test set out in section 42 of the CBCA was met.

109. In any event, the Former Directors deny that the creditors of Sears Canada had any reasonable expectations that the Board would not declare a dividend in the circumstances. Sears Canada's creditors could not reasonably have expected the Company to hold onto hundreds of millions of dollars in 2013 to hedge against the risk that it might fail three-and-a-half years and be unable to pay creditors. Such expectations, which are denied, are not supported by any legal duty.

110. The Former Directors further deny that they disregarded any reasonable expectations of Sears Canada or its creditors or that they exercised their powers to propose, plan for, prepare, recommend, or authorize the 2013 Dividend in a manner that was unfairly prejudicial, or which disregarded, the interests of Sears Canada and its creditors, which unfairness, prejudice, and disregard is denied.

111. In addition, the Former Directors deny that there is any basis in fact or in law for Sears Canada to claim oppression on behalf of creditors who were not creditors at the time of the 2013 Dividend or who were repaid after the 2013 Dividend was paid. These creditors do not themselves have a claim under section 241(2) of the CBCA. In particular,

(a) creditors who became creditors after the 2013 Dividend have no claim since they were not creditors at the time of the allegedly oppressive conduct and therefore

(i) cannot have had a reasonable expectation in relation to a past event, namely the declaration of the 2013 Dividend;

(ii) extended credit on the basis of Sears Canada's then-existing financial state, which accounted for the 2013 Dividend; and

(iii) cannot have suffered a loss caused by the 2013 Dividend.

(b) creditors who were creditors at the time of the 2013 Dividend but were thereafter repaid suffered no loss and therefore have no claim, even if they extended further credit thereafter since

(i) such further credit was extended taking into account the circumstances of Sears Canada after the 2013 Dividend was paid; and

(ii) any losses resulting from the extension of such further credit could not have been caused by the 2013 Dividend.

112. In any event, the Former Directors determined, in good faith and on reasonable grounds, that the payment of the 2013 Dividend would not impair Sears Canada's business. The decision was an informed exercise of business judgment and, as such, could not have unfairly disregarded the interests of creditors.

No Conspiracy

113. The Former Directors did not participate in any conspiracy with the other defendants or any other person to commit an unlawful act that would harm Sears Canada or in connection with the matters raised in the Amended Amended Statement of Claim.

114. In particular, in late 2012 or early 2013, the Former Directors specifically did not agree to effect a "scheme" whereby Sears Canada would sell certain of its important assets and then declare a dividend to distribute the proceeds from the sale to shareholders, and none of the Former Directors participated in such a plan.

115. Nor did the Former Directors breach their statutory duties to Sears Canada, or act in a manner that was oppressive or unfairly prejudicial towards, or that unfairly disregarded, the interests of Sears Canada or its creditors, or commit any unlawful act, in declaring the 2013 Dividend, as alleged or at all.

116. Moreover, the Former Directors did not intend to act to the detriment of Sears Canada, nor did they have any reason to believe that the 2013 Dividend would have a detrimental effect on Sears Canada. Rather, the Former Directors (and the Board as a whole) concluded, in the exercise of their business judgment, that the payment of the 2013 Dividend was in the best interests of Sears Canada.

NO CAUSATION OF DAMAGES

117. For three-and-a-half years after the 2013 Dividend, market events and corporate decisions made by management of Sears Canada intervened to shape the ultimate fate of Sears Canada.

118. Following the approval and payment of the 2013 Dividend and until at least June 21, 2017, Sears Canada continued to obtain and rely on financial, strategic, and other advice from new

management and third party professionals and continued to carry on business in the normal course. During that time, management and other employees of Sears Canada operated stores, sold goods, undertook marketing efforts, implemented new initiatives, and made strategic, business, financial, operational and other decisions.

119. However, after the Former Directors left the Board, the Canadian retail market faced increasingly significant and unpredictable changes and stresses that posed new challenges for the continued successful operation of retailers, including Sears Canada. These events affected all segments of the retail market in Canada, including apparel, house wares, kitchen wares, office supplies, electronics, furnishings, toys, department stores, and jewellery. Numerous prominent retailers operating in Canada became insolvent, ceased operations, restructured, or reduced their footprint in the period immediately preceding Sears Canada's application for CCAA protection.

120. After payment of the 2013 Dividend, while the Former Directors (other than Bird) remained on the Board and Bird remained an officer, Sears Canada's Board and management worked to implement strategies in the best interests of Sears Canada and the Company's financial position and share price remained strong. In 2014, the Company's shares traded as high as $17.12 per share and not lower than $8.56 per share.

121. However, after the Former Directors left the Board, new management ushered in and oversaw significant shifts in the Company's strategic direction, including a plan known as "Sears 2.0". In 2016, the Company's shares never traded higher than $7 per share (*i.e.,* the high in 2016 was lower than the low in 2014) and the average trading price was only $3.68 per share. By early 2017, Sears Canada was in a difficult financial position.

122. As late as January 28, 2017, Sears Canada operated 95 full-line department stores, 830 catalogue and on-line merchandise pick-up locations, and 14 outlet stores. At that time, it had current assets of over $1 billion, of which $235.8 million was cash, with shareholder equity in the

amount of $222.2 million. However, Sears Canada suffered a sudden, significant, and unexpected decline in early and mid-2017. In that period, cash-on-hand fell to $125.3 million and inventory on hand increased to $648.1 million from $598.5 million. In addition, as of April 2017, the Company had incurred debt of $125 million under a term loan. By June 5, 2017 it had incurred additional debt of $33 million under a revolving credit facility.

123. Upon filing for CCAA protection, Sears Canada confirmed that the decline in financial performance was the result of market factors causing the decline of other retailers, as well as, among other things,

(a) unsustainable fixed costs from an overly broad retail footprint;

(b) the decline of the catalogue business and lower than expected conversion of catalogue customers to online customers; and

(c) the inability to secure an agreement for the management of credit and financial services operations.

124. The approval and payment of the 2013 Dividend did not cause Sears Canada's insolvency three and a half years later, or otherwise cause harm to Sears Canada or its stakeholders.

125. In the alternative, even if the 2013 Dividend contributed to the ultimate insolvency of Sears Canada many years later, which is denied, that result was not foreseen, nor reasonably foreseeable, by the Former Directors when the 2013 Dividend was approved by the Board.

FAILURE TO MITIGATE

126. Even if Sears Canada or its creditors suffered harm for which the Former Directors are liable, which is denied, Sears Canada has failed to mitigate such damages, including by failing to

deal with its creditors in a manner that would eliminate or lessen such damages and by taking on new debt.

THE ACTION IS TIME-BARRED

127. This action is time-barred. The declaration of the 2013 Dividend occurred on November 18, 2013. This action was commenced five years later, more than three years after the expiration of the two-year limitation period under section 4 of the *Limitations Act, 2002*, S.O. 2002, c. 24, Sch. B. (the "Limitations Act"). Contrary to the allegations in the Amended Amended Statement of Claim, the Plaintiff's claim was discovered or discoverable more than two years before this action was commenced.

THE ACTION SHOULD BE DISMISSED

128. The insolvency of Sears Canada, or any harm to its creditors as a result of the insolvency, which harm is denied, did not result from the decisions, actions, or omissions of the Former Directors in 2013. There is no basis in fact or in law (i) to warrant a declaration that the Former Directors breached any of their duties, (ii) to set aside the 2013 Dividend or impose a constructive trust over the funds paid, or (iii) to require the Former Directors to pay the amount of the 2013 Dividend, or some portion of it, to Sears Canada or to anyone else.

129. Sears Canada continued to pay its creditors in the ordinary course, while reducing its overall debt, for many years after the 2013 Dividend was approved. Even if the 2013 Dividend impacted Sears Canada's creditors in June 2017, which is denied, only creditors who had advanced credit before the 2013 Dividend could have been impacted. Creditors who advanced credit after the 2013 Dividend did so on the basis of Sears Canada's financial and operational position and creditworthiness after payment of the 2013 Dividend.

130. The Former Directors claim the right, at law and in equity, to set off against the Plaintiff's claim the full amount of each of their unsecured claims against the estate of Sears Canada filed in the Company's CCAA proceeding.

131. There is no basis for any award of damages whatsoever, let alone the punitive damages sought by the Plaintiff.

132. The Former Directors plead and rely on the CBCA, the BIA, the CCAA, the Limitations Act, and the *Courts of Justice Act*, R.S.O. 1990, c. C.43, and request that this action be dismissed with costs on a substantial indemnity basis.

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Sears Holdings Corporation

Court File No.: CV-18-00611214-00CL

SEARS CANADA INC. Plaintiff	-and-	ESL INVESTMENTS INC. *et al.* Defendants

ONTARIO
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COMMERCIAL LIST

PROCEEDING COMMENCED AT TORONTO

STATEMENT OF DEFENCE OF THE DEFENDANTS EPHRAIM J. BIRD, DOUGLAS CAMPBELL, WILLIAM CROWLEY, WILLIAM HARKER, JAMES MCBURNEY, and DONALD ROSS

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William Crowley, William Harker,
James McBurney, and Donald Ross

Court File No. CV-18-00611214-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

B E T W E E N:

SEARS CANADA INC., by its Court-appointed Litigation Trustee, J. DOUGLAS CUNNINGHAM, Q.C.

Plaintiff

- and -

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

Defendants

STATEMENT OF DEFENCE

1. The defendants R. Raja Khanna ("**Khanna**") and Deborah E. Rosati ("**Rosati**") deny the allegations contained in the plaintiff's amended amended statement of claim (the "**Statement of Claim**"), unless expressly admitted herein.

Relationship with Sears Canada

2. 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***").

3. 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.

4. The defendant Khanna is a resident of Ontario and 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.

5. 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

6. (Set out in separate, consecutively numbered paragraphs each allegation of material fact relied on by way of defence.)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.

7. 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;

(d) the Board reviewed ongoing and detailed disclosure and analysis of the financial position and results of Sears Canada; and

(e) the Board determined that issuing each of the dividends was in the best interests of Sears Canada.

8. Contrary to what is alleged in the Statement of Claim, Rosati and Khanna did not "rubber-stamp" the 2013 dividend without scrutiny or evaluation. At the time, Sears Canada had over $1 billion in cash, and limited debt. Its pension plan had a 95% solvency ratio.

Project Matrix

9. Contrary to what is alleged in the Statement of Claim, Sears Canada did not sell off certain leases as part of a nefarious conspiracy to generate cash to pay a dividend to benefit certain shareholders.

10. Sears Canada sold the leases identified in the Statement of Claim as part of a plan known within the company as "Project Matrix". The plan involved focusing on smaller suburban markets, where Sears Canada anticipated greater success, and reducing operations in major urban locations, where Sears Canada was struggling.

11. The purported "crown jewel" leases identified in the Statement of Claim were leases for stores that were located in urban centres and were inconsistent with the Project Matrix plan and/or were prime urban locations that were more valuable to Sears Canada as real estate assets than as operating stores.

12. Rosati and Khanna carefully considered each of the lease transactions before approving them based on detailed information from management.

13. Rosati and Khanna exercised their business judgment and acted in the best interests of Sears Canada in approving the lease transactions.

Sears Canada's Performance and CCAA Filing

14. Sears Canada's performance declined in the period following the 2013 dividend, with net losses beginning in 2014.

15. 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.

16. Factors contributing to Sears Canada's decline in financial performance in the subsequent period 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.

17. 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.

Business Judgment Rule

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

19. The decision to authorize the 2013 dividend was reasonable and appropriate at the time it was made. Upon payment of the 2013 dividend, Sears Canada remained readily solvent and had significant cash on hand, with little debt. The market continued to view Sears Canada as a valuable public company.

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

No Breach of Fiduciary Duty

21. Rosati and Khanna did not breach their fiduciary duties owed to Sears Canada by authorizing the 2013 dividend. Their authorization of the 2013 Dividend was in the best interests of Sears Canada. No such duty was owed to creditors, and in any event no duty was breached.

22. Contrary to what is alleged in the Statement of Claim, Rosati and Khanna did not authorize the 2013 dividend to favour the interests of the "Significant Shareholders" (as defined in the Statement of Claim) or any other particular stakeholder of Sears Canada over the best interests of Sears Canada.

No Breach of the Standard of Care

23. Rosati and Khanna did not breach the standard of care in authorizing the 2013 dividend. They acted honestly and in good faith, and exercised the care, diligence and skill that a reasonably prudent person would have exercised in comparable circumstances when authorizing the 2013 dividend.

No Oppression

24. The oppression provisions of the *CBCA* do not permit Sears Canada to be the oppressed person. Pursuant to section 241(2) of the *CBCA*, the oppressive conduct must be directed to a "security holder, creditor, director or officer" – not the company itself. Accordingly, the plaintiff's claim for oppressive conduct towards Sears Canada must fail.

25. Contrary to what is alleged in the Statement of Claim:

(a) the plaintiff is not a proper "complainant" under section 238 of the *CBCA*;

(b) Rosati and Khanna did not disregard any reasonable expectation of Sears Canada or other stakeholders, and did not use their powers for the benefit of third parties rather than for the benefit of the company; and

(c) the authorization of the 2013 dividend by Rosati and Khanna was not oppressive, nor unfairly prejudicial to and did not disregard there interests of Sears Canada and its creditors.

26. Trade and other creditors who extended credit or performed services after November 2013 did so with full knowledge that the 2013 dividend was paid, and of Sears Canada's publicly disclosed financial position.

27. The plaintiff is not entitled to oppression relief under the *CBCA* as no case for oppression is made out. No reasonable expectations of any valid stakeholder were thwarted, and there is no basis for statutory liability. The plaintiff fails to sufficiently identify the reasonable expectations of particular classes of creditors on which it relies.

No Conspiracy

28. Rosati and Khanna deny that there was any conspiracy surrounding the 2013 dividend as alleged in the Statement of Claim.

29. As set out above, Rosati and Khanna did not breach their fiduciary duties or the standard of care and did not engage in oppressive conduct. Accordingly, contrary to what is alleged in the Statement of Claim, they engaged in no unlawful means to carry out any alleged conspiracy.

30. Rosati and Khanna were not involved in any agreement in late 2012 and early 2013, or at any other time, amongst Lampert, Crowley, Harker, and Bird, to sell Sears Canada's assets and distribute the bulk of the proceeds to Sears Holdings and ESL. They are not aware of any such agreement.

31. Rosati and Khanna did not agree with Lampert in fall 2013, or at any other time, to authorize the payment of the 2013 dividend by Sears Canada for the benefit of Sears Holdings, ESL, and Lampert.

The Claim is Limitations Barred

32. On January 20, 2014 – less than two months after the 2013 dividend was paid – counsel to beneficiaries of Sears Canada's pension 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.

33. 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.

34. 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.

35. 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.

36. 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 Losses or Damage

37. Rosati and Khanna deny that the plaintiff has incurred losses or damage as alleged in the Statement of Claim, or at all. Alternatively, if the plaintiff did incur any losses or damage (which is expressly denied):

(a) They are not responsible at law for any such losses or damages;

(b) any such losses or damages claimed are excessive, exaggerated and/or too remote to be recoverable at law;

(c) any such losses or damage were not caused by any negligence, act, omission, breach of duty, breach of contract or breach of any other legal obligation on the part of the defendants in fact or in law; and

(d) the plaintiff has failed to take reasonable or any measures to reasonably mitigate its damages.

38. The defendants Rosati and Khanna claim all rights of legal and equitable set-off that may be available to them.

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

July 29, 2019

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CC: **LITIGATION SERVICE LIST**

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Plaintiff

-and-

ESL INVESTMENTS INC. et al.
Defendants

Court File No. CV-18-00611214-00CL

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

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B E T W E E N:

MORNEAU SHEPELL LTD. in its capacity as administrator of the Sears Canada Inc. Registered Retirement ~~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 and SEARS HOLDINGS CORPORATION

Defendants

AMENDED STATEMENT OF DEFENCE OF THE DEFENDANTS WILLIAM HARKER, WILLIAM CROWLEY, DONALD CAMPBELL ROSS, EPHRAIM J. BIRD, JAMES MCBURNEY, and DOUGLAS CAMPBELL

1. The Defendants William Harker, William Crowley, Donald Campbell Ross, Ephraim J. Bird, James McBurney, and Douglas Campbell deny each and every allegation in the Amended Statement of Claim, except where hereinafter expressly admitted, and deny that the Plaintiff Morneau Shepell Ltd. is entitled to any of the relief sought in the Amended Statement of Claim.

OVERVIEW

2. The Plaintiff seeks to recover approximately $260 million of a $509 million dividend paid to the shareholders of Sears Canada Inc. ("Sears Canada" or the "Company") almost six years ago (the "2013 Dividend") on the theory that Sears Canada had a duty to make certain contributions to the Sears Registered Retirement Plan (the "Plan") at the time in excess of any legal requirements.

3. As sponsor of the Plan, Sears Canada made all of the contributions to the Plan that it was required to make and, as administrator of the Plan, it met all of its statutory and common law duties to the Plan and its members. At all materials times, the Company employed a robust governance process to oversee the Plan and the prudent investment of its assets.

4. When Sears Canada paid the 2013 Dividend, the Plan was healthy. In fact, its position on both a going concern and solvency basis had recently improved and there was no reason to believe that Sears Canada would ultimately fail three and a half years later. Rather, when the board of directors of Sears Canada (the "Board") approved the 2013 Dividend, it intended and expected that the Company would continue in business for the foreseeable future, and that it would continue to sponsor and administer the Plan.

5. Consistent with corporate governance best practices, the Board's decision regarding the use of the significant excess cash involved careful consideration of the financial and operational position of the Company in light of its strategic plan and capital requirements, market conditions, the financial health of the Plan, and the fact that the Company had virtually no debt. Among other things, the Board assessed the results of its strategic plan and the needs of the business based on management's priorities and operating plans, including strategies aimed at long-term growth.

6. Sears Canada was not insolvent or near insolvent when the 2013 Dividend was declared or paid, and it was not rendered insolvent by that payment. On the contrary, following payment of the 2013 Dividend, approximately $513.8 million in cash still remained on Sears Canada's balance sheet, with virtually no debt, and its operations and plans for implementing management's strategic objectives were fully funded. Indeed, Sears Canada remained financially sound for many years after the 2013 Dividend was paid and continued to make all required contributions to the Plan until the commencement Sears Canada commenced proceedings under the *Companies' Creditors Arrangement Act* (the "CCAA").

7. The Plaintiff's assertion that the Board had an obligation – in 2013 – to fund (or set aside money for) the wind up deficit of the Plan, at a point when Sears Canada continued to operate in the normal course and when there was no indication that Sears Canada would, many years later, cease operations or wind up the Plan, is factually baseless and untenable at law.

