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

SEARS CANADA INC.,
AND RELATED APPLICANTS

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

September 16, 2020

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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-NINTH 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 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 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 "**Allowed SHC Unsecured Claim**"). The settlement with SHC is described in greater detail in the Thirty-Fifth Report of the Monitor.

10. On August 25, 2020, the Court granted an order approving the settlement of the Claims as against Ephraim J. Bird, Douglas Campbell, William Crowley, William Harker, R. Raja Khanna, James McBurney, Deborah Rosati and Donald Ross. As part of the court order

approving the settlement of the Dividend Claims against the former directors, the Court ordered that the Plaintiffs' recovery from the ESL Parties with which any former director defendants were judicially determined to be jointly and severally liable was to be limited to that proportion of damages attributable to the liability of the ESL Parties.

11. Following the foregoing settlements, the only remaining defendants in the Claims were the ESL Parties.

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

13. In connection with the CCAA Proceedings, the Monitor has provided thirty-eight 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

14. The purpose of this thirty-ninth report of the Monitor (the "**Thirty-Ninth 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 as against the ESL Parties, and the Monitor's comments and recommendations in connection with the foregoing.

C. TERMS OF REFERENCE

15. In preparing this Thirty-Ninth 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 Administrator, and information in the Disclosure Statement (the "**SHC Disclosure Statement**") for the

Modified Second Amended Joint Chapter 11 Plan of SHC and Its Affiliated Debtors (collectively, the "**Information**").

16. Except as otherwise described in this Thirty-Ninth 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*.

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

18. The Monitor has prepared this Thirty-Ninth Report in connection with its request for approval of the Plaintiffs' settlement with the ESL Parties. The Thirty-Ninth Report should not be relied on for any other purpose.

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

D. CLAIMS AGAINST THE ESL PARTIES

20. 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.

21. The Claims allege that the ESL Parties 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 of the ESL Parties in these actions are attached hereto as Appendix "B".

E. SETTLEMENT NEGOTIATIONS WITH ESL PARTIES

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.

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 ESL Parties and the Plaintiffs have agreed, as a global settlement of all claims arising from or related to or that could have been asserted in the Claims, that the Plaintiffs, collectively, would receive $22.5 million, to be paid by the ESL Parties subject to terms agreed between the parties as described in greater detail below (the "**ESL Parties Settlement**"). The forms of settlement documentation will be provided in a Supplemental Report of the Monitor.

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 ESL Parties in the Estate 2013 Dividend Litigation; (ii) the time and cost required to determine the Claims through litigation, including through any appeals; and (iii) uncertainties around the ability to recover any judgment from the ESL Parties;

    (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 Estate 2013 Dividend Litigation is the last material remaining asset to be realized upon by Sears Canada and the resolution of the Claims will be an important step toward completion of these proceedings.

30. The Monitor and the Litigation Trustee provided updates to, and consulted with, the Creditors' Committee on the status of the settlement discussions with the ESL Parties. The Monitor has been advised that the Creditors' Committee, which includes representatives of key stakeholders, support the proposed settlement.

F. ESL PARTIES SETTLEMENT[1]

31. A summary of the material terms of the ESL Parties Settlement is set out below:

(a) Settlement Funds: The ESL Parties will pay to the Plaintiffs the amount of $22,500,000 (as defined and described below) (the "**Settlement Funds**") in full and final satisfaction of all claims arising from or related to or that could have been asserted in the Claims (the "**Released Claims**"). The Settlement Funds are to be paid to the Monitor, in trust for the Plaintiffs, within fifteen days after the required approval order of the Court is granted and has become final and non-appealable.

(b) Releases: The ESL Parties and the Plaintiffs will enter into mutual releases to be agreed by counsel acting reasonably.

(c) Non-Disparagement: The ESL Parties and the Plaintiffs will sign a non-disparagement agreement to be agreed to by counsel acting reasonably.