8. The claim that Harker, Crowley, Ross, McBurney, Campbell (collectively the "Former Directors"), and Bird should now pay $260 million to benefit the pensioners of Sears Canada at the time of its filing for CCAA protection, three and a half years after the 2013 Dividend was approved, should be dismissed.

THE PARTIES

The Former Directors and Bird

9. The Defendant William Harker was a director of Sears Canada from November 2008 to April 2015. Harker was at all material times a highly experienced corporate lawyer, corporate director, and senior manager with significant experience in the retail sector and in investment fund strategy and management.

10. Prior to, and concurrent with part of, his tenure on the Board, Harker held management roles with Sears Holdings Corporation ("Sears Holdings"), including as chief counsel from September 2005, then as general counsel from April 2006 to May 2010, and then as an officer until August 2012, and with ESL Investments Inc. as general counsel from February 2011 to August 2012. Harker also co-founded an investment fund in 2013. He previously practised as a corporate lawyer with the law firm of Wachtell Lipton Rosen & Katz LLP in New York City and has a law degree from the University of Pennsylvania.

11. The Defendant William Crowley was a director of Sears Canada from March 2005 to April 2015, and chair of the Board from December 2006 to April 2015. Crowley was at all material times

a highly experienced executive and corporate director with extensive experience in the management of retail organizations, investment fund strategy and management, and finance.

12. Prior to, and concurrent with part of, his tenure on the Board, Crowley held management roles with Sears Holdings, as executive vice-president, chief financial officer, and chief administrative officer at various times from March 2005 to January 2011, and with ESL Investments Inc., as president and chief operating officer from January 1999 to May 2012. Crowley previously worked as a financial analyst with Merrill Lynch and as a managing director of Goldman Sachs, and co-founded an investment fund in 2013. Crowley has an undergraduate degree and a law degree from Yale University and a master's degree in philosophy, politics, and economics from the University of Oxford.

13. The Defendant Donald Campbell Ross was a director of Sears Canada from May 2012 to April 2014. Ross was at all material times a highly experienced lawyer with extensive experience in corporate law and corporate governance. From 1988 to August 2013, Ross was a partner at Osler, Hoskin & Harcourt LLP, where he focused on domestic and cross-border mergers and acquisitions and corporate finance, and advised senior management and boards of directors on corporate governance matters. Since September 2013, he has held a senior counsel position with the New York office of Covington & Burling LLP.

14. Ross has been recognized for his work by numerous legal publications and organizations including Chambers Global, the Best Lawyers in Canada, the Lexpert / American Lawyer Guide to the Leading 500 Lawyers in Canada, and the IFLR 1000. He has an undergraduate degree from the University of Toronto, a law degree from Osgoode Hall Law School, and a master's degree from the London School of Economics. He is a member of Ontario and New York bars. Ross has never held any position at Sears Holdings or ESL Investments Inc.

15. The Defendant Ephraim J. Bird was a director of Sears Canada from May 2006 until November 18, 2013. Bird resigned from the Board prior to the time on November 18, 2013 that the Board approved the 2013 Dividend (for reasons not related to the 2013 Dividend).

16. Bird was the executive vice-president and chief financial officer of Sears Canada from March 2013 to June 2016. He was also the lead director of Sears Canada from May 2007 to March 2013. From 1991 to 2002, Bird was the chief financial officer of ESL Investments Inc. Bird is currently senior vice president and chief financial officer of Sears Hometown and Outlet Stores, Inc. He has an undergraduate degree in accounting from the Hankamer School of Business at Baylor University, a master of business administration degree from the Stanford University Graduate School of Business, and he is licensed as a certified public accountant.

17. The Defendant James McBurney was a director of Sears Canada from April 2010 to April 2015. Prior to joining the Board, McBurney was employed by Goldman Sachs in New York, where he focused on mergers and acquisitions. McBurney currently works as an executive in the technology industry. He has an undergraduate degree from Yale University and a master of business administration degree from the Harvard Business School. McBurney has never held any position with Sears Holdings or ESL Investments Inc.

18. The Defendant Douglas Campbell was a director of Sears Canada from September 2013 to October 2014. In 2011, Campbell joined Sears Canada as an executive vice-president. In 2012, Campbell was promoted to the position of chief operating officer. In September 2013, Campbell succeeded Calvin McDonald as president and chief executive officer of Sears Canada, a position that he held until he resigned in the fall of 2014 for family reasons.

19. Prior to joining Sears Canada, Campbell was a principal at Boston Consulting Group, where he focused on turnaround matters. Campbell is currently a partner with Harvest Partners, LP, a private equity firm focused on leveraged buyout and growth capital investments in

mid-market companies. He has an undergraduate degree in economics from the United States Naval Academy and a master of business administration degree in finance from The Wharton School at the University of Pennsylvania. Campbell has never held any position with Sears Holdings or ESL Investments Inc.

Rosati and Khanna

20. To the best of the Former Directors' and Bird's knowledge, the Defendant Deborah E. Rosati was a director of Sears Canada from April 2007 to August 2018 and the Defendant R. Raja Khanna was a director of Sears Canada from October 2007 to August 2018.

Sears Holdings Corporation

20A. To the best of the Former Directors' and Bird's knowledge, the Defendant Sears Holdings is a corporation incorporated under the laws of Delaware. On October 15, 2018, Sears Holdings filed for protection from its creditors under Chapter 11 of the *United States Bankruptcy Code*.

The ESL Defendants

21. To the best of the Former Directors' and Bird's knowledge, the Defendant ESL Investments Inc. is an investment fund incorporated under the laws of Delaware. The Defendants ESL Partners LP, SPE I Partners, LP, SPE Master I LP, and ESL Institutional Partners, LP were at all material times controlled directly or indirectly by ESL Investments Inc. (these limited partnerships, together with ESL Investments Inc., "ESL").

22. To the best of the Former Directors' and Bird's knowledge, the Defendant Edward S. Lampert is an individual residing in Florida who at all material times was the principal of ESL. Lampert was also, at all material times, the chair and chief executive officer of ESL Investments Inc., the chair of Sears Holdings, and beginning in February 2013 the chief executive officer of Sears Holdings.

23. To the best of the Former Directors' and Bird's knowledge, at all material times, Sears Holdings held a 51% interest in Sears Canada, ESL held a 17.4% interest in Sears Canada, and Lampert held a 10.2% interest in Sears Canada.

The Plaintiff

24. The Plaintiff Morneau Shepell Ltd. was appointed as administrator of the Plan by the Superintendent of Financial Services for Ontario effective October 16, 2017.

THE PENSION BENEFITS REGIME

25. The *Pension Benefits Act,* R.S.O. 1990, c. P.8 and corresponding regulations (collectively, the "Pension Benefits Regime") required Sears Canada, as administrator, to obtain actuarial reports for the Plan at least every three years. Pension plan actuarial reports are subject to detailed requirements under the Pension Benefits Regime, as well as the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) (the "ITA") and actuarial standards set by the Canadian Institute of Actuaries.

26. The actuarial methods and assumptions that may be used in the preparation of actuarial reports are highly regulated and subject to regulatory oversight by the Superintendent of Financial Services (Ontario) and by the Canada Revenue Agency. The actuarial assumptions to be used in actuarial reports change over time and are subject to prevailing interest rates, investment returns, salary increases, mortality, termination rates, and other factors.

27. The Pension Benefits Regime required actuarial reports to contain a number of metrics, including going concern unfunded liability, based on a going concern valuation, and solvency deficiency and solvency ratio (which is the ratio of a plan's solvency assets to its solvency liabilities), based on a solvency valuation.

28. The going concern valuation assesses a plan's financial position on the premise that the plan will continue indefinitely. This valuation determines the actuarial value of the assets, and subtracts the going concern liabilities, resulting in the going concern position. The prior year credit balance is then applied, resulting in the going concern surplus or unfunded liability.

29. In contrast, the solvency valuation assumes that a plan is terminated and wound up on the valuation date, and assesses a plan based on the premise that certain obligations (prescribed in the Pension Benefits Regime) are settled on the valuation date for all members. Estimated wind up expenses as well as solvency liabilities (essentially, payments to plan members) are subtracted from the assets, resulting in the solvency position. Further adjustments (provided for in the Pension Benefits Regime) are made to determine the solvency surplus or deficiency.

30. Actuarial valuation reports also contain a hypothetical wind up valuation and report on whether or not there is a hypothetical wind up deficiency. The hypothetical wind up valuation is not required by the Pension Benefits Regime, but instead by professional standards published by the Canadian Institute of Actuaries. The hypothetical wind up valuation is similar to the solvency valuation, except that it includes all benefits that would be payable under the postulated scenario that would maximize benefits. For example, in valuation reports for the Plan, the hypothetical wind up valuation included inflation indexing, whereas the solvency valuation did not.

31. Valuations of pension plans vary over time based on a number of factors, including:

(a) performance of investments (poor performance will reduce assets, increasing going concern unfunded liabilities and solvency deficiencies; strong performance will increase assets, reducing unfunded liabilities and solvency deficiencies);

(b) interest rates and discount rates (lower interest rates will increase liabilities; higher interest rates will decrease them). Different discount rates are used for going

concern and solvency valuations. The discount rates for solvency valuations fluctuate continuously, such that the solvency position of a pension plan can vary from month to month;

(c) pension benefits paid to plan members; and

(d) actuarial assumptions about mortality (the trend toward longer life expectancies means pensions are paid over a longer period of time, increasing liabilities, thus increasing going concern unfunded liabilities and solvency deficiencies).

THE SEARS CANADA REGISTERED RETIREMENT ~~PENSION~~ PLAN

Sears Canada and the Plan

32. Prior to the CCAA proceedings, Sears Canada was a multi-format retailer focused on merchandising and sale of goods and services through its network of approximately 111 full-line department stores and 295 speciality stores, including Sears Home stores and Sears Hometown dealer stores, as well as its direct (catalogue / internet) channel.

33. On June 22, 2017, Sears Canada obtained protection under the CCAA ~~*Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 (the "CCAA")~~. By January 2018, Sears Canada had closed all of the stores that it had operated and had ceased active operations.

34. Prior to the appointment of the Plaintiff as administrator of the Plan, Sears Canada was the sponsor and the administrator of the Plan. The Plan consisted of two components: a defined benefit component and a defined contribution component. On July 1, 2008, the defined benefit component was discontinued and the defined contribution component was added.

35. Sears Canada continued to make all contributions that were due to the Plan as required by the Pension Benefits Regime. Under the defined contribution component, members contributed

between 1% and 7% of their earnings to the Plan, and Sears Canada matched these member contributions at the rate of 50%.[1]

36. The Board, which had oversight responsibilities regarding the administration of the Plan and the investment of its assets, established an investment committee (the "Investment Committee") to oversee investment management of the Plan's assets.

Good Pension Governance Structure

37. The Investment Committee's charter provided that it would have at least five members, at least two of whom would be Board members. Its mandate included the following:

(a) investment policy: the committee was charged with considering and adopting the investment policy recommended by management and an independent consultant, and reviewing it annually;

(b) investment managers: the committee was responsible for considering and approving (or not) recommendations for hiring or terminating investment managers. It was also responsible for monitoring the performance of the investment managers; and

(c) review of financial statements of the Plan.

38. Harker, Crowley, and Bird were members of the Investment Committee from at least November 2010 until May 2014.

39. The Investment Committee was responsible for reviewing the investments of the Plan to ensure compliance with the statement of investment policies and procedures ("SIP&P"). The

[1] The allegations in the Amended Statement of Claim relate solely to the defined benefit component. Unless the context indicates otherwise, the term "Plan" is intended to reference the defined benefit component.

Investment Committee was also required to review the SIP&P at least annually and either confirm it or amend it. The Investment Committee complied these obligations.

40. The SIP&P established an approach to investing which reduced volatility in the portfolio and protected capital for the benefit of Plan members. The risk policy and asset mix policy, contained within the SIP&P, provided for an equity investment allocation of between 25% and 45% and a fixed income investment allocation of 55% and 75%.

41. Sears Canada administered the Plan with the benefit of the advice and input of external financial, legal, and actuarial advisors.

42. In particular, Towers Watson was retained as an investment consultant in respect of the management and ongoing investment strategy for Plan assets. Towers Watson reported to Sears Canada on at least a quarterly basis about the performance of investments held by the Plan. Aon Hewitt ("Aon") was retained as an actuarial consultant and provided advice on the valuation of the Plan assets and prepared the required actuarial reports for the Plan.

43. Additionally, Sears Canada regularly obtained advice from Torys LLP on its legal obligations in relation to the Plan, including advice on funding requirements in accordance with the Pension Benefits Regime.

44. The Investment Committee met regularly, at least quarterly, and reported to the full Board. At its meetings, the Investment Committee received and reviewed reports from Towers Watson on the performance of the Plan's investments, the allocation of invested funds as compared with the investment policy, as well as the asset allocation ranges established in the SIP&P. Towers Watson provided reports comparing the performance of the Plan's investments to market indices and benchmarks, as well as other investment portfolios, where available.

45. The Investment Committee also received and reviewed reports from management on the performance of the Plan. These reports included estimates of the Plan's valuation and funding on both a going concern and a solvency basis.

Actuarial Reports

46. Sears Canada also obtained actuarial valuation reports for the years ending 2007, 2010, 2013, and 2015 from Aon. The key metrics in these reports are as follows:

Key Metric	**2007**	**2010**	**2013**	**2015**
Going concern position	$114,072	$(68,039)	$14,645	$29,936
Going concern surplus/(unfunded liability)	$114,072	$(68,039)	$(355)	$28,876
Solvency position	$7,625	$(205,788)	$(76,405)	$(201,328)
Solvency surplus/(deficiency)	$7,625	$(96,059)	$(27,735)	$(138,575)
Solvency ratio	1.00	0.86	0.95	0.85
All dollar figures expressed in thousands				

47. These metrics show that the Plan, like many other registered pension plans, was impacted by the 2008 and 2009 recession and showed a solvency deficiency in the actuarial valuation report for the year ending in 2010. However, as at December 31, 2013, the Plan had a surplus going concern position and a reduction in its solvency deficiency of over 60%.

48. The actuarial reports prepared by Aon identify the influence of various factors on the Plan's metrics, such as:

(a) most of the decline in the Plan's assets between 2007 and 2010 was attributable to actuarial losses associated with investment return;

(b) the Plan experienced a drop in active membership from 16,013 in 2007 to 10,959 in 2010. The Plan made 4,702 lump sum payouts during that period. This factor had a significant impact on the assets and liabilities in the Plan;

(c) prevailing interest rates had a significant impact on the magnitude of liabilities in the Plan and on the funding of those liabilities. According to the 2010 actuarial report, a 1% decrease in the discount rate would have increased the Plan's accrued liabilities by 12.9% or just under $170 million and would have increased the Plan's solvency liabilities by 11.3% or just over $162 million;

(d) variances in the investment returns on the pension fund from the assumed rate of return had a significant impact on funding obligations. With assets of about $1.25 billion as reported in the 2010 actuarial report, a 1% difference in investment returns would have had an impact of $12.5 million;

(e) actuarial assumptions required to be used had a material impact on the Plan's liabilities. The 2010 actuarial report indicated that the Canadian Institute of Actuaries adopted revised standards for the computation of commuted values, which came into effect in 2011. In addition, the discount rate declined by 0.5% between the 2010 actuarial report and the 2013 actuarial report. The net impact was an increase in going concern liabilities of $68 million; and

(f) similarly, revised mortality tables reflecting longer life expectancies of Canadians increased the Plan's going concern liabilities by $38 million in 2013. The above two changes increased the Plan's going concern liabilities by $106 million, or approximately 9%.

49. The Pension Benefits Regime required Sears Canada, as the sponsor of the Plan, to make "special payments" to liquidate any going concern underfunded liabilities and any solvency deficiencies, over a period of several years. Going concern underfunded liabilities had to be liquidated within fifteen years, while solvency deficiencies had to be liquidated within five years.

50. The Pension Benefits Regime also contained provisions, introduced in 2009 and 2012, that permitted sponsors to elect to defer beginning these payments for twelve months, and to make other elections, including to consolidate a solvency deficiency from a previous report with a solvency deficiency in a new report and establish a new five-year amortization schedule.

51. The 2010, 2013, and 2015 actuarial reports set out the special payments that Sears Canada was required to make. These special payments were the only payments that Sears Canada was required to make after the Plan ceased accruing defined benefit service on July 1, 2008.

52. Sears Canada made all special payments that it was required to make by the Pension Benefits Regime at all relevant times: approximately $29 million in 2012, $44 million in 2013, $20 million in 2015, and $12.6 million in 2016.[2] No contributions were required in 2014.

53. The Pension Benefits Regime does not impose any requirement to liquidate a hypothetical wind up deficiency. Indeed, any eventual wind up deficiency can only be quantified when a plan is actually wound up, since a number of factors will influence the valuation of the assets and liabilities of a plan at the time of wind up.

[2] The 2013 actuarial report calculated the 2016 special payment as $20.2 million. The 2016 special payment was revised in the 2015 actuarial report as $12.6 million.

SEARS CANADA'S TRANSFORMATION PLAN

54. Beginning in 2011, under the guidance of its new CEO Calvin McDonald, Sears Canada undertook a full diagnostic review of all aspects of its business. The purpose of this review, which included an assessment of, among other things, merchandising and marketing, operations and logistics, direct sales (website and catalogue), and the nature and extent of the Company's "retail footprint", was (i) to focus the business on the Company's strengths and (ii) to determine how best to respond to changing market conditions.

55. This review culminated in a three-year strategic plan designed to transform the Company over time by renewing and improving its operational performance and re-focusing its retail business on its traditional core strengths (the "Transformation Plan"). The Transformation Plan acknowledged that Sears Canada had strong performance in suburban and smaller centre / rural markets, had "lost its focus" by pursuing urban markets, and was "stuck" without a relevant value proposition for these three distinct markets: rural, suburban, and urban.

56. The Transformation Plan, which was carefully considered and approved by the Board, was a "compass" for the business transformation, with annual financial and operational plans functioning as "roadmaps" for the implementation of that transformation. The Transformation Plan and annual financial and operational plans included initiatives to improve Sears Canada's operational performance, enhance its core retail business, and unlock value, including through operational changes and capital investment to refresh a number of Sears Canada's stores and thereby improve the performance of the refreshed stores.

57. The Transformation Plan acknowledged the need for Sears Canada to focus on getting the basics of retail right before it could realize any benefit from investing significantly in its retail locations, and provided for a disciplined approach to capital investment. In connection with the store refreshes, management recommended a phased approach, with an initial limited phase of

refreshes, and a demonstrated return on investment prior to any further or Company-wide implementation of store refreshes. The Board authorized the phased approach to capital investment to ensure adequate return for the benefit of the Company.

58. Sears Canada made significant investments in its business as part of the implementation of the Transformation Plan and operating plans in 2012 and 2013. Among other things, it:

(a) invested a total of $165 million in capital expenditures;

(b) invested approximately $40 million completing the refresh or reset of 58 full-line stores, with emphasis on merchandise presentation and standards; and

(c) invested $125 million in various other capital projects, including $8 million in its website, which drove e-commerce growth that exceeded the decline in catalogue.

59. As part of the Transformation Plan, management initiated a thorough assessment of the Company's real estate assets to identify unproductive stores and excess space that, in the context of the strategic review, had higher "real estate value" than "trading value", measured by a multiple of "four-wall" EBITDA.[3] Management called their initiative "Project Matrix".

60. Project Matrix was not initiated, as alleged, because Sears Holdings, ESL and Lampert "had an immediate need for cash" in early 2013. Nor was it devised, as alleged, by Sears Holdings, ESL or Lampert as a "plan to extract cash" from Sears Canada. In fact, the Former Directors and Bird were not aware of any cash liquidity issues or cash constraints for Sears Holdings, ESL or Lampert while they were directors of Sears Canada.

[3] EBITDA refers to earnings before interest, tax, depreciation and amortization. It is a key measure of a company's operating performance and in particular indicates the cash operating profit of a business. It is used by management and investors to assess a company's operational performance by eliminating the effects of financing decisions, accounting decisions, or tax environments.

61. In fact, Project Matrix was initiated by Sears Canada's management in early 2012. It was led by a steering committee composed of senior management from the real estate, legal, and finance departments of Sears Canada, not by the Former Directors and Bird. The assessment undertaken in connection with Project Matrix confirmed that the Company was not optimally positioned with its "real estate footprint", that certain locations (particularly in large urban centres) were more valuable to the Company as real estate assets than as operating stores, and that the divestiture of those assets could "right-size" and re-focus the business by reducing major urban locations.

62. In particular, given economic conditions and the increasingly competitive retail landscape in Canada, management recognized that the sale of store leases for stores that did not generate meaningful operational returns would allow the Company to focus on its core retail business. At the same time, aggressive entry into the Canadian market by American retailers presented a unique and time-limited opportunity to Sears Canada by increasing demand for space that did not fit within the Company's business model.

63. The initiative became a key aspect of the ongoing implementation of the Transformation Plan to refocus operations on Sears Canada's core customer base in suburban, mid-market, and smaller / rural locations, and generate long-term value. Management provided detailed reports to the Board on the results of Project Matrix, including an assessment of each store, with rankings according to their respective real estate values and trading values, measured by a detailed "four-wall" EBITDA assessment, and the proposal to divest unproductive real estate assets to transition the Company to a mid-market retailer without major urban locations.

64. Management identified the top ten stores for which the real estate value far exceeded the trading value. Management presented various scenarios and proposed that Sears Canada

pursue the sale of six to eight of these full-line stores, located in urban markets, and right-size an additional seven or eight full-line stores by subletting excess space in the near term.

65. The Board approved annual financial and operational plans presented by management relating to implementation of the Transformation Plan, which were designed to address changes in retail market conditions and the impact of the various initiatives on the Company's business. In addition to quarterly meetings, the Board met with management every month to review financial and operational performance and each fall, the Board attended a two-day strategic session prior to the review and approval of the annual financial and operational plan.

REAL ESTATE DIVESTITURES

66. Project Matrix culminated in Sears Canada entering into four transactions in 2013 for the sale or redevelopment of certain store locations. Management led the negotiations for each transaction with assistance from external advisors and input from various Board members. The Board was specifically aware of the assistance provided by members of the Board and Jeffrey Stollenwerck, an executive with Sears Holdings, who had relevant expertise and relationships with Sears Canada's and other retail landlords. Sears Holdings, ESL, and Lampert did not direct the negotiating strategy in connection with these transactions.

67. Management recommended each transaction to the Board following comprehensive review and consideration and provided detailed presentations to the Board with its recommendations, which included an assessment of the transaction, an evaluation of store performance versus real estate value, accounting implications of a sale, and the impact of the proposed sale on operational and financial performance, EBITDA, and the balance sheet. Each of

the four transactions was carefully reviewed and unanimously approved by the Board as being in the best interests of Sears Canada.[4]

The Oxford Transaction

68. Sears Canada entered into a transaction with Oxford Properties Group ("Oxford") for the sale of leases for Yorkdale and Square One for total consideration of $191 million and a $1 million payment by Oxford in exchange for an option to purchase the Scarborough Town Centre lease for $53 million.

69. The transaction was not initiated by the Company. Rather, it was initiated by a proposal from Oxford and negotiations were led by Sears Canada's management with input as necessary from external advisors and various Board members.

70. Management had ranked the three stores in the Oxford transaction in the top ten stores with real estate value exceeding trading value, and the divestiture of these assets was consistent with the Company's plan to right-size and re-focus its business. The consideration of $191 million represented a value of more than 21 times the four-wall trading EBITDA for Yorkdale and the Square One locations, 10.6 times the four-wall trading EBITDA for Scarborough Town Centre, and greatly exceeded management's estimate of real estate value by approximately $55 million.

The Concord Transaction

71. Sears Canada entered into a transaction with Concord Kingsway Project Limited Partnership ("Concord") for the sale of a 50% beneficial interest in its property in Burnaby, British Columbia – except for the new Sears Canada store site – and the creation of a co-ownership joint venture for the redevelopment of a mixed-use residential office and retail shopping centre. The total consideration proposed was approximately $140 million.

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[4] In light of a potential conflict related to outside business activities not related to Sears Canada, Harker and Crowley recused themselves from the review and approval of the Concord transaction, described below.

72. Management recommended partnering with Concord over two other candidates that had been considered on the basis that Concord proposed the most favourable structure, was one of Canada's largest mixed-use developers, and offered the highest net present value.

The Cadillac Fairview Transaction

73. Sears Canada entered into a transaction with Cadillac Fairview Corporation Limited ("Cadillac Fairview") for the sale of leases for five stores: the Toronto Eaton Centre, Sherway Gardens, Markville Shopping Centre, Masonville Place, and Richmond Centre. The total consideration proposed was $400 million.

74. The transaction was not initiated by the Company. Rather, it was initiated by a proposal from Cadillac Fairview and negotiations were led by Sears Canada's management with input as necessary from external advisors and various Board members.

75. Management had ranked the five stores in the Cadillac Fairview transaction in the top seventeen stores with real estate value exceeding trading value, with three being in the top ten. The divestiture of these assets was consistent with the Company's plan to right-size and re-focus its business. The consideration of $400 million represented a value of more than 26.1 times the four-wall trading EBITDA and greatly exceeded management's estimate of real estate value by approximately $158 million.

The Montez Transaction

76. Sears Canada entered into a transaction with Montez Income Properties ("Montez") for the sale of Sears Canada's 50% joint venture interest with Westcliff Group of Companies in eight shopping centres in Quebec for consideration of approximately $315 million.

77. Management advised the Board that this amount represented fair market value for these non-core real estate assets. The transaction allowed the Company to refocus is business by

exiting the joint venture arrangement while continuing to operate full-line stores in the eight shopping centres, with the leases being revised to account for Sears Canada being a tenant and not a landlord.

78. When announcing the transaction with Montez, the Company explained that "unlocking the value of assets is a lever we use as a way to help create total value. The joint venture assets we are selling to Montez impact neither our store operations nor our ability to serve customers. As such, our primary focus in creating long-term value remains on the basics of the business and continuing to become more relevant with Canadians coast to coast."

The Board Rejected Transactions Inconsistent with <u>the</u> Transformation Plan

79. Transactions proposed by management that were inconsistent with the Transformation Plan were not authorized by the Board. In particular, in late 2013 management proposed a transaction with Ivanhoe Cambridge to sell five store leases and its 15% joint venture interest in a shopping centre in Quebec. As with all potential real estate divestitures presented by management, the Board conducted a thorough review and consideration of this transaction to determine whether it was consistent with Sears Canada's strategy and long-term interests.

80. After careful consideration, the Board decided that the proposed transaction was not consistent with the objectives of the Transformation Plan, including the right-sizing of the retail footprint, since most of these locations were too valuable as operating stores to be divested. Accordingly, the Board declined to authorize management to pursue the proposed transaction.

All Transactions Were Driven by the Transformation Plan

81. These transactions did not represent a sale of the Company's "crown jewels", as alleged. In fact, the opposite is true. All of these transactions related to store locations where value as real estate assets far exceeded their trading value as operating stores. The sale of these assets was consistent with the Transformation Plan – the strategy approved by the Board to right-size the

Company's full-line store network and refocus Sears Canada's retail operations on its core customer base in suburban and smaller / rural locations while growing that business.

82. The Former Directors and Bird deny that any of these transactions was entered into for an improper purpose and deny that the divestment of these real estate assets in 2013 had any negative short term or long term impact on the Company, or in the alternative, could be foreseen to have a long-term negative impact.

83. In fact, these transactions were expected to generate positive results. In September 2013, management presented the 2014 financial and operating plan, with a focus on improving earnings through further cost savings, right-sizing, and targeted capital expenditures. The plan outlined various financial and operational improvements from the implementation of the Transformation Plan in the first half of 2013, including improvements in EBITDA of approximately $19 million (on a comparable basis) and in gross margin rate of approximately 66 basis points year over year.

84. The plan outlined a path, in light of retail market conditions, to achieve EBITDA ranging from 3.9% to 5% of total revenue with more moderate sales growth and projected cost savings initiatives totalling approximately $200 million in various areas of the business, including logistics and cost of goods sold over the next three years. It also incorporated the impact of the divestiture of full-line locations as part of the Company's continued right-sizing. Through the continued implementation of these initiatives, Sears Canada's EBITDA was projected to be $196 million by 2016 rather than the projected negative $105 million without such initiatives.

APPROVAL OF THE 2013 DIVIDEND

85. The four real estate transactions resulted in total cash consideration of $906 million, and management anticipated that Sears Canada would have cash on hand of approximately $1 billion at the end of fiscal year 2013. As a result, the Board determined in early November 2013 to consider the use of the proceeds, which would include consideration of the financial and

operational position of the Company, as well as future needs of the business, as Sears Canada implemented its strategic plan, at the Board meeting scheduled for November 18 and 19, 2013.

86. The process undertaken by the Board leading up to the approval of the 2013 Dividend was robust and consistent with good corporate governance practices. The approval of the 2013 Dividend by the Board was an exercise of informed business judgment.

The Board Was Aware of the Requirements for Declaring Extraordinary Dividends

87. Approximately one year earlier, on December 12, 2012, in the midst of implementing the Transformation Plan, Sears Canada declared an extraordinary dividend of $102 million (the "2012 Dividend"). Prior to the declaration of the 2012 Dividend, Sears Canada had anticipated cash and cash equivalents of approximately $400 million. As of year-end 2012, after paying the 2012 Dividend, Sears Canada had approximately $240 million in cash and cash equivalents.

88. Prior to approving the 2012 Dividend, the Board received a presentation which included an analysis of the impact of a dividend on the Company's financial position, including its liquidity position, cash, EBITDA and total debt, the anticipated cash requirements for operations, and a sensitivity assessment. This presentation reviewed the Board's governance considerations, and summarized the statutory solvency and process requirements under the *Canada Business Corporations Act*, R.S.C. 1985, c. C-44 (the "CBCA").

89. The Board also received confirmation from the chief financial officer, following consultation with the Company's auditor, Deloitte, that statutory solvency requirements were met, and was provided with an officer's certificate certifying that, among other things, there were no reasonable grounds for believing that Sears Canada was, or would be after the payment of the 2012 Dividend, unable to pay its liabilities as they became due.

90. In light of the Board's ongoing dialogue and consideration of the Company's business and operations throughout 2012, including at numerous Board meetings and otherwise, much of the information contained within this presentation was already known to the Board when the presentation was provided.

91. The process undertaken by management and the Board leading up to the declaration of the 2012 Dividend was robust and consistent with corporate best practices. The decision to declare the 2012 Dividend was an exercise of informed business judgment by the Board acting in the best interests of Sears Canada.

The Board Was Fully Informed and Engaged

92. The Board was provided with the information necessary for the consideration of a dividend in 2013, and the decision by the Board to approve the 2013 Dividend was informed by the analyses, presentations, and discussions that occurred during the November 18, 2013 meetings and the informal and formal meetings of the Board and the audit committee of the Board (the "Audit Committee"), which took place leading up to those meetings, and in the course of extensive dialogue among members of the Board.

93. In particular, in advance of the declaration of the 2013 Dividend, the Audit Committee, composed entirely of independent directors, met on February 26, March 14, May 21, August 20, and November 18, 2013. Additionally, in advance of the declaration of the 2013 Dividend, the Board met on January 30, March 14, April 24, April 25, April 29, May 21, June 13, July 16, September 4, September 5, September 23, October 11, October 28, and November 18, 2013.

94. Aside from formal meetings, members of the Board were in frequent contact not only around the scheduled meetings but also on an as-needed basis, and at least once per month. The Board was also informed by the analyses and discussions that occurred at such meetings in

advance of the Company declaring the 2013 Dividend and their experience and knowledge regarding practices and processes relating to a decision to declare a dividend.

95. In 2013, the Board received, among other things:

(a) annual operating plans which included detailed cash flow analyses, operating cash requirements, and capital expenditures relating to the ongoing business and the implementation of the Transformation Plan;

(b) regular updates on the financial and operational position of the Company, the status of the implementation of the Transformation Plan – including capital needs required to drive long-term growth in a manner consistent with this strategy, cash flow analyses and cash requirements, debt, and the status of pension funding, including at quarterly Board meetings and on monthly financial update calls; and

(c) regular updates on the implementation of Project Matrix, the divestiture of real estate assets, including at quarterly board meetings, at special purpose board meetings, by e-mail, and at informal Board meetings.

96. In light of the significant amount of information provided to the Board by management, in the summer of 2013 the Board was aware of the cash needs and operational requirements of the Company. In particular, from ongoing monthly and, at times, weekly discussions with management, the Board was aware that all transformation and operating plan projects were adequately funded and that no additional capital could be usefully deployed to enhance these projects and drive long-term growth for the Company.

97. In the summer of 2013, the Board was also aware, from reports provided by management and Towers Watson, that:

(a) the Plan had achieved investment gains of $134.3 million in 2012, which more than offset payments made to retirees, resulting in a net gain of $46.1 million;

(b) the Plan balance had increased by $32.1 million on a net basis in the first quarter after taking into account income, contributions and withdrawals, and pension payments. Overall, the Plan achieved a 4.57% return in that quarter; and

(c) the year-to-date return to June 30, 2013 was 5.61% and that there had been a net decrease in Plan assets of $12.2 million during the second quarter of 2013.

98. In September, October, and early November 2013, over multiple meetings of the Board, management provided analyses and other details relating to the business and operations of the Company, cash flows, and pending real estate transactions, all of which were discussed and considered by the Board. The financial performance updates in respect of the implementation of the Transformation Plan and annual operating plan provided by management to the Board in that period advised that the Company's EBITDA was improving as compared to the prior year as follows:

(a) regarding the September 2013 financial results, that EBITDA had improved by $2 million compared to September 2012;

(b) regarding the October 2013 financial results, that EBITDA had improved by $5.6 million compared to October 2012; and

(c) regarding the third quarter 2013 financial results, that EBITDA had improved by $11.7 million compared to October 2012 on a year-to-date basis and by $19.6 million on a comparable year-to-date basis.

99. As part of the preparation for the Board meeting scheduled for November 18 and 19, 2013, management prepared *pro forma* balance sheet, income statement, and cash flow analyses for the remainder of 2013 and 2014 and analyzed the impact of potential dividend scenarios. Based on these analyses, management determined that the difference between Sears Canada's cash-on-hand and cash needs to implement its strategic plan resulted in significant excess cash and would allow for a dividend of between $7 and $8 per share, assuming no debt.

100. The Board had previously agreed to consider the appropriate use of excess cash at its meeting in November. In advance of that Board meeting, the Board received and reviewed voluminous materials. In particular, the materials provided to the Board in advance of the Audit Committee meeting, which was attended by the entire Board, included:

(a) the draft third quarter results, MD&A and draft press release, as well as an analysis prepared by management relating to the Company's financial performance, factors relating to the retail sector, and accounting implications of divestiture of real estate assets;

(b) an analysis prepared by Deloitte relating to third quarter 2013 results; and

(c) an analysis regarding pending litigation.

101. In addition, the materials provided to the Board in advance of the Board meeting included

(a) an analysis outlining management's immediate priorities, including:

(i) building a long-term growth strategy by focusing on sustainable growth on a smaller asset base; and

(ii) generating cash from investing activities to create value and fund growth by selling assets deemed to be non-core;

(b) an analysis of asset valuation, which confirmed that there was a substantial core business remaining after the real estate divestitures;

(c) an analysis of operating efficiency, which included a plan to drive excess cost out of the business, allowing Sears Canada to meet 70% of its $200 million savings target in 2014 and an update on a “90 Day Program”, advising that top opportunities were being pursued that would yield $106 million in annual savings;

(d) an analysis of merchandising value, which included a category performance review, strategies to address gaps in operational performance and strategies to re-build Sears Canada’s value proposition with the goal of clearly and consistently standing for something in the minds of Canadian consumers; and

(e) a financial analysis prepared by the CFO together with the Company’s 2014 Financial Plan, which provided management’s view of the Company’s financial position and cash needs for 2014.

102. The Investment Committee met on November 14, 2013. At this meeting it received presentations prepared by Towers Watson and management relating to the Plan, which were relayed to the Board at the meeting, and confirmed that:

(a) the Plan had continued to improve. Returns were above benchmarks, at 8.3% year-to-date (to September 30) and 2.54% for the third quarter. The overall balance in the Plan had increased on a net basis by $10.2 million in that quarter;

(b) improvements from the Plan’s position as at December 31, 2012 were predicted. On a going concern basis, the Plan was forecasted to achieve a surplus of $77 million, up from a deficit of $15 million in 2012. The Plan’s solvency was forecasted to improve more than 50%, from a deficiency of $376 million in 2012 to a deficiency

of $162 million at the end of 2013. As set out above, the Plan beat the solvency forecast in 2013; and

(c) Sears Canada might not have to make any special payments to the Plan for the December 2013 valuation: “Funding would no longer by required for Dec. 31, 2013 valuation if interest rates were to increase approx 100-125bps and assets earn 5.5% per annum for 2013”.

Declaration of 2013 Dividend: Exercise of Business Judgment

103. On November 18 and 19, 2013, the Board met to review and consider a number of items, including the possible declaration of a dividend. This meeting was held in New York, consistent with the Board’s practice to have periodic meetings in both Toronto and New York.