(d) No Admission of Liability: The settlement has been made on the basis that none of the allegations against the ESL Parties have been proven. As part of the requested approval of the ESL Parties Settlement, the Plaintiffs will confirm that all claims

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[1] This summary is provided for general information purposes only. In the case of any inconsistency between this summary and the terms of the ESL Parties Settlement, the ESL Parties Settlement shall govern. The bar orders contemplated by the ESL Parties Settlement shall apply to the following affiliates of the ESL Parties as well: ESL Investors, LLC, RBS Partners, LP, CRK Partners, LLC, RBS Investment Management, LLC.

and allegations in their respective pleadings of intentional wrongdoing by the ESL Parties are withdrawn.

(e) Allowed SHC Unsecured Claim: The Plaintiffs agree that at the written election of ESL Investments, Inc., and subject to the terms and conditions of the ESL Parties Settlement, the Plaintiffs shall either execute documents reasonably requested by ESL Investments, Inc. for the purposes of assigning the Plaintiffs' right, title and interest in the Allowed SHC Unsecured Claim to ESL Investments, Inc. or retain legal title to the Allowed SHC Unsecured Claim but grant ESL Investments, Inc. or their designee a 100% participation interest in the Allowed SHC Unsecured Claim. In addition, the Plaintiffs acknowledge that the ESL Parties may elect to release the Allowed SHC Unsecured Claim at any time on reasonable written notice to the Plaintiffs.

(f) Court Approval: The settlement is conditional upon receipt of approval of the 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.

(g) Joint Statement: Following the granting of the Approval Order, the parties would release a joint public statement. The form of public statement has been agreed and will be set out in the settlement documentation to be served in a Supplemental Report of the Monitor.

32. The Monitor notes in particular that the proposed settlement provides for a potential assignment of the Allowed SHC Unsecured Claim at the election of ESL Investments, Inc.

33. The Monitor previously provided information on the Allowed SHC Unsecured Claim in the Thirty-Fifth Report dated February 28, 2020. As described in the SHC Disclosure Statement attached as an Appendix to the Thirty-Fifth Report of the Monitor, the Modified Second Amended Joint Chapter 11 Plan of SHC and its Affiliated Debtors (the "**SHC Plan**") contemplates a wind down of the remaining assets of SHC and then a distribution to creditors in accordance with the absolute priority rule and certain settlements described in the SHC Plan.

34. The SHC Disclosure Statement provided an estimate of recoveries to general unsecured creditors of SHC, which would include the Plaintiffs in connection with the Allowed SHC Unsecured Claim. The estimated recoveries were subject to a number of assumptions and qualifications including assumptions about recoveries from future and ongoing avoidance and litigation actions. At the time of the SHC Disclosure Statement, the liquidation analysis therein contained an estimate of recoveries under the SHC Plan to Class 4 general unsecured creditors of approximately 2.3% of such creditors' allowed claims.[2] The Monitor noted in the Thirty-Fifth Report that it could provide no assurance regarding the actual recoveries under the SHC Plan and there was and remains a high degree of uncertainty around potential recoveries under the SHC Plan. The Plaintiffs have received no recoveries to date on the Allowed SHC Unsecured Claim.

35. The terms of the ESL Parties Settlement, including the potential assignment of the Allowed SHC Unsecured Claim, are, in the Monitor's view, reasonable in the circumstances.

G. APPROVAL ORDER

36. The proposed settlement is conditional upon the granting of Court approval of the settlement and the assignment of the Allowed SHC Unsecured Claim.

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

   (a) approve the ESL Parties Settlement, including for the purposes of the *Class Proceedings Act, 1992* in the case of the Dealer Class Action; and

   (b) approve releases and bar orders described in the ESL Parties Settlement, which releases and bar orders shall apply to all persons, including those not party to the ESL Parties Settlement.

38. The Settlement Funds shall only be paid by the ESL Parties upon the Approval Order becoming final and non-appealable.

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[2] These estimates are subject to the assumptions and qualifications set out in the SHC Disclosure Statement.

H. RELEASES

39. The ESL Parties Settlement contemplates a release in favour of the ESL Parties in respect of the Released Claims.

40. The requested form of Approval Order also includes a bar of the Released Claims and any claims that could be asserted by any person in connection with the subject matter of the Released Claims. This is a requirement of the ESL Parties Settlement in return for the consideration paid by the ESL Parties.