104. The Board did not decide to authorize the 2013 Dividend at a “short pre-dinner discussion on November 18, 2013”, or without receiving any financial analyses or information from management, as alleged. In fact, in advance of the Board meeting, on November 18, 2013, the Audit Committee met to consider a number of matters. All of the members of the Audit Committee were independent directors. Consistent with past practice, all of the Board members attended the Audit Committee meeting. The Company’s auditor, Deloitte, also participated in the meeting and an in camera session with the committee members.

105. The presentation provided by management at this meeting indicated that the Company’s balance sheet and liquidity position remained strong, with significant cash on hand and no draw downs on the credit facility. The presentation also indicated that Sears Canada had approximately $1.66 billion in current assets, and provided information on real estate transactions completed, including the Oxford, Concord, Montez, and Cadillac Fairview transactions.

106. Additionally, Deloitte delivered a report on November 18, 2013 which noted that it had discussed a number of matters with management, including pending litigation, changes to pension discount rates and the required reserve, and the recent real estate transactions completed by the Company.

107. The real estate divestiture transactions, cash position, capital requirements and funding for turnaround projects, long-term growth, and possibility of declaring a dividend, including the potential amount of the dividend, were discussed by management and the Board during the Audit Committee meeting, with the benefit of the information provided to the Board in advance of and at the Audit Committee meeting.

108. The Board then discussed the potential dividend during the Board meeting held on November 18, 2013, following the Audit Committee meeting. At the Board meeting, the Board, among other things:

(a) received and considered a detailed presentation on management's priorities and asset valuation, including strategies aimed at long-term growth for the Company – all of which were fully funded;

(b) received a sensitivity analysis with respect to the payment of a potential dividend, and discussed and considered the timing and quantum of a dividend in light of the Company's operational and cash position, and the cash that would remain following payment, including in the event that:

(i) the Montez transaction entered into by Sears Canada, which was expected to close in January 2014, did not close; or

(ii) projected revenues and earnings were not achieved;

(c) received and considered a detailed presentation from the CFO regarding the financial and operational position of the Company, future cash requirements, cash flow and liquidity, and the impact of the payment of a dividend of $5 per share on the Company's financial and liquidity position in 2013 and 2014;

(d) received and considered a presentation from the chair of the Investment Committee regarding the Plan; and

(e) received confirmation from management, following consultation with Deloitte, that the statutory solvency requirements were met and received a certificate of solvency from the CFO prior to approving the 2013 Dividend.

109. All but two of the directors, Campbell and Ron Weissman, were members of the Board when Sears Canada had declared an extraordinary dividend less than one year earlier, after receiving legal advice about their duties in relation to declaring dividends. The Board, which was composed of highly skilled and experienced corporate directors with expertise in retail, finance, accounting, and law, had significant and specific experience relating to these duties. In addition, the Board had the benefit of the participation of both the general counsel and the assistant general counsel at the Audit Committee and Board meetings.

110. The two directors who were not members of the Board when it approved the 2012 Dividend were, like the other directors, satisfied that the 2013 Dividend was in the best interest of Sears Canada on the basis of the information provided to them in advance of and at the Audit Committee and Board meetings, their discussions with other members of the Board, and the information presented to the Board by management on November 18, 2013.

111. None of the Former Directors or Bird had a material relationship with Sears Holdings, ESL, or Lampert which could reasonably have been expected to interfere with their independent

judgment in supporting the 2013 Dividend. At all material times, and in particular on November 18, 2013, the Former Directors and Bird were not conflicted and exercised their independent judgment with a view to the best interests of Sears Canada in voting to approve the 2013 Dividend.[5] Historic relationships between some of the Former Directors or Bird and Sears Holdings, ESL, and Lampert specifically did not motivate any decisions whatsoever in which they participated as directors of Sears Canada.

112. Additionally, and in any event, the interests of all shareholders with respect to the Company's declaration of the 2013 Dividend were aligned, all shareholders were treated the same, and Sears Holdings, ESL and Lampert had the strongest interest in (and investment in) the ongoing financial and operational success of Sears Canada.

113. The 2013 Dividend was not driven or dictated by Sears Holdings, Lampert or ESL, or their need for funds. The Former Directors and Bird specifically deny the allegations that they approved or acquiesced in approving the 2013 Dividend or that Sears Canada paid the 2013 Dividend fraudulently and dishonestly for the purpose of benefiting Sears Holdings, Lampert and ESL in alleged disregard of the interests of the Plan or its beneficiaries.

114. Indeed, none of the decisions regarding Project Matrix, the divestiture of real estate assets, any other aspect of the Company's financial and operational plans, or the 2013 Dividend were in any way directed by or related to the financial needs of Sears Holdings, ESL or Lampert. There was no "plan to extract cash from Sears Canada" through the sale of real estate assets devised by Sears Holdings, ESL or Lampert, or at all. Even if there were such a plan, which is denied, the Former Directors and Bird were not generally or specifically aware of it, and they were certainly not participants.

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[5] Although Harker and Crowley were not considered to be independent under National Instrument 52-110, which relates to independence for the purpose of audit committee membership only, they were not members of the Audit Committee.

115. Rather, the process undertaken by management and the Board leading up to the declaration of the 2013 Dividend was robust and consistent with corporate best practices. Moreover, the decision was an exercise of informed business judgment by the Board acting in the best interests of Sears Canada, with knowledge that the Plan was in surplus on a going concern basis, that its solvency position had improved, and that the Company was intended to remain a going concern indefinitely.

116. On December 6, 2013, the 2013 Dividend was paid *pro rata* to Sears Canada's shareholders. Sears Canada was not insolvent or near insolvent when the 2013 Dividend was declared or paid and was not rendered insolvent by that payment. On the contrary, following that payment, approximately $513.8 million in cash still remained on Sears Canada's balance sheet, with virtually no debt, and its operations and plans for the future remained fully funded.

No Dividend in 2014: Exercise of Business Judgment

117. In March 2014, the Board considered the Company's cash position following the completion of the Montez transaction and the possibility of a further dividend. In particular, the Board reviewed two further dividend scenarios presented by management, valued at $1.50 per share and $2.50 per share, respectively.

118. At that time, the Board received a detailed presentation from management regarding the financial and operating results for the fourth quarter of 2013, the drivers for such results, and various initiatives being undertaken by management to improve performance.

119. Consistent with its approach to the consideration of the 2012 Dividend and the 2013 Dividend, the Board undertook a comprehensive review and consideration of the financial position and the potential impact of various dividend scenarios.

120. Ultimately, the Board decided not to declare a dividend. This decision was not the result of concerns about Sears Canada's long-term viability. Rather, the Board decided not to declare a dividend in early 2014 in light of Sears Canada's unexpected poor performance in the fourth quarter of 2013 and its resulting cash position, which was lower than expected.

121. As with the decision to declare the 2013 Dividend, the decision not to declare a dividend in 2014 was an exercise of informed business judgment by the Board acting in the best interests of Sears Canada.

THE PLAN'S STATUS AFTER THE DIVIDEND

122. After the 2013 Dividend was paid, Sears Canada continued to operate as a going concern and continued to meet its obligations to the Plan.

123. In fact, the funded status of the Plan continued to improve into 2014. For example, the Investment Committee met on February 25, 2014 and then on May 20, 2014. The information presented at these meetings indicated that the position of the Plan continued to improve. In the first quarter of 2014, the fund balance in the Plan had increased by a net $8.6 million.

124. The actuarial report provided to Sears Canada by Aon in June 2014 (which related to the Plan as at December 31, 2013) showed a positive going concern position of $14.6 million and a reduction in its solvency deficiency of over 60%, to $138.6 million. The Plan's solvency ratio was 0.95, well above the threshold set in the Pension Benefits Regime for identifying plans with solvency issues.

SUBSEQUENT EVENTS

125. Following the approval and payment of the 2013 Dividend, Sears Canada continued to obtain and rely on financial, strategic, and other advice from third party professionals and continued to carry on business in the normal course for three and a half years – until at least June

21, 2017. During that time, management and other employees of Sears Canada operated stores, sold goods, undertook marketing efforts, implemented new initiatives, and made strategic, business, financial, operational and other decisions.

126. However, after the Former Directors and Bird left Sears Canada, the Canadian retail market faced increasingly significant and unpredictable changes and stresses which posed new challenges for the continued successful operation of retailers, including Sears Canada. These events affected all segments of the retail market in Canada, including apparel, house wares, kitchen wares, office supplies, electronics, furnishings, toys, department stores, and jewellery. Numerous prominent retailers operating in Canada became insolvent, ceased operations, restructured, or reduced their footprint in the period immediately preceding Sears Canada's application for CCAA protection.

127. After payment of the 2013 Dividend, while the Former Directors remained on the Board and Bird remained an officer, Sears Canada's Board and management worked to implement strategies in the best interests of Sears Canada and the Company's share price and financial position remained strong. In 2014, the Company's shares traded as high as $17.12 per share and not lower than $8.56 per share.

128. However, after the Former Directors ceased to hold positions on the Board and Bird left the Company, new management ushered in and oversaw significant shifts in the Company's strategic direction, including with a plan known as "Sears 2.0". In 2016, the Company's shares never traded higher than $7 per share (lower than the low in 2014) and the average trading price was only $3.68 per share. By early 2017, Sears Canada was in a difficult financial position.

129. As late as January 28, 2017, Sears Canada operated 95 full-line department stores, 830 catalogue and on-line merchandise pick-up locations, and 14 outlet stores. At that time, it had current assets of over $1 billion, of which $235.8 million was cash, with shareholder equity in the

amount of $222.2 million. However, Sears Canada suffered a sudden, significant, and unexpected decline in early and mid-2017. In that period, cash on hand had fallen to $125.3 million and inventory on hand had increased to $648.1 million from $598.5 million. In addition, as of April 2017, the Company had incurred debt of $125 million under a term loan. By June 5, 2017 it had incurred additional debt of $33 million under a revolving credit facility.

130. Upon filing for CCAA protection, Sears Canada confirmed that the decline in financial performance was the result of market factors causing the decline of other retailers, as well as, among other things:

(a) unsustainable fixed costs from an overly broad retail footprint;

(b) the decline of the catalogue business and lower than expected conversion of catalogue customers to online customers; and

(c) the inability to secure an agreement for the management of credit and financial services operations.

NO BREACH OF ANY DUTIES

131. At all material times, Sears Canada complied with its obligations to the Plan under the Pension Benefits Regime in its distinct roles as administrator and plan sponsor.

No Breach of Duties as Sponsor

132. As sponsor, Sears Canada had a statutory obligation to fund the Plan in accordance with the Pension Benefits Regime. At all material times, Sears Canada complied with its duties as sponsor and, in particular, made all the funding contributions required by the Pension Benefits Regime.

133. As sponsor, Sears Canada did not owe fiduciary duties to the Plan or its members.

134. Provided that the sponsor complies with its funding obligations under the Pension Benefits Regime, decisions about whether to fund a pension plan above the minimum requirements are a matter of business judgment by the sponsor.

135. Sears Canada had no obligation to immediately liquidate the solvency deficiency, or the hypothetical wind up deficiency, of the Plan or otherwise fund the Plan above the statutory requirements.

136. The Former Directors and Bird did not owe any duties, whether fiduciary, statutory, or otherwise, to the Plan or its members. They complied at all times with the duties they owed to Sears Canada in relation to the Plan. The Former Directors and Bird had no duty to cause Sears Canada to fund the Plan above the statutory requirements or to immediately liquidate the solvency deficiency of the Plan.

137. The Former Directors and Bird did not owe any duty of care to the Plan or its members. In the alternative, they were not negligent in relation to Sears Canada's role as sponsor of the Plan. There was no reason in November 2013 to believe that it would be necessary to wind up the Plan three and a half years later.

No Breach of Duties as Administrator

138. As administrator of the Plan, Sears Canada had both statutory and fiduciary duties. Those duties relate primarily to the management and administration of the Plan. As set out above, Sears Canada adopted a robust pension governance structure, including the creation of an Investment Committee, and the retention of expert advisors.

139. The duty to fund a pension plan is not the duty of the administrator, but the duty of the sponsor. The administrator's duty in relation to funding is to ensure that the sponsor meets its

obligations, and to report to the regulator (the Superintendent of Financial Services) if the sponsor fails to do so.

140. At the time of the 2013 Dividend, Sears Canada had no duty (nor did the Former Directors and Bird) to consider or implement any additional funding contributions to the Plan. Sears Canada was not insolvent or near insolvent, and it was not foreseeable that it would become insolvent three and a half years later.

141. Sears Canada met its statutory and fiduciary duties in relation to the administration of the Plan at all times. Sears Canada was not negligent in its management and administration of the Plan. Sears Canada administered the Plan diligently.

142. The Former Directors and Bird did not owe any duties, whether fiduciary, statutory, or otherwise, to the Plan or its members. They complied at all times with the duties they owed to Sears Canada in relation to the management and administration of the Plan. The Former Directors and Bird had no duty to cause Sears Canada to fund the Plan above the statutory requirements or to immediately liquidate the solvency deficiency of the Plan. In the alternative, if they had any such duties, then they met those duties.

143. The Former Directors and Bird did not owe a duty of care to the Plan or its members in relation to the management and administration of the Plan. In the alternative, they were not negligent in relation to Sears Canada's role as administrator of the Plan

The 2013 Dividend Had No Impact on Sears Canada's Ability to Fund the Plan

144. The payment of the 2013 Dividend caused no harm to the Plan or its members. It had no impact on Sears Canada's ability to fund the Plan. As at February 1, 2014, Sears Canada had $513.8 million in cash. Although Sears Canada did not have a duty immediately to liquidate the solvency deficiency, or the hypothetical wind up deficiency, it had more than enough cash to

make the maximum contribution for 2014 permitted by the ~~Income Tax Act~~ ITA as reported in the 2013 Actuarial Report, being $133 million.

145. In any event, when the 2013 Dividend was declared and paid, the Former Directors and Bird had no reason to believe that Sears Canada would become insolvent three and a half years later – especially given the value of its assets and the fact that it had virtually no debt. They also had no reason to believe that the 2013 Dividend could have an impact on Sears Canada's ability to continue to make special payments to the Plan three and a half years later. On the contrary, they were actively planning to improve Sears Canada's performance and expected that Sears Canada would continue to operate indefinitely.

146. Sears Canada continued to meet its funding obligations up to the time of the commencement of CCAA proceedings. The decision in October 2017 to wind up the Plan was not made by the Former Directors or Bird.

NO OPPRESSION

147. None of the acts or omissions of the Former Directors or Bird was oppressive. Neither the Plan nor its beneficiaries had any reasonable expectation that Sears Canada would liquidate the solvency deficiency or the hypothetical wind up deficiency instead of paying the 2013 Dividend.

148. To the extent that the Plan members had any reasonable expectations in respect of the funding of the Plan, those expectations were that Sears Canada would comply with its statutory and common law duties as administrator and sponsor of the Plan. As set out above, it did so.

149. The payment of the 2013 Dividend did not have any impact on Sears Canada's ability to make contributions to the Plan that were required by the Pension Benefits Regime. It did not, therefore, oppress the Plan members, or prejudice or unfairly disregard their interests.

150. It was in the interests of the Plan members that Sears Canada continue to operate as a going concern and improve its performance. The Former Directors and Bird were actively engaged in attempting to achieve that by continuing to support and oversee management's plan to right-size Sears Canada's operations and thereby continue to carry on business in the ordinary course.

151. The 2013 Dividend could not be and was not oppressive on the basis that Sears Canada failed in 2017, after the Former Directors and Bird were no longer involved with the Company, and three and a half years after the 2013 Dividend was approved and paid.

NO KNOWING RECEIPT, NO UNJUST ENRICHMENT, NO CONSTRUCTIVE TRUST

152. There was no breach of any statutory, fiduciary, or other duty by any of the Former Directors or Bird, by Sears Canada, or by its Board. Harker and McBurney are therefore not liable for knowing receipt or unjust enrichment, and there is no basis for the imposition of a constructive trust over the dividend payments received by them.

153. Additionally, none of the elements of unjust enrichment is met. Neither Harker nor McBurney received an enrichment because a dividend is not an enrichment, but instead the conversion of a shareholder's interest from one form, the value of equity, to another, cash.

154. Moreover, neither the Plaintiff nor the Plan nor its members suffered any corresponding deprivation. Sears Canada paid the 2013 Dividend out of its own funds. At the time the 2013 Dividend was declared and paid, Sears Canada had made all contributions to the Plan that it was required to make. The Plan and its members had no entitlement to or claim over the funds used to pay the 2013 Dividend. In any event, even after payment of the 2013 Dividend, Sears Canada had sufficient cash to make all payments to the Plan that it was required to make, and it continued to make those payments for three and a half years. There was no proprietary nexus between the 2013 Dividend payment and the deficiency in the Plan determined on wind up in 2017.

155. Finally, there was a juristic reason for the payment received by Harker and McBurney. The 2013 Dividend was properly declared, in compliance with the CBCA, and once declared, the 2013 Dividend was payable to all shareholders of Sears Canada, including Harker and McBurney, who were legally entitled to receive it.

NO BREACH OF ANY OTHER DUTIES, NO KNOWING ASSISTANCE

156. The Former Directors and Bird did not breach their fiduciary duty or induce or knowingly assist anyone else to do so. They deny all other bases of alleged liability pleaded in the Amended Statement of Claim including, without limitation, knowing assistance and fraud.

NO LIABILITY OF NON-DIRECTOR

157. At the time the 2013 Dividend was approved, Bird was not a director of Sears Canada. He did not have any power to approve or reject the 2013 Dividend and thus cannot have any liability at law in respect of the 2013 Dividend. Bird did not instigate or urge the declaration of the 2013 Dividend or induce the Former Directors or the Board to breach any duties they owed to the Plan.

NO CAUSATION OF DAMAGES

158. For three and a half years after the 2013 Dividend, market events and corporate decisions made by management of Sears Canada intervened to shape the ultimate fate of Sears Canada. The 2013 Dividend did not cause or contribute to the deficiency in the Plan arising from the Company's CCAA filing. Even if the Former Directors and Bird had breached their duties, which is denied, none of their acts or omissions caused or contributed to any loss or damages.

FAILURE TO MITIGATE

159. Even if the Plan or its members suffered harm for which the Former Directors or Bird are liable, which is denied, the Plaintiff on behalf of the Plan and its members has failed to mitigate such damages, including by failing to assert the statutory trust provided for in the Pension Benefits Regime over Sears Canada's remaining estate.

160. Additionally, the Plaintiff, as administrator of the Plan, has failed to mitigate such damages by failing to make sound investment decisions for the Plan, which has denied the Plan and its members benefits from upward market trends that the Plan and its members would otherwise have realized.

THE ACTION IS TIME-BARRED

161. This action is time-barred. The declaration of the 2013 Dividend occurred on November 18, 2013. This action was commenced on December 19, 2018. That was over three years after the expiration of the two-year limitation period under section 4 of the *Limitations Act, 2002*, S.O. 2002, c. 24, Sch. B. (the "Limitations Act"). The Plaintiff's claim was discovered more than two years before this action was commenced.

THE ACTION SHOULD BE DISMISSED

162. The Former Directors and Bird plead and rely on the Pension Benefits Regime, the Limitations Act, the ITA, the CBCA, and the CCAA, and request that this action be dismissed with costs on a substantial indemnity basis.

May 10, 2019

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

MORNEAU SHEPELL LTD. Plaintiff	-and-	ESL INVESTMENTS INC. *et al.* Defendants

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

PROCEEDING COMMENCED AT TORONTO

AMENDED STATEMENT OF DEFENCE OF THE DEFENDANTS WILLIAM HARKER, WILLIAM CROWLEY, DONALD CAMPBELL ROSS, EPHRAIM J. BIRD, JAMES MCBURNEY and DOUGLAS CAMPBELL

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

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. (Set out in separate, consecutively numbered paragraphs each allegation of material fact relied on by way of defence.)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:

	2010	**2013**	**2015**
Going concern position	$(68,039,000)	$14,645,000	$29,936,000
Solvency ratio	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

STATEMENT OF DEFENCE

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

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SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

B E T W E E N:

1291079 ONTARIO LIMITED

Plaintiff

- and -

SEARS CANADA INC., SEARS HOLDINGS 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

1. The defendants R. Raja Khanna ("**Khanna**") and Deborah E. Rosati ("**Rosati**") deny the allegations contained in the plaintiff's fresh as amended statement of claim ("**Statement of Claim**"), unless expressly admitted herein.

Relationship with Sears Canada

2. 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***").

3. 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.

4. The defendant Khanna is a resident of Ontario and 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.

5. 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 Hometown Dealer Class Action and Subsequent Oppression Action

6. The plaintiff, 1291079 Ontario Limited, is the representative plaintiff in a class proceeding that it commenced in July 2013 against Sears Canada and Sears, Roebuck and Co.

7. In the 2013 class action, the plaintiff seeks up to $100 million in damages for breach of contract, negligent misrepresentation, and breaches of various provincial franchise legislation.

8. The action was certified as a class proceeding in September 2014. The class is defined as "all corporations, partnerships, and individuals carrying on business as a Sears Hometown Store under a Dealer Agreement with Sears [Canada] at any time from July 5, 2011 to the date of sending of the notice of certification".

9. Sears Canada defended the action on the basis that the claims asserted had no merit.

10. Sears Canada never disclosed any contingencies arising from the class action in its public disclosures.

The 2010 to 2013 Dividends

11. (Set out in separate, consecutively numbered paragraphs each allegation of material fact relied on by way of defence.)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.

12. 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;

(ii) it is unlikely that Sears Canada would be required to make payment in respect of any contingent liability within a reasonably foreseeable period; and

(iii) 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;

(d) the Board reviewed ongoing and detailed disclosure and analysis of the financial position and results of Sears Canada; and

(e) the Board determined that issuing each of the dividends was in the best interests of Sears Canada.

13. Contrary to what is alleged in the Statement of Claim, Rosati and Khanna did not authorize the 2013 dividend without sufficient scrutiny. At the time, Sears Canada had over $1 billion in cash, and limited debt. Its pension plan had a 95% solvency ratio.

Project Matrix

14. Contrary to what is alleged in the Statement of Claim, Sears Canada did not sell off certain leases as part of a nefarious conspiracy to generate cash to pay a dividend to benefit certain shareholders.

15. Sears Canada sold the leases identified in the Statement of Claim as part of a plan known within the company as "Project Matrix". The plan involved focusing on smaller suburban markets, where Sears Canada anticipated greater success, and reducing operations in major urban locations, where Sears Canada was struggling.

16. The purported "crown jewel" leases identified in the Statement of Claim were leases for stores that were located in urban centres and were inconsistent with the Project Matrix plan and/or were prime urban locations that were more valuable to Sears Canada as real estate assets than as operating stores.

17. Rosati and Khanna carefully considered each of the lease transactions before approving them based on detailed information from management.

18. Rosati and Khanna exercised their business judgment and acted in the best interests of Sears Canada in approving the lease transactions.

Sears Canada's Performance and CCAA Filing

19. Sears Canada's performance declined in the period following the 2013 dividend, with net losses beginning in 2014.

20. 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.

21. Factors contributing to Sears Canada's decline in financial performance in the subsequent period 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.

22. 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.

Business Judgment Rule

23. Rosati and Khanna exercised their business judgment when authorizing the lease transactions and the 2013 dividend. They acted in the best interests of Sears Canada when making those decisions and did not make those decisions to prefer any particular stakeholder over another.

24. The decisions to authorize the lease transactions and the 2013 dividend were reasonable and appropriate at the time those decisions were made. Upon payment of the 2013 dividend, Sears Canada remained readily solvent and had significant cash on hand, with little debt. The market continued to view Sears Canada as a valuable public company.

25. The decisions to authorize the lease transactions and the 2013 dividend are entitled to deference under the business judgment rule.

No Oppression

26. The plaintiff and the class members are not proper "complainants" under section 238 of the *CBCA*.

27. The oppression provisions of the *CBCA* do not permit the plaintiff or class members to be the oppressed persons. Pursuant to section 241(2) of the *CBCA*, the oppressive conduct must be directed to a "security holder, creditor, director or officer" – not a plaintiff with an unproven claim. Accordingly, the claim for oppressive conduct must fail.

28. At the time the 2013 dividend was authorized, the 2013 class action had not even been certified, let alone adjudicated on the merits. Accordingly, contrary to what is alleged in the Statement of Claim, the plaintiff and class members were not creditors of Sears Canada; rather, they were contingent creditors with unliquidated, weak claims that were unlikely to succeed on the merits.

29. The plaintiff and class members did not hold the reasonable expectations alleged in the Statement of Claim. To the extent they held those expectations, it was not reasonable for them to do so in the circumstances.

30. Rosati's and Khanna's actions in authorizing the lease transactions and the 2013 dividend were not oppressive or unfairly prejudicial to and did not unfairly disregard the interests of the plaintiff or the class members.

31. The plaintiff and class members are not entitled to oppression relief as no case for oppression is made out. No reasonable expectations of any valid stakeholder were thwarted, and there is no basis for statutory liability.

No Losses or Damage

32. Rosati and Khanna deny that the plaintiff or class members have incurred losses or damages as alleged in the Statement of Claim, or at all. Alternatively, if the plaintiff or class members did incur any losses or damage (which is expressly denied):

(a) they are not responsible at law for any such losses or damage;

(b) any such losses or damages claimed are excessive, exaggerated and/or too remote to be recoverable at law;

(c) any such losses or damage were not caused by any negligence, act, omission, breach of duty, breach of contract or breach of any other legal obligation on the part of the defendants in fact or in law; and

(d) the plaintiff and class members have failed to take reasonable or any measures to reasonably mitigate their damages.

33. The defendants Rosati and Khanna claim all rights of legal and equitable set-off that may be available to them.

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

July 29, 2019

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APPENDIX "C"

SETTLEMENT AND RELEASE AGREEMENT

THIS SETTLEMENT AND RELEASE AGREEMENT is made as of July 27, 2020, between Sears Canada Inc. ("**Sears**") by its Court-Appointed Litigation Trustee, J. Douglas Cunningham, Q.C. (the "**Litigation Trustee**") in proceedings pursuant to the *Companies' Creditors Arrangement Act,* R.S.C. 1985, c. c-36, as amended ("**CCAA**") (the "**CCAA Proceedings**"); FTI Consulting Canada Inc. in its capacity as Court-appointed monitor (the "**Monitor**") in the CCAA Proceedings; Morneau Shepell Ltd., in its capacity as administrator of the Sears Canada Inc. Registered Retirement Plan (the **"Plan**") as appointed under the *Pension Benefits Act* (the "**Pension Administrator**"); and 1291079 Ontario Limited ("**129**") in its capacity as representative plaintiff in the class proceeding certified pursuant to the order of McEwen J. dated June 21, 2019 in Court File No. CV-19-617792-00CL (the Monitor, the Litigation Trustee, the Pension Administrator, and 129, collectively, the "**Plaintiffs**"), the Chief Executive Officer of the Financial Services Regulatory Authority of Ontario ("**FSRA**") as administrator of the Pension Benefits Guarantee Fund (Ontario), and Ephraim J. Bird, Douglas Campbell, William C. Crowley, William R. Harker, R. Raja Khanna, James McBurney, Donald C. Ross, and Deborah E. Rosati (the "**Former Directors**") (each individually, a "**Party**", and collectively, the "**Parties**").

WHEREAS, pursuant to an order of the Ontario Superior Court of Justice (Commercial List) (the "**Court**") dated June 22, 2017, Sears and its affiliates (together the "**CCAA Applicants**") obtained protection under the CCAA*,* and the Monitor was appointed;

WHEREAS, pursuant to an order of the Court dated December 3, 2018 (the "**LT Order**"), the Litigation Trustee was appointed and empowered to prosecute certain claims including, *inter alia*, the power to settle or compromise any such proceeding, in whole or in part, in consultation with the Monitor and subject to further order of the Court;

WHEREAS the Plaintiffs commenced actions in Court File Nos. CV-18-00611219-00CL, CV-18-00611214-00CL, CV-18-00611217-00CL, and CV-19-00617792-00CL against the Former Directors and others arising from a dividend declared and paid by Sears in 2013 (collectively the "**Actions**");

WHEREAS Sears has proposed a plan of compromise and arrangement in respect of the CCAA Applicants;

WHEREAS the Parties have engaged in arm's-length, good faith negotiations to resolve the Actions as against the Former Directors;

WHEREAS, through a judicial mediation process and otherwise the Parties have negotiated a settlement that will resolve the Actions and all Released Claims whatsoever against the Former Directors and bring value to the Plaintiffs;

WHEREAS the Former Directors deny liability in respect of the Claims alleged in the Actions and believe that they have good and reasonable defences to the Actions;

WHEREAS the Former Directors assert that they would vigorously defend the Actions if they were not resolved;

WHEREAS it is essential to the Former Directors and the Insurers (as defined below) that by virtue of this Settlement Agreement, all Released Claims (as defined below) be fully and finally resolved on the Effective Date so as to bring finality to their potential liability for Released Claims, and without such finality, the financial contributions under the Settlement Agreement would not have been made;

WHEREAS the Parties agree that the Approval Order (as defined below) and the Settlement Agreement provide finality to the Released Parties for the Released Claims on the Effective Date; and

WHEREAS the Plaintiffs intend to continue to pursue Non-Settling Defendants (as defined below) in the Actions but only in respect of the Non-Settling Defendants' proportionate share of liability;

NOW THEREFORE in consideration of the covenants set out below and the representations made in the Recitals above and for other good and valuable consideration, the receipt and sufficiency of which are acknowledged, and subject to the provisions set out herein respecting Court approval of this settlement and its material terms, the Parties agree as follows:

1. Definitions and Interpretation

(a) Definitions

"**Approval Order**" means an order of the Court acceptable to the Former Directors, Insurers, and the Plaintiffs approving this Settlement Agreement, containing the terms required in this Settlement Agreement and making the declarations set out

herein. For greater certainty, an order of the Court substantially as set out in Schedule "C" hereto is acceptable to the Released Parties and the Plaintiffs.

"**CCAA Plan**" means the Joint Plan of Compromise and Arrangement filed by the CCAA Applicants in the CCAA Proceedings, as may be amended, modified or supplemented from time to time in accordance with the terms thereof.

"CCAA Supervising Judge" shall mean the judge of the Court assigned to supervise the CCAA Proceedings.

"Claim" means any and all manner of actions, causes of action, counterclaims, cross-claims, third (or subsequent) party claims, proceedings, suits, debts, dues, accounts, bonds, covenants, contracts, complaints, rights, obligations, claims, and demands, or other related proceedings of any nature or kind whatsoever (including, without limitation, any proceeding in a judicial, arbitral, administrative or other forum) of any Person that has been, could have been, or may be asserted or made against any other Person, whether personal or subrogated, existing or possible, asserted or made, known or unknown, existing or potential, suspected or unsuspected, actual or contingent, liquidated or unliquidated, in whole or in part, for damages of any kind, based in any way whatsoever upon, arising in any way whatsoever out of, relating in any way whatsoever to, or in connection in any way whatsoever with, any conduct anywhere, from the beginning of time to the date of the Approval Order.

"Defense Expenses" has the meaning ascribed to it in the XL Policy.

"**D&O Claim**" means a Claim against the Former Directors based in any way whatsoever upon, arising in any way whatsoever out of, relating in any way whatsoever to the Former Directors' role, decisions, acts, and omissions (i) as employees, officers, directors of, or consultants to, Sears and/or (ii) relating to the business, operations, and other affairs of Sears (even if allegedly undertaken in the Former Directors' capacity as employees, officers, directors, or consultants of another corporation or entity), including any matters that were raised or could have been raised in the Actions and any D&O Claims (as defined in the CCAA Plan) regardless of whether such Claims were filed or required to be filed in accordance with the CCAA claims process.

"**Effective Date**" means the date on which the conditions precedent set out in Section 7 herein have been satisfied or waived and the Settlement Funds have been paid.

"**Final Order**" means any order that is no longer subject to (a) any application to amend, vary, or set aside that has not been dismissed; and (b) any appeals, either because the time to appeal has expired without an appeal being filed, or because it has been affirmed by any and all courts with jurisdiction to consider any appeals therefrom.

"Insurance Claim" means a Claim that may be asserted against an Insurer relating to, or arising out of, a D&O Claim or Other Insured Claim.

"**Insurance Policies**" means, collectively, the insurance policies listed in **Schedule "A"**, which are directors' and officers' insurance policies issued to Sears Holdings Corporation as named insured and covering the period from May 15, 2015 to May 15, 2016.

"**Insured Persons**" has the meaning ascribed to it in the XL Policy.

"**Insurers**" means the insurance companies that issued the Insurance Policies;

"Loss" has the meaning ascribed to it in the XL Policy.

"Minutes of Settlement" means the Minutes of Settlement dated July 16, 2020 in the Actions.

"Non-Settling Defendants" means the defendants in the Actions other than the Former Directors.

"**Other Insured**" means any Insured Person other than a Former Director.

"Other Insured Claim" means a Claim against an Other Insured with respect to Loss arising from one or more Wrongful Acts of that Other Insured undertaken in that person's capacity as an Insured Person.

"**Person**" means and includes an individual, a natural person or persons, a group of natural persons acting as individuals, a group of natural individuals acting in

collegial capacity (e.g., as a committee, board of directors, etc.), a corporation, partnership, limited liability company or limited partnership, a proprietorship, joint venture, trust, legal representative, or any other unincorporated association, business organization or enterprise, any government entity and any successor in interest, heir, executor, administrator, trustee, trustee in bankruptcy, or receiver of any person or entity, wherever resident in the world.

"**Plan Beneficiary**" means the members, former members, retirees and beneficiaries under the Plan.

"**Released Claims**" means, collectively,

(i) D&O Claims;

(ii) Insurance Claims; and

(iii) Other Insured Claims.

"Released Parties" means, collectively,

(i) the Former Directors;

(ii) the Insurers; and

(iii) the Other Insureds solely in regard to Other Insured Claims against such Other Insureds.

"**Sanction Order**" means the order sanctioning the CCAA Plan as amended as described in this Settlement Agreement.

"**Settlement Agreement**" means this agreement.

"**Settlement Funds**" means the amount of CAD $50 million.

"Wrongful Acts" has the meaning ascribed to it in the XL Policy.

"XL Policy" means Cornerstone A-Side Management Liability Insurance Policy No. ELU139030-15 issued by XL Specialty Insurance Company to Sears Holding Corporation.

(b) Interpretation

This Settlement Agreement shall be interpreted applying the following rules of interpretation:

i. any reference in the Settlement Agreement to an order, agreement, contract, instrument, release, exhibit or other document means such order, agreement, contract, instrument, release, exhibit or other document as it may have been or may be validly amended, modified or supplemented;

ii. the division of the Settlement Agreement into "sections" is for convenience of reference only and it does not affect the construction or interpretation of the Settlement Agreement, nor are the descriptive headings of the "sections" intended as complete or accurate descriptions of the content thereof;

iii. unless the context otherwise requires, words importing the singular shall include the plural and vice versa, and words importing any gender shall include all genders;

iv. the words "includes" and "including" and similar terms of inclusion shall not, unless expressly modified by the words "only" or "solely", be construed as terms of limitation, but rather shall mean "includes but is not limited to" and "including but not limited to", so that references to included matters shall be regarded as illustrative without being either characterizing or exhaustive;

v. unless otherwise specified, all references to time herein and in any document issued pursuant hereto shall mean local time in Toronto, Ontario and any reference to an event occurring on a Business Day (as defined in the CCAA Plan) shall mean prior to 5:00 p.m. (Toronto time) on such Business Day;

vi. unless otherwise specified, time periods within or following which any payment is to be made or act is to be done shall be calculated by excluding the day on which the period commences and including the day on which

the period ends and by extending the period to the next succeeding Business Day if the last day of the period is not a Business Day;

vii. unless otherwise provided, any reference to a statute or other enactment of parliament or a legislature includes all regulations made thereunder, all amendments to or re-enactments of such statute or regulations in force from time to time, and, if applicable, any statute or regulation that supplements or supersedes such statute or regulation; and

viii. references to a specified "article" or "section" shall, unless something in the subject matter or context is inconsistent therewith, be construed as references to that section of the Settlement Agreement, whereas the terms, "hereof, "herein", "hereto", "hereunder" and similar expressions shall be deemed to refer generally to the Settlement Agreement and not to any particular section or other portion of the Settlement Agreement and include any documents supplemental hereto.

2. MOTIONS FOR SETTLEMENT APPROVAL

(a) Settlement Approval

The Parties shall use their best efforts to implement the Settlement Agreement and, among other things, to secure the prompt, complete, and final dismissal, with prejudice and without costs, of the Actions as against the Former Directors pursuant to the Approval Order. The Parties shall consent to all orders, including the Approval Order, required to implement the Settlement Agreement provided that they are consistent with the terms of this Settlement Agreement.

(b) 1291079 Ontario Limited Action

129 shall immediately upon execution of this Settlement Agreement, and at its own expense, implement such steps as are necessary under the *Class Proceedings Act, 1992*, S.O. 1992, c. 6 to obtain the Approval Order. The Parties hereto agree that the steps shall include a motion for notice approval, the provision of notice to the Class and settlement approval of the Ontario Superior Court of Justice (Commercial List), all brought before the CCAA Supervising Judge (or such judge as the CCAA Supervising Judge shall designate) who the Parties shall seek to

have designated as the Class Proceedings Judge for the purposes of settlement approval as soon as practicable and so that the Approval Order is binding on 129 and the Class.