41. The Monitor believes the ESL Parties' request for these releases and bar orders is reasonable in the circumstances to provide finality in respect of any claims that may be raised against the ESL Parties in connection with these matters in return for the payment of $22.5 million.

42. 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 ESL Parties. 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 ESL Parties.

I. ALLOCATION OF SETTLEMENT FUNDS

43. The payment of the Settlement Funds pursuant to the ESL Parties Settlement will be made to the Monitor in trust for the Plaintiffs.

44. The Settlement Funds will then be allocated between the Dealer Class Action plaintiffs, Sears Canada, and the Pension Plan pursuant to agreements that have been reached between those parties.

J. MONITOR'S RECOMMENDATION

45. The ESL Parties Settlement is the result of extensive arm's-length negotiations between the Plaintiffs and the ESL Parties and provides material and immediate value to Sears

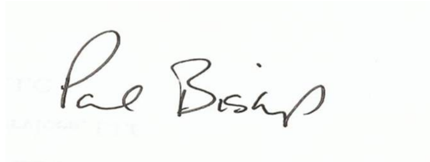
Canada and its stakeholders. For the reasons set out in this Thirty-Ninth Report, the Monitor recommends that the ESL Parties Settlement be approved.

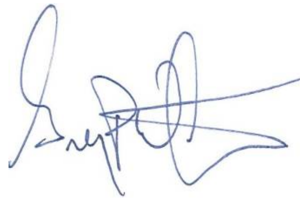
46. The Monitor also supports the proposed form of Approval Order. The Approval Order provides certainty and finality to the ESL Parties regarding the claims to which they may be subject in connection with the 2013 dividend matters.

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

Dated this 16th day of September, 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.

"December 19, 2018"
~~December 19, 2018~~
Date: ~~May , 2019~~ | Issued by "Ray Williams"
Local registrar

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AND TO: **ESL Institutional Partners, LP**
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U.S.A

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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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

<u>AMENDED</u> 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"
Local Registrar

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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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Lawyers for the Plaintiff

SEARS CANADA INC. by its litigation trustee
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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Lawyers for the Plaintiff

AMENDED THIS 05 July 2019 PURSUANT TO
MODIFIÉ CE CONFORMÉMENT À
☐ RULE/LA RÈGLE 26 02 (______)
☒ THE ORDER OF Justice McEwen
L'ORDONNANCE DU
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)

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 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

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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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Lawyers for the Plaintiff

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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Lawyers for the Plaintiff

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 GREFFIER
SUPERIOR COURT OF JUSTICE 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"

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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-18-00611214-00CL;

(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-19-617792-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

B E T W E E N:

1291079 ONTARIO LIMITED

Plaintiff

and

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

Defendants

Proceeding under the *Class Proceedings Act, 1992*

AMENDED STATEMENT OF DEFENCE OF ESL INVESTMENTS, INC.

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

Overview

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

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

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

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

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

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

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

5. No oppression by ESL Investments. The class' attempt to make ESL Investments liable for SCI's alleged oppressive acts hinges upon three key assertions: that ESL Investments controlled SCI's board of directors; that it "denuded" SCI of its "prime assets"; and that it had an

"urgent" and "immediate need for cash" to fund redemption obligations from the hedge funds it promoted (the "**ESL Funds**"). Each of these assertions is false.

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

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

8. Third, the alleged motive for the sale of the so-called "crown jewels" —that the ESL Funds were facing an "urgent" and "immediate" need for cash to fund redemption obligations—is a bald fabrication. The ESL Funds had no need for cash. They had the option to distribute

securities they owned in fulfilment of their redemption obligations, which, in part, they did. Moreover, at the time of the dividend, the ESL Funds had far more cash and securities on hand than they needed to satisfy the outstanding redemptions. By the end of 2013, the ESL Funds had **US$1.433 billion** in residual cash.