3. PAYMENTS

(a) Payments

The Former Directors shall cause the Insurers to pay the Settlement Funds by wire transfer of immediately available funds to the Monitor within 10 Business Days following the Approval Order (containing the terms required herein) becoming a Final Order. Payment of the Settlement Funds will be the sole responsibility of the Insurers and the Former Directors will have no personal obligation to pay the Settlement Funds. Payment of the Settlement Funds to the Monitor shall be in trust for the Plaintiffs.

(b) Use of the Settlement Funds

Payment of the Settlement Funds shall be in full and final satisfaction of all Released Claims. For greater certainty, the settlement shall not be dependent on the Plaintiffs reaching agreement amongst themselves as to allocation of the Settlement Funds as among the Plaintiffs or the Actions. This Settlement Agreement shall be effective with or without the allocation being finalized.

(c) No Further Contributions, Liability or Exposure

Notwithstanding any other provision of the CCAA Plan or the Settlement Agreement, and without in any way restricting, limiting or derogating from the releases provided herein and in the CCAA Plan, or in any way restricting, limiting or derogating from any other protection provided for herein and in the CCAA Plan to the Released Parties, under no circumstances shall the Released Parties be required to or be called upon to make any further financial contribution or payment on account of any Released Claims, nor shall the Former Directors or the Insurers have any liability whatsoever for or have any exposure whatsoever to anything directly or indirectly, related to, arising out of, based on, or connected with any Released Claims, over and above the payment of the Settlement Funds, which payment is solely the responsibility of the Insurers. Costs associated with any

notice to claimants required in connection with the CCAA Plan or the Settlement Agreement shall not be paid by the Released Parties. The Settlement Funds are the full monetary contribution and payment of any kind to be made by the Released Parties in consideration of the settlement and release of the Released Claims, and are inclusive of all costs, interest, legal fees, taxes (including any GST, HST, or any other taxes that may be payable in respect of the CCAA Plan or the Settlement Agreement) and other costs associated with any distributions, further litigation, administration or otherwise. For greater certainty, an Other Insured shall be released under this Settlement Agreement and shall be required to make no further financial contribution only with respect to Other Insured Claims.

4. RELEASES AND BAR ORDER/INJUNCTIONS

(a) Release

On or prior to the Effective Date of this Settlement Agreement, the Plaintiffs will execute and provide to the Former Directors and the Insurers a release in the form attached hereto as **Schedule "B"**. In the event that any of the Plaintiffs fails to execute the release, so long as the conditions precedent set out this Settlement Agreement are satisfied, the release shall be effective notwithstanding such failure to execute the form of release.

(b) Approval Order

The Monitor and the Litigation Trustee will, at the expense of Sears, seek an order from the CCAA Court substantially in the form attached hereto as **Schedule "C"** on notice to the service lists in the Actions and the CCAA Proceeding as well as any parties that the Insurers identify to the Plaintiffs, not less than 14 days prior to the scheduled date for the Approval Order motion, as potential claimants under the Insurance Policies.

(c) Dismissal Orders

The Plaintiffs will obtain orders dismissing the Actions as against the Former Directors, without costs, immediately upon receipt of the Settlement Funds.

(d) Acknowledgement that Knowledge not Complete

For greater certainty, the Parties acknowledge that they may subsequently discover facts adding to those they now know, but nonetheless agree that on the Effective Date, all of the protections provided for herein (including the protections in section 4 of this Settlement Agreement) for the Parties and the Released Parties shall be definitive and permanent irrespective of whether any subsequently discovered facts were unknown, unsuspected, or not disclosed.

By means of this Settlement Agreement, the Parties waive any right they might have under the law, common law, civil law, in equity or otherwise, to disregard or avoid the protections provided for herein (including the protections in section 4 of this Settlement Agreement) and expressly relinquish any such right and each member of the Class and each Plan Beneficiary and any party that may be subrogated to such claims shall be deemed to have waived and relinquished such right in respect of Released Claims or any Claims related to the subject matter of the Actions. Furthermore, the Parties agree to this waiver of their own volition, with full knowledge of its consequences and that this waiver was negotiated and constitutes a key element of the Settlement Agreement.

5. COOPERATION

(a) Testimony

If requested by the Plaintiffs, the Former Directors shall appear and give sworn evidence as witnesses at the trials of the Actions as against the Non-Settling Defendants. Sears Canada shall pay the legal costs of the Former Directors' current counsel (Cassels Brock & Blackwell LLP and Bennett Jones LLP) in connection with the Former Directors' preparation for testimony at the trials of the Actions in an amount not to exceed CAD $100,000 in the aggregate.

(b) Public Disclosures

Public statements about the settlement by the Parties shall be consistent with the language, tone and parameters of the following:

> The claims in the Ontario Superior Court against certain former directors of Sears Canada Inc. relating to their consideration and approval of the payment of a $509 million dividend in November 2013 have been resolved by way of settlement agreement. The

settlement does not constitute an admission of liability or wrongdoing by the former directors and such are expressly denied by the former directors. The claims brought included claims against the directors of Sears Canada Inc. in its capacity as administrator of the Sears pension plan. FSRA's view, as the regulator of pension plans in Ontario, is that directors of pension administrators have an obligation to consider the interests of plan beneficiaries in their decision-making. The Sears pension plan, which was funded in accordance with statutory requirements, had a solvency deficit at the time the dividend was approved. When the plan was wound up in October 2017, it had an estimated $260 million wind up deficit. The settlement agreement provides for the payment of $50 million through D&O insurance coverage, together with other specified terms. None of the allegations were proven in court as the matter settled against the former directors prior to trial.

6. CCAA PLAN

(a) Amendment to the CCAA Plan

The CCAA Plan will be amended to provide for full and complete releases in favour of the Former Directors consistent with this Settlement Agreement. The amendments to the CCAA Plan (including the wording of the release) will be in a form and substance acceptable to the Former Directors, acting reasonably.

The Monitor will, at Sears Canada's expense and subject to approval of the CCAA Plan by the requisite majorities of the creditors, seek approval of the amended CCAA Plan from the Court on notice to the service list in the CCAA proceeding in respect of Sears Canada as well as any parties identified by the Insurers to the plaintiffs not less than 14 days prior to the scheduled date for the Sanction Order.

(b) Indemnity Claims

The Former Directors will waive any distribution on account of their indemnity claims and release such indemnity claims filed in the CCAA proceeding to the extent that they relate to the subject matter of the Actions.

7. CONDITIONS PRECEDENT

The terms of this Settlement Agreement are conditional upon the fulfillment (or waiver as applicable) of the following conditions:

(a) Granting of the Approval Order

The Approval Order shall have been granted by the Court.

The Former Directors, in their sole discretion, may waive this condition in full or in part and elect to proceed with the settlement if the Approval Order is granted but does not contain all of the terms of the draft order set out at **Schedule "C"**. The Former Directors will have 10 Business Days from the making of such order that does not contain all of the terms of the draft order set out at **Schedule "C"** to advise the Plaintiffs whether they are waiving this condition or terminating the settlement. If the Former Directors do not advise within such 10 Business Day period that they are terminating the settlement, then the condition shall be deemed waived. If this condition is not satisfied or waived (and not deemed waived), the Former Directors shall have the absolute right to terminate the settlement and the parties will not be bound by this Settlement Agreement.

(b) Expiry of Appeal Periods

The Approval Order shall have become a Final Order.

(c) Release

The Plaintiffs executing and delivering a release in the form attached as **Schedule "B"** or such release being deemed effective in accordance with Section 4(a).

For greater certainty, the CCAA Plan and Sanction Order shall be supplemental to, and shall not derogate from, the releases and injunctions set out in this Settlement Agreement and the Approval Order. The effectiveness of this Settlement Agreement shall not be conditional upon the granting of the Sanction Order or the implementation of the CCAA Plan.

8. EFFECT OF SETTLEMENT

(a) No Admission of Liability

Neither this Settlement Agreement, nor anything contained herein, shall be interpreted as a concession or admission of wrongdoing or liability by the Released Parties, or as a concession or admission by the Released Parties of the

truthfulness or merit of any claim or allegation asserted in the Actions. Neither this Settlement Agreement, nor anything contained herein, shall be used or construed as an admission by the Released Parties of any fault, omission, liability or wrongdoing whatsoever. Any and all liability or wrongdoing is expressly denied.

(b) Agreement Not Evidence

Except as required (i) to defend against the assertion of Released Claims, (ii) to enforce the terms of the Settlement Agreement, (iii) in the Actions, (iv) in the CCAA Proceedings, or (v) in other proceedings as evidence of the scope of this Settlement Agreement, neither this Settlement Agreement, nor anything contained herein, nor any of the negotiations or proceedings connected with it, nor any related document, nor any other action taken to carry out the Settlement Agreement shall be, offered as evidence or received in evidence in any pending or future civil, criminal, quasi-criminal, regulatory or administrative action or proceeding.

9. DISMISSAL OF ALL ACTIONS AGAINST THE FORMER DIRECTORS

Pursuant to the Approval Order, all Claims in the Actions as against the Former Directors shall be dismissed, without costs and with prejudice. The Approval Order shall provide that the Plaintiffs shall be permitted to recover from the Non-Settling Defendants only the amount of recovery that reflects the proportion of liability attributable to the Non-Settling Defendants, as determined by the trial judge hearing the Actions as against the Non-Settling Defendants.

10. MISCELLANEOUS

(a) Entire Agreement

This Settlement Agreement and the documents referred to herein together constitute the entire agreement between the Parties with respect to the matter herein. The execution of this Settlement Agreement has not been induced by, nor do any of the Parties rely upon or regard as material, any representations,

promises, agreements or statements whatsoever not incorporated herein and made a part hereof.

(b) Governing Law

This Settlement Agreement shall be governed by, and will be construed and interpreted in accordance with, the laws of the Province of Ontario and the laws of Canada applicable in the Province of Ontario. The Parties hereby attorn to the jurisdiction of the Court in respect of any dispute arising from this Settlement Agreement.

(c) Amendment

No amendment, supplement, modification or waiver or termination of this Settlement Agreement and, unless otherwise specified, no consent or approval by any Party, is binding unless executed in writing by the party to be bound thereby. Any failure by any Party to insist upon the strict performance by the other Party of any of the provisions of this Agreement shall not be deemed a waiver of any of the provisions hereof, and such Party, notwithstanding such failure, shall have the right thereafter to insist upon strict performance of any and all of the provisions of this Agreement to be performed by such other Party.

(d) Expenses

Each of the Parties (and in the case of the Former Directors, the Insurers) shall pay their respective legal, accounting, and other professional advisory fees, costs and expenses incurred in connection with this Settlement Agreement and its implementation.

(e) Counterparts

This Settlement Agreement may be executed in counterparts, each of which shall be deemed to be an original and which together shall constitute one and the same agreement. Delivery of an executed original counterpart of a signature page of this Settlement Agreement by facsimile or electronic transmission shall be as effective

as delivery of a manually executed original counterpart of this Settlement Agreement.

(f) Motions for Directions

To the extent that there is any dispute among the Parties regarding this Settlement Agreement, such dispute shall be decided by Justice Hainey on a summary basis or, in the event Justice Hainey is unable to do so, by another judge of the Court to be designated by Justice Hainey or the Commercial List office.

(g) Negotiated Agreement

The Settlement Agreement has been the subject of negotiations and many discussions among the Parties. Each of the Parties has been represented and advised by competent counsel, so that any statute, case law, or rule of interpretation or construction that would or might cause any provision to be construed against the drafters of the Settlement Agreement shall have no force and effect. The Parties further agree that the language contained in or not contained in previous drafts of the Settlement Agreement, or any agreement in principle, shall have no bearing upon the proper interpretation of the Settlement Agreement.

(h) Acknowledgements

Each of the Parties hereby represents and warrants that

i. Subject to Court approval in the case of the Monitor, the Litigation Trustee and 129, the Party has all requisite corporate power and authority to execute, deliver and perform the Settlement Agreement and has been duly authorized to do so;

ii. the Settlement Agreement has been duly and validly executed and delivered by the Party and, subject to Court approval in the case of the Monitor, the Litigation Trustee and 129, constitutes legal, valid, and binding obligations;

iii. the terms of the Settlement Agreement and the effects thereof have been fully explained to him, her or its representative by his, her or its counsel;

iv. he, she or its representative fully understands each term of the Settlement Agreement and its effect; and

v. he, she or its representative have required and consented that this Settlement Agreement and all related documents be prepared only in English; les parties reconnaissent avoir exigé que la présente convention et tous les documents connexes soient rédigés seulement en anglais.

The representations and warranties contained in the Settlement Agreement shall survive its execution and implementation.

(i) Plaintiffs' Acknowledgements

The Litigation Trustee and the Monitor hereby represent and warrant that

i. the Creditors' Committee (as defined in the LT Order) does not object to the Litigation Trustee and the Monitor entering into this Agreement or performing any of their obligations hereunder; and

ii. the Plaintiffs have not assigned or otherwise transferred any of or part of the Released Claims to any of their parents, subsidiaries, affiliated or related entities or any person or entity or to any other Person.

(j) Notices

Any notice, instruction, motion for court approval or motion for directions or court orders sought in connection with the Settlement Agreement or any other report or document to be given by any of the Parties to any of the other Parties shall be in writing and delivered personally, by facsimile or e-mail during normal business hours, or sent by registered or certified mail, or courier postage paid as follows:

Ephraim J. Bird, Douglas Campbell, William C. Crowley,
William R. Harker, James McBurney, Donald C. Ross
c/o Cassels Brock & Blackwell LLP
2100 Scotia Plaza
40 King St West
Toronto, ON M5H 3C2

Attention: Lara Jackson, John Birch, Natalie Levine, and John M. Picone
Fax: 416 640 3207
Email: ljackson@cassels.com
jbirch@cassels.com
nlevine@cassels.com
jpicone@cassels.com

R. Raja Khanna and Deborah Rosati
c/o Bennett Jones LLP
100 King St W
Suite 3400
Toronto, ON M5X 1A4

Attention: Richard Swan and Jason Berall
Fax: 416 863 1716
Email: swanr@bennettjones.com
berallj@bennettjones.com

SEARS CANADA INC.,
by its Court-appointed Litigation Trustee, J. Douglas Cunningham, Q.C.
c/o Lax O'Sullivan Lisus Gottlieb LLP
145 King Street west
Suite 2750
Toronto, ON M5H 1J8

Attention: Matthew P. Gottlieb
Fax: 416 598 3730
Email: mgottlieb@lolg.ca

FTI CONSULTING CANADA INC.,
in its capacity as court-appointed Monitor in proceedings pursuant to the CCAA
c/o Norton Rose Fulbright Canada LLP
Royal Bank Plaza, South Tower
222 Bay Street, Suite 3000, P.O. Box 53
Toronto, ON M5K 1E7

Attention: Orestes Pasparakis/Robert Frank/Evan Cobb
Fax: 416 216 3930
Email: orestes.pasparakis@nortonrosefulbright.com
robert.frank@nortonrosefulbright.com
evan.cobb@nortonrosefulbright.com

MORNEAU SHEPELL LTD.,
in its capacity as administrator of the Sears Canada Inc. Registered Retirement Plan
c/o Blake Cassels & Graydon LLP
199 Bay Street
Suite 4000
Toronto ON M5L 1A9

Attention: Michael Barrack
Fax: 416 863 2653
Email: michael.barrack@blakes.com

1291079 ONTARIO LIMITED
c/o Sotos LLP
180 Dundas Street West
Suite 1200
Toronto, ON M5G 1Z8

Attention: David Sterns
Fax: 416 977 0717
Email: dsterns@sotosllp.com

and

c/o Blaney McMurtry LLP
2 Queen Street East
Suite 1500
Toronto, ON M5C 3G5

Attention: Lou Brzezinski
Fax: 416 594 5084
Email: lbrzezinski@blaney.com

Financial Services Regulatory Authority of Ontario
c/o Paliare Roland Rosenberg Rothstein LLP
155 Wellington Street West, 35th Floor
Toronto, ON M5V 3H1

Attention: Lily Harmer
Fax: 416.646.4301
Email : lily.harmer@paliareroland.com

or to such other address as any party may from time to time notify the others in accordance with this section. Any such communication so given or made shall be deemed to have been given or made and to have been received on the day of delivery if delivered, or on the day of faxing or emailing, provided that such day in either event is a Business Day and the communication is so delivered, faxed or emailed before 5:00 p.m. (Toronto time) on such day. Otherwise, such communication shall be deemed to have been given and made and to have been received on the next following Business Day.

(k) Further Assurances

The Parties all covenant and agree:

i. to pursue as promptly as practicable court approval of the Settlement Agreement and the granting of the Approval Order in an expedited and commercially reasonable fashion;

ii. to amend the CCAA Plan (as provided herein), hold a meeting of creditors, if approved by the requisite majority of creditors, seek court sanction of the CCAA Plan, and (if approved by the Court) implement the CCAA Plan; and

iii. to execute any and all documents and perform any and all acts required by the CCAA Plan and the Settlement Agreement, including any consent, approval or waiver requested by the Parties, acting reasonably.

(l) Successors and Assigns

This Settlement Agreement shall be binding upon and shall enure to the benefit of the heirs, administrators, executors, legal personal representatives, successors and assigns of any Person named or referred to in this Settlement Agreement.

(m) Class Proceedings Levy

To the extent that any levy is payable to a class proceedings funding organization such as the Law Foundation of Ontario Class Proceedings Fund or the Fonds d'aide aux actions collectives (Quebec), such levy shall be calculated based on, and paid out of, the portion of the Settlement Funds allocated to the 129 Action. For greater certainty, the Former Directors and the Insurers shall not be required to pay any additional sum to the Plaintiffs in excess of the Settlement Funds in order to satisfy any class proceedings funding organization levy.

(n) Plaintiffs' Capacity

The Parties acknowledge and agree that the Monitor and the Litigation Trustee have entered into this agreement in their capacities as court-appointed monitor and court-appointed litigation trustee of Sears, that the Pension Administrator has entered into this agreement in its capacity as an administrator appointed under the *Pension Benefits Act* (Ontario) and that the Chief Executive Officer of FSRA has entered into this agreement in its capacity as administrator of the Pension Benefits Guarantee Fund (Ontario) and not in their personal or corporate capacities and

that the Monitor, the Litigation Trustee, the Pension Administrator and the Chief Executive Officer of FSRA shall have no personal or corporate liability in connection with this Agreement.

11. TERMINATION

(a) No Termination Rights Regarding Class Counsel Fees

The refusal of any competent court to approve, or uphold in the case of an appeal, any request by Class Counsel for fees shall not be grounds to terminate this Settlement Agreement.

(b) Impact of Non-Approval and/or Termination

If the conditions precedent set out in section 7 of this Settlement Agreement are not met or waived, or if the Settlement Agreement terminates or is terminated in accordance with its terms prior to the Effective Date, then

i. the Settlement Agreement and Minutes of Settlement shall be null and void in all respects (subject to any survival provisions);

ii. nothing contained in the Settlement Agreement or Minutes of Settlement, and no act taken in preparation of the consummation of the Settlement Agreement or the CCAA Plan, shall

a. constitute or be deemed to constitute a waiver or release of any Claims or any defences thereto, by or against any of the Parties or any other Person;

b. prejudice in any manner the rights of any of the Parties or any other Person; or

c. constitute an admission of any sort by any of the Parties, or any other Person;

iii. the Parties and any other Person affected by the Settlement Agreement or the Minutes of Settlement will be restored to their respective positions prior

to the execution of the Settlement Agreement and the Minutes of Settlement;

iv. subject to any survival provisions herein, the Settlement Agreement and the Minutes of Settlement will have no further force and effect and no effect on the rights of the Parties and any other Person affected by the Settlement Agreement or the Minutes of Settlement;

v. neither the Minutes of Settlement nor the Settlement Agreement will be introduced into evidence or otherwise referred to in any litigation or proceeding against the Released Parties;

vi. the recitals, the provisions of this section, and sections 1(a), 1(b), 8(a), 8(b), and 10(a)-10(l) of the Settlement Agreement shall survive termination and shall continue in full force and effect;

IN WITNESS OF WHICH the Parties have executed this Settlement Agreement.

[signature pages follow]

SEARS CANADA INC., by J. Douglas Cunningham, Q.C., in his capacity as court-appointed litigation trustee and not in his personal capacity and without personal liability

Per: _____
Name:
Title:

I have the authority to bind the Corporation.

FTI CONSULTING CANADA INC., in its capacity as court-appointed monitor of Sears Canada Inc., and not in its personal or corporate capacity and without personal or corporate liability

Per: _____
Name: Paul Bishop
Title: Senior Managing Director

I have the authority to bind the Corporation

MORNEAU SHEPELL LTD., in its capacity as administrator of the Sears Canada Inc. Registered Retirement Plan and not in its personal or corporate capacity and without personal or corporate liability

Per: _____
Name:
Title:

I have the authority to bind the Corporation.

SEARS CANADA INC., by J. Douglas Cunningham, Q.C., in his capacity as court-appointed litigation trustee and not in his personal capacity and without personal liability

Per: _____
Name:
Title:

I have the authority to bind the Corporation.

FTI CONSULTING CANADA INC., in its capacity as court-appointed monitor of Sears Canada Inc., and not in its personal or corporate capacity and without personal or corporate liability

Per:
Name: Paul Bishop
Title: Senior Managing Director

I have the authority to bind the Corporation

MORNEAU SHEPELL LTD., in its capacity as administrator of the Sears Canada Inc. Registered Retirement Plan and not in its personal or corporate capacity and without personal or corporate liability

Per: _____
Name:
Title:

I have the authority to bind the Corporation.

SEARS CANADA INC., by J. Douglas Cunningham, Q.C., in his capacity as court-appointed litigation trustee and not in his personal capacity and without personal liability

Per: _____
Name:
Title:

I have the authority to bind the Corporation.

FTI CONSULTING CANADA INC., in its capacity as court-appointed monitor of Sears Canada Inc., and not in its personal or corporate capacity and without personal or corporate liability

Per: _____
Name: Paul Bishop
Title: Senior Managing Director

I have the authority to bind the Corporation

MORNEAU SHEPELL LTD., in its capacity as administrator of the Sears Canada Inc. Registered Retirement Plan and not in its personal or corporate capacity and without personal or corporate liability

Per: _____
Name: Hamish Dunlop
Title: Managing Principal

I have the authority to bind the Corporation.

1291079 ONTARIO LIMITED

Per: _____
Name: Jim Kay
Title: President

As Representative of the Plaintiff I have the authority to bind the corporation and all members of the Class of Plaintiffs.

CHIEF EXECUTIVE OFFICER OF THE FINANCIAL SERVICES REGULATORY AUTHORITY OF ONTARIO AS ADMINISTRATOR OF PENSION BENEFITS GUARANTEE FUND (ONTARIO)

Per: _____
Name:
Title:

EPHRAIM J. BIRD

_____

DOUGLAS CAMPBELL

_____

WILLIAM CROWLEY

_____

WILLIAM HARKER

_____

1291079 ONTARIO LIMITED

Per: _____
Name:
Title:

As Representative of the Plaintiff I have the authority to bind the corporation and all members of the Class of Plaintiffs.

CHIEF EXECUTIVE OFFICER OF THE FINANCIAL SERVICES REGULATORY AUTHORITY OF ONTARIO AS ADMINISTRATOR OF PENSION BENEFITS GUARANTEE FUND (ONTARIO)

Per: _____
Name: Mark White
Title: Chief Executive Officer, Financial Services Regulatory Authority of Ontario

EPHRAIM J. BIRD

_____

DOUGLAS CAMPBELL

_____

WILLIAM CROWLEY

_____

1291079 ONTARIO LIMITED

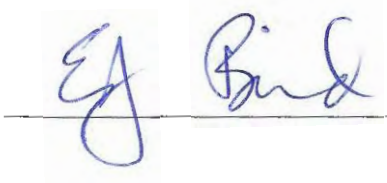
Per: _____
Name:
Title:

As Representative of the Plaintiff I have the authority to bind the corporation and all members of the Class of Plaintiffs.

FINANCIAL SERVICES REGULATORY AUTHORITY OF ONTARIO, on its own behalf and on behalf of the Pension Benefits Guarantee Fund (Ontario)

Per: _____
Name:
Title:

EPHRAIM J. BIRD



DOUGLAS CAMPBELL

_____

WILLIAM CROWLEY

_____

WILLIAM HARKER

_____

1291079 ONTARIO LIMITED

Per: _____
Name:
Title:

As Representative of the Plaintiff I have the authority to bind the corporation and all members of the Class of Plaintiffs.

FINANCIAL SERVICES REGULATORY AUTHORITY OF ONTARIO, on its own behalf and on behalf of the Pension Benefits Guarantee Fund (Ontario)

Per: _____
Name:
Title:

EPHRAIM J. BIRD

_____

DOUGLAS CAMPBELL

WILLIAM CROWLEY

_____

WILLIAM HARKER

_____

1291079 ONTARIO LIMITED

Per: _____
Name:
Title:

As Representative of the Plaintiff I have the authority to bind the corporation and all members of the Class of Plaintiffs.

FINANCIAL SERVICES REGULATORY AUTHORITY OF ONTARIO, on its own behalf and on behalf of the Pension Benefits Guarantee Fund (Ontario)

Per: _____
Name:
Title:

EPHRAIM J. BIRD

_____

DOUGLAS CAMPBELL

_____

WILLIAM CROWLEY

_____

WILLIAM HARKER

_____

1291079 ONTARIO LIMITED

Per: _____
Name:
Title:

As Representative of the Plaintiff I have the authority to bind the corporation and all members of the Class of Plaintiffs.

FINANCIAL SERVICES REGULATORY AUTHORITY OF ONTARIO, on its own behalf and on behalf of the Pension Benefits Guarantee Fund (Ontario)

Per: _____
Name:
Title:

EPHRAIM J. BIRD

_____

DOUGLAS CAMPBELL

_____

WILLIAM CROWLEY

_____

WILLIAM HARKER

R. RAJA KHANNA

JAMES MCBURNEY

DONALD ROSS

DEBORAH E. ROSATI

R. RAJA KHANNA

JAMES MCBURNEY

DONALD ROSS

DEBORAH E. ROSATI

R. RAJA KHANNA

JAMES MCBURNEY

DONALD ROSS

Donald C Ross

DEBORAH E. ROSATI

R. RAJA KHANNA

_____

JAMES MCBURNEY

_____

DONALD ROSS

_____

DEBORAH E. ROSATI

D. Rosati

_____

Schedule “A”

Definition of “Insurance Policies”

For purposes of the Settlement Agreement, the term “Insurance Policies” refers to the policies indicated in the chart below. For greater certainty, the term “Insurance Policies” as defined in this Schedule “A” and used in this Settlement Agreement does not include policy number QPL0045025 issued by QBE Insurance Corporation covering the period from May 15, 2015 to May 15, 2016 (the “**QBE Policy**”) and the term “Insurers” does not include QBE Insurance Corporation (“QBE”). In the event that QBE agrees to pay or does in fact pay the full limits of the QBE Policy in respect of the Settlement Funds or Defense Expenses (as defined in the XL Policy) relating to the Actions, QBE shall be treated as an “Insurer” for purposes of the Settlement Agreement and settlement of the Actions and shall be entitled to the benefits received by the other Insurers, including a release.

Insurer	Policy Number	Limits of Policy (in USD)
XL Specialty Insurance Company SIDE A	ELU139030-15	$15,000,000
Lloyd’s Syndicate 2623	FD1581481	$15,000,000 xs $30,000,000
AXIS Insurance Company	MCN738227/01/2015	$15,000,000 xs $45,000,000
Illinois National Insurance Company	01-309-63-06	$15,000,000 xs $60,000,000
Berkshire Hathaway Specialty Insurance Company	47-XDA-301368-01	$15,000,000 xs $75,000,000
Hiscox Insurance Company Inc.	FD1581601	$10,000,000 xs $90,000,000
Allied World National Assurance Company	0308-3251	$10,000,000 xs $100,000,000
Illinois National Insurance Company	01-310-13-60	$10,000,000 xs $110,000,000
Navigators Insurance Company	CH15DOL586634IV	$10,000,000 xs $120,000,000
Westchester Fire Insurance Company	G2759699A001	$10,000,000 xs $130,000,000
Aspen American Insurance Company	MCAA1K415	$10,000,000 xs $140,000,000

Schedule "B"

FULL AND FINAL RELEASE

IN CONSIDERATION OF payment to the **PLAINTIFFS** (as defined below) in the full and total amount of **CDN $50,000,000.00 (FIFTY MILLION CANADIAN DOLLARS)**, which is hereby directed to be paid to **FTI CONSULTING CANADA INC. in its capacity as Court-appointed Monitor of Sears Canada Inc. in proceedings pursuant to the *Companies' Creditors Arrangement Act*, RSC 1985, c c-36** (the "**MONITOR**"), the receipt of which is acknowledged, and in consideration of the dismissal without costs of the following actions:

a) Ontario Superior Court of Justice (Commercial List) at Toronto, Court File No. CV-18-00611219-00CL, wherein the **MONITOR** is the plaintiff and ESL Investments Inc., ESL Partners, LP, SPE I Partners, LP, SPE Master I, LP, ESL Institutional Partners, LP, Edward S. Lampert, Sears Holdings Corporation, William Harker, and William Crowley are the defendants;

b) Ontario Superior Court of Justice (Commercial List) at Toronto, Court File No. CV-18-00611217-00CL, wherein **MORNEAU SHEPELL LTD., in its capacity as administrator of the Sears Canada Registered Retirement Plan** ("**MORNEAU**") is the plaintiff and ESL Investments Inc., ESL Partners, LP, SPE I Partners, LP, SPE Master I, LP, ESL Institutional Partners, LP, Edward S. Lampert, Sears Holdings Corporation, William Harker, William Crowley, Donald Campbell Ross, Ephraim J. Bird, Deborah E. Rosati, R. Raja Khanna, James McBurney, and Douglas Campbell are the defendants;

c) Ontario Superior Court of Justice (Commercial List) at Toronto, Court File No. CV-18-00611214-00CL, wherein **SEARS CANADA INC., by its Court-appointed Litigation Trustee, J. Douglas Cunningham, Q.C.** (the "**LITIGATION TRUSTEE**") is the plaintiff and ESL Investments Inc., ESL Partners, LP, SPE I Partners, LP, SPE Master I, LP, ESL Institutional Partners, LP, Edward S. Lampert, Sears Holdings Corporation, William Harker, William Crowley, Donald Ross, Ephraim J. Bird, Deborah Rosati, R. Raja Khanna, James McBurney, and Douglas Campbell are the defendants; and

d) Ontario Superior Court of Justice (Commercial List) at Toronto, Court File No. CV-19-617792-00CL, wherein **1291079 ONTARIO LIMITED** ("**129**") is the representative plaintiff in a class proceeding on behalf of all Sears Hometown Dealer stores operating under a Dealer Agreement with Sears Canada Inc. at any time on or after July 5, 2011 (the "**CLASS**"), and Sears Canada Inc., ESL Investments Inc., Sears Holdings Corporation, William R. Harker, William C. Crowley, Donald Campbell Ross, Ephraim J. Bird, Deborah E. Rosati, R. Raja Khanna, James McBurney, and Douglas Campbell are the defendants;

(collectively, the **"ACTIONS**")

the **MONITOR**, **MORNEAU**, the **LITIGATION TRUSTEE**, and **129** (collectively, the "**PLAINTIFFS**") **on** behalf of themselves and their respective heirs, executors, administrators, predecessors, representatives, successors, assigns, parent or other related companies, subsidiaries and affiliates, along with the officers, directors, employees, shareholders, agents, successors and assigns of all such persons and entities and **129** on behalf of all members of the **CLASS** and their respective heirs, executors, administrators, predecessors, representatives, successors, assigns, parent or other related companies, subsidiaries and affiliates, along with the officers, directors, employees, shareholders, agents, successors and assigns of all such persons and entities (collectively, the "**RELEASORS**"), do hereby release and forever discharge **WILLIAM R. HARKER, WILLIAM C. CROWLEY, DONALD CAMPBELL ROSS, EPHRAIM J. BIRD, DEBORAH E. ROSATI, R. RAJA KHANNA, JAMES MCBURNEY,** and **DOUGLAS CAMPBELL**, (collectively, the "**Former Directors**"), their respective heirs, executors, administrators, predecessors, representatives, successors, and assigns (collectively, the "**Related Parties**"), and the Insurers (hereafter, the Former Directors, Related Parties, and Insurers shall be referred to collectively as the "**RELEASEES**") from any and all actions, causes of action, suits, debts, dues, accounts, bonds, covenants, contracts, proceedings, complaints, claims, demands and rights which the **RELEASORS** ever had, now have, or may in the future have against the **RELEASEES**, for any losses, injuries, damages, cause, matter or thing whatsoever, whether at law or in equity or under any statute, whether anticipated or unanticipated, that were set out or could have been set out in the **ACTIONS**, including without restricting the generality of the above, all claims and allegations whatsoever against the **RELEASEES** resulting from, arising out of or connected, directly or indirectly, with (a) the Former Directors' roles as employees, officers, and directors of, or consultants to, Sears Canada Inc. from the beginning of time up to the date of this release, (b) the business, operations, and other affairs of Sears Canada Inc. (even if allegedly undertaken in

the Former Directors' capacity as employees, officers, directors, or consultants of another corporation or entity), (c) the Former Directors' consideration and approval of, and the payment by Sears Canada Inc. of, a dividend of $5 per share in 2013, (d) the Insurance Policies, and (e) any Loss arising from one or more Wrongful Acts of any Former Director undertaken in that person's capacity as an Insured Person.

THE RELEASORS do also hereby release and forever discharge all Insured Persons other than the **RELEASEES** from any and all actions, causes of action, suits, debts, dues, accounts, bonds, covenants, contracts, proceedings, complaints, claims, demands and rights which the **RELEASORS** ever had, now have, or may in the future have against such other Insured Person with respect to Loss arising from one or more Wrongful Acts of that Insured Person undertaken in that person's capacity as an Insured Person. For greater certainty, an Insured Person other than the **RELEASEES** is only released with respect to Loss arising from one or more Wrongful Acts undertaken in that person's capacity as an Insured Person.

IT IS UNDERSTOOD AND AGREED that the above-described consideration is not an admission of liability on the part of the **RELEASEES** and that such liability is expressly denied.

IT IS FURTHER UNDERSTOOD AND AGREED that the **RELEASORS** will not make any claim or take any proceeding against any person, corporation, partnership or other entity which may or does claim contribution or indemnity by statute or otherwise from the **RELEASEES** or their administrators, assigns, servants and agents with respect to any of the matters to which this Full and Final Release applies; provided, however, that this release shall not prevent the Releasors from advancing their ongoing claims against any of the Non-Settling Defendants, subject to any determination by the Court that any such claims are Released Claims.

IT IS FURTHER UNDERSTOOD AND AGREED that if the **RELEASORS** make any claim or take any proceeding in violation of the paragraphs above, this Full and Final Release may be raised as an estoppel to any such claim or proceeding, and the **RELEASORS** undertake and agree to indemnify the **RELEASEES** in respect of any defence costs incurred by or on behalf of the same in relation to such claim or proceeding.

IT IS FURTHER UNDERSTOOD AND AGREED that this Full and Final Release shall operate conclusively as an estoppel in the event of any claim, action, complaint or proceeding which might be brought in the future by the **RELEASORS** against the Releasees with respect to matters released by this Full and Final Release. This Full and Final Release may be pleaded in the event

any such claim, action, complaint or proceeding is brought, as a complete defence and reply, and may be relied upon in any proceeding to dismiss the claim, action, complaint or proceeding on a summary basis and no objection will be raised by the **RELEASORS** in any subsequent proceeding.

THE RELEASORS represent and warrant that they are authorized and entitled to sign this Full and Final Release, and that they own and have not sold, pledged, hypothecated, assigned or transferred the claims being released herein.

IT IS FURTHER UNDERSTOOD AND AGREED that the invalidity or unenforceability of any particular term of this Full and Final Release will not affect or limit the validity or enforceability of the remaining terms.

IT IS FURTHER UNDERSTOOD AND AGREED that the **RELEASORS** are satisfied with the information provided and have no outstanding requests for information.

IT IS ACKNOWLEDGED AND CONFIRMED that the **RELEASORS** have received, or have had the opportunity to receive, independent legal advice from counsel of their choice with respect to the terms of the settlement of the **ACTIONS**, including the terms of this Full and Final Release.

IT IS FURTHER ACKNOWLEDGED AND CONFIRMED that the **RELEASORS** have read this Full and Final Release carefully and have signed it voluntarily and freely and without any form of duress being exerted by the **RELEASEES**, or anyone acting on their behalf, and with the express purpose of making full and final compromise, adjustment and settlement with respect to all of the matters to which this Full and Final Release applies.

IT IS FURTHER UNDERSTOOD AND AGREED that capitalized terms not otherwise defined in this Full and Final Release shall have the meaning attributed to those terms in the settlement and release agreement between the Plaintiffs and the Former Directors dated as of July 27, 2020.