9. Far from having the alleged motive to remedy a fabricated "urgent" need for cash, Edward Lampert ("**Lampert**"), the CEO of ESL Investments, demonstrated by his actions the opposite intention. Lampert continuously supported SCI's long-term viability as a significant Canadian retailer. Lampert's commitment to SCI began in 2002, and his stake in SCI (through one or more of the ESL Funds) only grew over time. In October, 2014, Lampert increased the ESL Funds' shareholdings—as well as his own direct shareholdings—in SCI to their highest level ever. Given Lampert's and the ESL Funds' substantial stake in SCI, as well as Lampert's role as CEO of SHC, no one had a greater interest in the success of SCI as a continuing retail business than Lampert and the ESL Funds.

10. SCI continued to operate, pay its debts and employ and pay benefits to its personnel for three-and-a-half years after it paid the impugned 2013 dividend. The class does not seek to prove that the 2013 dividend caused SCI's 2017 insolvency because doing so would be impossible—the causes of SCI's 2017 insolvency had nothing to do with the 2013 dividend and certainly nothing to do with ESL Investments.

11. This claim should be dismissed not only because its allegations are unfounded. Its unprecedented attempt to reverse a solvent public company's more than five-year-old dividend would compromise corporate decision-making, undermine investment and create confusion and uncertainty in the Canadian capital markets.

The parties

1291079 Ontario Inc.

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

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

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

ESL Investments

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

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

17. At the time of the 2013 dividend ESL Investments itself did not own any shares of SCI or SHC. ESL Investments received no part of the 2013 dividend.

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

Sears Holdings Corporation

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

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

The ESL Funds' investment strategy

21. The ESL Funds invested in corporations that faced business challenges but could be made viable in the long term through the implementation of strategies tailored to their circumstances. The ESL Funds' turn-around strategies did not generally involve significant corporate restructuring. Instead, Lampert encouraged the companies within the ESL Funds' portfolio to test limited initiatives to determine which, if any, produced positive results. Those that succeeded would be adopted on a larger scale. Underlying the ESL Funds' strategy was the view that well-judged changes implemented by strong, independent leadership could produce major improvements in revenues and long-term results. Lampert believed that this strategy, if employed with SHC and with SCI, would produce good results.

SHC nominates Crowley and Harker to the SCI board

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

23. Lampert also relied upon two trusted and highly competent individuals nominated to SCI's board by SHC. William Crowley was a Yale-educated lawyer, with a master's degree from Oxford, who came to ESL Investments in 1999 from his position as a Managing Director of Goldman Sachs. He joined SHC in 2005 as EVP and CFO and served on the SCI board from March, 2005 until April, 2015. William Harker was a University of Pennsylvania-educated Wall

Street lawyer who served as SHC's SVP and General Counsel from 2005 to 2012. He served as SHC's nominee to the SCI board from November, 2008 until April, 2015. In or about late 2012, both Crowley and Harker left SHC and ESL Investments to found Àshe Capital Management, LP, an investment fund unaffiliated with ESL Investments, SHC or SCI.

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

Project Matrix

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

26. The stores with particularly poor ROI tended to be those in large, urban locations for which the value of the store's lease was highest. The retail market in such locations was shifting to a more upscale consumer that attracted retailers such as Nordstrom, Saks Fifth Avenue and the newly transformed Hudson's Bay Company. The Sears brand, on the other hand, was perceived to appeal to middle-market consumers and to be, increasingly, incompatible with pricier urban locations. The SCI stores identified as having among the lowest ROI were locations such as the Eaton Centre in Toronto (which became a Nordstrom), Sherway Gardens in Mississauga (which became a Saks Fifth Avenue) and the Pacific Centre in Vancouver (which became a Nordstrom).

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

The 2013 dividend

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

29. Although Lampert expressed his opinion to Crowley, Lampert knew well that the SCI board would make the decision in what it determined to be the best interests of SCI and without

any further input from him. Lampert had no communication at any time, let alone during the period of deliberation over the dividend, with the other six independent board members who he knew would have to consider and vote on the proposed dividend. He did not in any way request or direct Crowley, Harker or any other person to exert any pressure or influence on other members of the board.

ESL Investments had no need for cash prior to the 2013 dividend

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

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

SCI declares a dividend of $509 million

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

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

No dividend in 2014

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

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

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

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

37. SHC first sought offers for all of the outstanding shares of SCI. In June and July, 2014, Bank of America Merrill Lynch solicited a number of bids for SCI on behalf of SHC. Offers were made by at least three potential buyers, namely Kohlberg Kravis Roberts ("**KKR**"), Sycamore Partners Management, LLC ("**Sycamore**") and Hudson's Bay Company (**"HBC"**). KKR offered a purchase price of $14 to $15 per share; Sycamore offered $16 to $18 per share; and HBC offered $14 to $16 per share. These values represented a premium of up to 33% over the shares' trading value, and suggested a valuation of SCI of between $1.4 and $1.8 billion.

38. Ultimately, no transaction came to fruition.

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

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

40. Through the 2014 SHC rights offering, the ESL Funds and Lampert acquired a further 18 million shares of SCI, at a cost of approximately $190 million. This was the maximum allowed under the terms of the rights offering. As a result of this transaction, the ESL Funds and Lampert

became the holders of approximately 49.5% of the outstanding shares of SCI. Following the rights offering, ESL Investments continued to hold zero shares of SCI.

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

Circumstances leading to SCI's insolvency

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

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

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

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

46. Lampert did not support these decisions, which involved borrowing significant amounts on punitive terms in support of a strategy that carried with it significant risk. In particular,

Lampert was of the view that the company should not be taking on new debt while engaging in dramatic price reductions. In Lampert's view, Stranzl's decisions would place SCI at risk of failure. Lampert suggested to Stranzl that the better approach was to close under-performing stores.

47. Despite his concern, Lampert did not make an effort to intervene with the board, in line with his regular practice of providing input where appropriate but leaving the board to direct the company as it saw fit. Lampert was and is of the view that if Stranzl had taken his advice SCI would still be in operation today.

SCI borrowed on punitive terms

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

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

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

SCI experienced a liquidity crisis

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

52. When SCI entered CCAA protection, both its management and the Monitor expected SCI might continue as a going concern. The initial application suggested a plan Lampert himself had proposed earlier: closing those stores that were underperforming in order to keep a core-retail business going. Ultimately, SCI liquidated all of its stores.

The 2013 Wishart Action

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

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

55. 129 made three principal allegations in the 2013 Wishart Action: (1) that SCI breached duties owed to Dealers under provincial franchise legislation; (2) that SCI misrepresented the

profitability of the Hometown stores to the Dealers; and (3) that the changes SCI made in August 2012 to Dealers' commission rates and advertising subsidies were detrimental to the Dealers.

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

> (a) Has Sears Canada at any time since July 5, 2011 breached its obligations under the Dealer Agreements with each of the class members including the asserted obligation to exercise contractual discretion in good faith by:
>
> > (i) Failing to increase commission paid to class members;
> >
> > (ii) Changing commissions paid to class members in August 2012;
> >
> > (iii) Selling directly to consumers located within the class members' Market Areas (as defined in their respective Dealer Agreements), or, alternatively, by failing to pay commission to the class members for goods sold directly to consumers located within the class members' Market Areas through direct channels;
> >
> > (iv) Changing local store advertising subsidies;
> >
> > (v) Failing to provide a monthly accounting of how compensation was calculated; or
> >
> > (vi) Imposing handling fees payable by customers on catalogue sales made by dealers?
>
> (b) Has Sears Canada been unjustly enriched by any of the acts or omissions (a)(i) to (vi) above?
>
> (c) If liability is established what is the appropriate measure of damages or compensation, if any, for the class?
>
> (d) Is Sears Canada a "franchisor" within the meaning of the *Arthur Wishart Act (Franchise Disclosure)*, 2000, S.O. 2000, c. 3 (*Arthur Wishart Act)*? If so:
>
> > (i) Did Sears Canada breach the duty of fair dealing under s. 3 of the *Arthur Wishart Act* by any of the acts or omissions (a)(i) to (vi) above, and if so, what are the damages for the class?