This Full and Final Release shall be governed and construed by the laws of the Province of Ontario. Any questions or disputes arising out of this Full and Final Release shall be determined by the Ontario Superior Court of Justice (Commercial List) at Toronto.

The **RELEASORS** acknowledge and agree that no representations or promises have been made to or relied upon by them or by any person acting for or on their behalf in connection with the subject matter of this Full and Final Release which is not specifically set forth herein or in the

Settlement and Release Agreement between the parties. All representations and promises made by any party to another, whether in writing or orally are understood by the parties to be merged in this Full and Final Release and the Settlement and Release Agreement. This Full and Final Release shall further be binding upon and shall inure to the benefit of the parties, their respective heirs, beneficiaries, personal representatives, successors, and assigns.

IN WITNESS WHEREOF, the **RELEASORS** have executed this Full and Final Release on the date written below.

DATED at _____, Ontario, this _____ day of July 2020.

SIGNED, SEALED & DELIVERED
In the presence of:

FTI CONSULTING CANADA INC., in its capacity as Court-appointed monitor of Sears Canada Inc., and not in its personal or corporate capacity and without personal or corporate liability

Witness

Name: Paul Bishop
Title: Senior Managing Director

I have authority to bind the Monitor.

SIGNED, SEALED & DELIVERED
In the presence of:

MORNEAU SHEPELL LTD., in its capacity as administrator of the Sears Canada Inc. Registered Retirement Plan , and not in its personal or corporate capacity and without personal or corporate liability

Witness

Name: Hamish Dunlop
Title: Managing Principal

I have authority to bind the Plan Administrator.

SIGNED, SEALED & DELIVERED
In the presence of:

SEARS CANADA INC., by its Court-appointed Litigation Trustee, J. Douglas Cunningham, Q. C., and not in his personal capacity and without personal liability

Witness

Name: J. Douglas Cunningham, Q.C.
Title: Litigation Trustee

I have authority to bind the corporation.

SIGNED, SEALED & DELIVERED
In the presence of:

1291079 ONTARIO LIMITED

Witness

Name: James Kay
Title: President

I have authority to bind the corporation.

Schedule “C”

Court File No. CV-17-11846-00CL
Court File No. CV-18-611214-00CL
Court File No. CV-18-611217-00CL
Court File No. CV-18-611219-00CL
Court File No. CV-19-617792-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

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

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF SEARS CANADA INC., 9370-2751 QUEBEC INC., 191020 CANADA INC., THE CUT INC., SEARS CONTACT SERVICES INC., INITIUM LOGISTICS SERVICES INC., 9845488 CANADA INC., INITIUM TRADING AND SOURCING CORP., SEARS FLOOR COVERING CENTRES INC., 173470 CANADA INC., 2497089 ONTARIO INC., 6988741 CANADA INC., 10011711 CANADA INC., 1592580 ONTARIO LIMITED, 955041 ALBERTA LTD., 4201531 CANADA INC., 168886 CANADA INC., AND 3339611 CANADA INC.

SEARS CANADA INC., by its Court-appointed Litigation Trustee,
J. DOUGLAS CUNNINGHAM, Q.C.

Plaintiff

- and -

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

Defendants

MORNEAU SHEPELL LTD. in its capacity as administrator of the Sears Canada Inc. Registered Retirement ~~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 and SEARS HOLDINGS CORPORATION

Defendants

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, SEARS HOLDINGS CORPORATION, WILLIAM HARKER and WILLIAM CROWLEY

Defendants

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

ORDER
(APPROVAL ORDER)

THIS MOTION made by Sears Canada Inc. ("**Sears**") by its Court-Appointed Litigation Trustee, J. Douglas Cunningham, Q.C. (the "**Litigation Trustee**") in proceedings pursuant to the *Companies' Creditors Arrangement Act,* R.S.C. 1985, c. c-36 (the "**CCAA Proceedings**")**,** FTI Consulting Canada Inc. in its capacity as Court-appointed monitor (the "**Monitor**"), Morneau Shepell Ltd., in its capacity as administrator of the Sears Canada Inc. Registered Retirement Plan (the "**Pension Administrator**") and 1291079 Ontario Limited ("**129**" and collectively with the Monitor, the Litigation Trustee and the Pension Administrator, the "**Plaintiffs**") for an order approving the settlement and release agreement between the Plaintiffs and Ephraim J. Bird, Douglas Campbell, William Crowley, William Harker, R. Raja Khanna, James McBurney, Donald Ross, and Deborah E. Rosati (the "**Former Directors**") and for an order releasing claims against the Former Directors as more particularly defined below was heard this day via videoconference.

ON READING the Motion Record of the Plaintiffs, the 37th Report of the Monitor dated July ●, 2020, and the Supplementary Motion Record of 129, and on hearing the submissions of counsel for the Plaintiffs and the Defendants, no one appearing for any other party although duly

served and such other notice as required by the Order of Justice McEwen dated July ●, 2020 respecting the form of notice for the settlement approval hearing and plan for distribution of notice to the class ("**Notice Order**") having been provided:

Sufficiency of Service and Definitions

1. **THIS COURT ORDERS** that the time for service and manner of service of the Notice of Motion and Motion Record of the Plaintiffs, the 37th Report of the Monitor dated July ●, 2020, and the Supplementary Motion Record of 129 on any Person are, respectively, hereby abridged and validated, and any further service thereof is hereby dispensed with so that this Motion was properly returnable July ●, 2020 in all proceedings set out in the styles of cause hereof.

2. **THIS COURT ORDERS** that capitalized terms not otherwise defined in this Order shall have the meaning attributed to those terms in the settlement and release agreement between the Plaintiffs and the Former Directors dated as of July 27, 2020, (the "**Settlement Agreement**").

3. **THIS COURT FINDS** that all applicable parties have adhered to, and acted in accordance with, the Notice Order and that the procedures provided for in the Notice Order have provided good and sufficient notice of the hearing of this Motion, and that all persons who failed to appear before the court today shall be and are hereby barred from objecting to the Settlement Agreement.

Approval of Settlement Agreement

4. **THIS COURT ORDERS** that the Settlement Agreement is hereby approved, and the parties thereto are hereby bound by this Order and by those terms of the Settlement Agreement that are conditional upon the granting of this Order and are authorized and directed to comply with their obligations thereunder.

Release

5. **THIS COURT ORDERS** that in accordance with the terms and conditions of the Settlement Agreement and without narrowing the scope of the Released Claims, the following Claims, are, as of the Effective Date, irrevocably, absolutely, and unconditionally fully, finally, and forever released, remised and discharged:

a) D&O Claims;

b) Other Insured Claims;

c) Insurance Claims;

d) all Claims of the Plaintiffs against the Former Directors in the Actions;

e) all Claims of 129 and any member of the Class against the Former Directors;

f) all Claims of the Plan against the Former Directors;

g) all claims of the beneficiaries of the Plan ("Plan Beneficiaries") against the Former Directors related to the subject matter of the Actions;

h) all Claims, including subrogated Claims, of the Pension Benefits Guarantee Fund (Ontario) against the Former Directors; and

i) all claims over, cross claims, counter claims or related claims that could have been asserted against the Former Directors in (i) the Actions or (ii) any other action in any way related to the subject matter of the Actions and/or D&O Claims;

and for greater certainty, the Plaintiffs may advance the Actions against any Non-Settling Defendant.

6. **THIS COURT ORDERS** that the releases set out herein and in the Settlement Agreement shall apply to Claims contemplated by s. 5.1(2) and 19(2) of the CCAA, but shall not apply to:

a) the obligations of any Person in respect of this Order, and the Settlement Agreement, including the obligation of the Insurers to pay the Settlement Funds;

b) the rights of the Former Directors against the Insurers under the Insurance Policies except as affected by the declarations set out in paragraph 17 of this Order; and

c) the liability of the defendants to the Actions other than the Former Directors for any Claims other than Other Insured Claims.

7. **THIS COURT ORDERS** that this Order, including the Settlement Agreement, is binding upon each class member in Court File No. CV-19-00617792-00CL (the "**129 Settlement Class**") including those Persons who are minors or mentally incapable and the requirements of Rules 7.04(1) and 7.08(4) of the *Rules of Civil Procedure* are dispensed with in respect of the action in Court File No. CV-19-00617792-00CL.

8. **THIS COURT ORDERS** that the Settlement Agreement is fair, reasonable and in the best interest of the 129 Settlement Class.

9. **THIS COURT ORDERS** that the Settlement Agreement is hereby approved pursuant to s. 29 of the *Class Proceedings Act, 1992* and shall be implemented and enforced in accordance with its terms.

Bar Orders

10. **THIS COURT ORDERS** that no person not party to the Settlement Agreement (the "**Non-Parties**") shall now or hereafter institute, continue, maintain or assert, either directly or indirectly, whether in Canada or elsewhere, on their own behalf or on behalf of any other person, any action, suit, cause of action, claim or demand against any of the Released Parties (or any other person who may claim contribution or indemnity from any of the Released Parties) in respect of the Released Claims or any Claims related to the subject matter of the Actions. All claims for contribution or indemnity or other claims over (whether asserted or unasserted, tolled or not tolled, and relating to or arising from any of the Actions) which were or could have been brought in any of the Actions or in a separate proceeding by any Non-Party against the Released Parties are barred, extinguished, prohibited and enjoined by this Order. For greater certainty, the Plaintiffs may advance the Actions against any of the Non-Settling Defendants.

11. **THIS COURT ORDERS** that all Persons (regardless of whether or not such Persons are creditors or claimants), including the 129 Settlement Class, Sears, the Litigation Trustee, the Monitor, the Pension Administrator, the Pension Benefits Guarantee Fund (Ontario), the Plan Beneficiaries, the Former Directors, the Released Parties, and all beneficiaries of any of the foregoing, shall be permanently and forever barred, estopped, stayed and enjoined, as of the Effective Date, from:

a) commencing, conducting, pursuing, instituting, intervening in, asserting, advancing, or continuing in any manner, directly or indirectly, any action or other related proceedings of any nature or kind whatsoever (including, without limitation, any proceeding in a judicial, arbitral, administrative or other forum) which constitutes a Released Claim;

b) enforcing, levying, attaching, collecting or otherwise recovering or enforcing by any manner or means, directly or indirectly, any judgment, award, decree,

damages, or order in respect of a Released Claim, other than the enforcement of the Settlement Agreement;

c) subject to paragraphs 5**,** 6, 10, 11 b) and 12, making, asserting, pursuing, instituting, intervening in, advancing, commencing, conducting or continuing in any manner, directly or indirectly, any Released Claim, including for contribution or indemnity or other relief, or other proceedings of any nature or kind whatsoever (including, without limitation, any proceeding in a judicial, arbitral, administrative or other forum) against any Person who makes or asserts, or might reasonably be expected to make or assert, such a Claim, in any manner or forum, against one or more of the Released Parties;

d) creating, perfecting, asserting or otherwise enforcing, directly or indirectly, any lien or encumbrance of any kind against the Released Parties or their property in respect of a Released Claim; or

e) taking any actions to interfere with the implementation or consummation of the Settlement Agreement.

12. **THIS COURT ORDERS** that the bar order and injunctions set out herein and in the Settlement Agreement shall apply to Claims contemplated by s. 5.1(2) and 19(2) of the CCAA, but shall not apply to

(a) the obligations of any Person in respect of this Order, and the Settlement Agreement; and

(b) the rights of the Former Directors against:

(i) the Insurers to seek payment of the Settlement Funds and Defense Expenses; and

(ii) QBE in relation to the coverage proceeding involving the QBE Policy.

13. **THIS COURT ORDERS** that the Plaintiffs' recovery from the Non-Settling Defendants and with which any Former Director is judicially determined to be jointly and severally liable shall be limited to only that proportion of damages attributable to the liability of the Non-Settling Defendants, as finally determined in the Actions.

14. **THIS COURT ORDERS** that the CCAA Plan and Sanction Order shall be supplementary to, and shall not derogate from, the releases and injunctions set out in this Order.

15. **THIS COURT ORDERS** that, notwithstanding:

a) the pendency of these proceedings;

b) any applications for a bankruptcy order now or hereafter issued pursuant to the Bankruptcy and Insolvency Act (Canada) in respect of any of the CCAA Parties and any bankruptcy order issued pursuant to any such applications; and

c) any assignment in bankruptcy made in respect of any of the CCAA Parties,

the settlement approved pursuant to this Order and the releases and bar orders shall be binding on any trustee in bankruptcy that may be appointed in respect of any of the CCAA Parties and shall not be void or voidable by creditors of any of the Applicants in the CCAA Proceedings, nor shall it constitute nor be deemed to be a fraudulent preference, assignment, fraudulent conveyance, transfer at undervalue, or other reviewable transaction under the Bankruptcy and Insolvency Act (Canada) or any other applicable federal or provincial legislation, nor shall it constitute oppressive or unfairly prejudicial conduct pursuant to any applicable federal or provincial legislation.

16. **THIS COURT ORDERS** that releases, bar orders and injunctions set out herein shall be conditional upon the completion of the settlement set out in the Settlement Agreement.

Insurance Declarations

17. **THE COURT HEREBY DECLARES** that Payment of the Settlement Funds:

a) is made by the Insurers in good faith;

b) is fair and reasonable under the circumstances;

c) does not violate the interests of any person who might have a claim against any person or entity potentially covered under the Insurance Policies;

d) constitutes covered Loss (as defined in the Insurance Policies) regardless of any future determination of any court with respect to the conduct alleged in the Actions;

e) reduces the Limits of Liability (as defined in the Insurance Policies) under the Insurance Policies;

f) is without prejudice to any coverage positions or reservations of rights taken by the Insurers in relation to any other matter advised to the Insurers or any other Claim (as defined in the Insurance Policies) made or yet to be made against the Insured Persons, provided that neither coverage nor payment in respect of the settlement of the Actions, will be voided or impacted by any such coverage position or reservation of rights; and

g) subject to payment in full of the Settlement Funds and the Defense Expenses of the Former Directors, fully and finally releases the Insurers from any further obligation, and from any and all claims against them under or in relation to the Insurance Policies, in respect of the matters set out in the Actions with respect to the Former Directors or any Other Insured.

Recognition and Enforcement

18. **THIS COURT HEREBY REQUESTS** the aid and recognition of any court, tribunal, regulatory or administrative body (collectively, "**Bodies**") having jurisdiction in Canada or in the United States or in any other jurisdiction to give effect to this order and to assist the Plaintiffs, the Litigation Trustee (as an officer of this Court) and the Monitor (as an Officer of this Court) and their respective agents in carrying out the terms of this order. All Bodies are hereby respectfully requested to make such orders and to provide such assistance to the Plaintiffs, the Litigation Trustee (as an officer of this Court) and the Monitor (as an officer of this Court) as may be necessary or desirable to give effect to this order or to assist the Plaintiffs, the Litigation Trustee (as an officer of this Court) and the Monitor (as an officer of this Court) and their respective agents in carrying out the terms of this order.

Appeals

19. **THIS COURT ORDERS** that the provisions of the *Companies' Creditors Arrangement Act* (Canada) and the *Rules of Civil Procedure* (Ontario) establishing the period within which any appeal or motion for leave to appeal this Order must be commenced shall apply without suspension to this Order, notwithstanding any provision of the *Emergency Management and Civil Protection Act* and any regulations thereunder including Ontario Regulation 73/20.

HAINEY, J.

Court File No. CV-17-11846-00CL

IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT,* R.S.C. 1985, C. c-36, AS AMENDED
AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF SEARS CANADA INC. et al.

		Court File No. CV-18-00611214-00CL
SEARS CANADA INC. Plaintiff	-and-	ESL INVESTMENTS INC. *et al.* Defendants
		Court File No. CV-18-00611217-00CL
MORNEAU SHEPELL LTD. Plaintiff	-and-	ESL INVESTMENTS INC. *et al.* Defendants
		Court File No. CV-18-00611219-00CL
FTI CONSULTING CANADA INC. Plaintiff	-and-	ESL INVESTMENTS INC. *et al.* Defendants
		Court File No. CV-19-00617792-00CL
1291079 ONTARIO LIMITED Plaintiff	-and-	SEARS CANADA INC. *et al.* Defendants

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

PROCEEDING COMMENCED AT TORONTO

SETTLEMENT APPROVAL AND BAR ORDER

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

BENNETT JONES LLP
1 First Canadian Place, Suite 3400
P.O. Box 130, Toronto, ON M5X 1A4

Lawyers for the Defendant Former Directors

Court File No. CV-17-11846-00CL

IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT,* R.S.C. 1985, C. c-36, AS AMENDED AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF SEARS CANADA INC. et al.

		Court File No. CV-18-00611214-00CL
SEARS CANADA INC. Plaintiff	-and-	ESL INVESTMENTS INC. *et al.* Defendants
		Court File No. CV-18-00611217-00CL
MORNEAU SHEPELL LTD. Plaintiff	-and-	ESL INVESTMENTS INC. *et al.* Defendants
		Court File No. CV-18-00611219-00CL
FTI CONSULTING CANADA INC. Plaintiff	-and-	ESL INVESTMENTS INC. *et al.* Defendants
		Court File No. CV-19-00617792-00CL
1291079 ONTARIO LIMITED Plaintiff	-and-	SEARS CANADA INC. *et al.* Defendants

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

PROCEEDING COMMENCED AT TORONTO

SETTLEMENT AND RELEASE AGREEMENT

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

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF SEARS CANADA INC., *et al.*

Court File No. CV-17-11846-00CL

ONTARIO
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Proceeding commenced at TORONTO

THIRTY-EIGHTH REPORT TO THE COURT SUBMITTED BY FTI CONSULTING CANADA INC., IN ITS CAPACITY AS MONITOR

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FTI CONSULTING CANADA INC. Plaintiff		ESL INVESTMENTS INC. et al. Defendants	Court File No. CV-18-00611219-00CL
SEARS CANADA INC., by its Court-appointed Litigation Trustee, J. Douglas Cunningham, Q.C. Plaintiff	-and-	ESL INVESTMENTS INC. et al. Defendants	Court File No. CV-18-00611214-00CL
MORNEAU SHEPELL LTD. Plaintiff	-and-	ESL INVESTMENTS INC. et al. Defendants	Court File No. CV-18-00611217-00CL
1291079 ONTARIO LIMITED Plaintiff	-and-	ESL INVESTMENTS INC. et al. Defendants	Court File No. CV-19-00617792-00CL
IN THE MATTER OF THE COMPANIES' CREDITORS ARRANGEMENT ACT, R.S.C. 1985, c. C-36, AS AMENDED AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF SEARS CANADA INC., et al			Court File No. CV-17-11846-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
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Proceeding Commenced at Toronto

MOTION RECORD OF THE PLAINTIFFS
(Motion re: Approval of Director Settlement returnable August 25, 2020)

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