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

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

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

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

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

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

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

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

58. ESL Investments understands that:

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

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

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

(d) in evaluating all pending lawsuits, SCI took into account available information, including guidance from experts (such as internal and external legal counsel) to

determine whether it was probable that a present legal or constructive obligation existed with respect to the claim and whether SCI could reliably measure such an obligation; and

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

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

No liability exists under the oppression cause of action

The directors complied with their duties at all times

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

61. The class does not dispute that the declaration and payment of the 2013 dividend accorded with both requirements in s. 42 of the CBCA. First, SCI was solvent at the time of the declaration of the dividend and it would remain so after the payment of the dividend. Second,

after the payment of the dividend the realizable value of SCI's assets exceeded the aggregate of its liabilities and the stated capital of all classes of its shares.

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

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

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

The class has no standing

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

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

66. Further, the class has not proven, and does not seek in this action to prove, that it is entitled to judgment in the 2013 Wishart Action. Absent any attempt to prove that it had an interest capable of being oppressed (rather than an interest in an unproven lawsuit), the class is not entitled to standing as a complainant under the CBCA or to a finding that SCI oppressed an "interest" held by a "creditor".

The class' alleged expectations are unreasonable

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

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

69. The reasonable expectations that the class alleges it had would attribute to directors a duty to manage the affairs of the corporation to the benefit of contingent judgment creditors. No such duties exist at law, so no such duties can be said to ground the class' purported

expectations. Contingent judgment creditors can have no reasonable expectation that a corporation will preserve and protect its assets for their potential benefit. Nor can they have a reasonable expectation that a corporation's affairs will be conducted with a view to protecting their contingent interest.

No oppression

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

71. ESL Investments relies on the reasonableness of the professional advice SCI and its directors received and on the reasonableness of SCI and its directors' assessment and subsequent treatment of the 2013 Wishart Action. The directors were entitled to exercise their business judgment with regard to the treatment of the 2013 Wishart Action.

72. Although ESL Investments presently has no access to the underlying advice that SCI and its directors received regarding the 2013 Wishart Action, ESL Investments understands from publicly available documents that SCI and its directors received information and professional advice regarding the viability and materiality of the 2013 Wishart Action. With the benefit of professional advice, SCI, its directors and its auditors concluded that although the outcome of the proceedings could not be predicted with certainty, the final disposition was not expected to have a material financial adverse effect on SCI's consolidated financial statements, including consolidated financial positions, net earnings, income, and cash flows. The Officer's Certificate for the solvency tests under s. 42 of the CBCA of SCI's Chief Financial Officer, Bird, dated

November 18, 2013 stated: "…it is unlikely that the Corporation will be required to make payment in respect of any contingent liability within a reasonably foreseeable period."

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

Shareholder immunity

74. Under s. 45(1) of the *Canada Business Corporations Act*, R.S.C. 1985, c. C-44, ESL Investments is not liable for any liability, act or default of SCI, including the declaration and payment of a dividend, other than by reason of exceptions that do not apply in this case. This legislative provision is a full defence to the action.

The 2013 dividend did not cause SCI's insolvency

~~74.~~75. The class does not allege that the 2013 dividend *caused* SCI's insolvency in 2017, an essential element to proving its alleged damages. Attributing the 2013 dividend to SCI's insolvency would be impossible, since: (i) it occurred over three-and-a-half years after the declaration of the 2013 dividend; (ii) it was not a foreseeable consequence of the declaration and payment of the dividend; and (iii) it would have occurred regardless of the declaration and payment of the dividend. Therefore, the 2013 dividend could not have *caused* the class' inability to recover damages in the 2013 Wishart Action.

No harm suffered as a result of the 2013 dividend

~~75.~~76. The class has suffered no harm as a result of the declaration and payment of the 2013 dividend because it would not have recovered damages in the 2013 Wishart Action. ESL Investments relies on all defences pleaded by SCI in the 2013 Wishart Action, including those based on the *Limitations Act, 2002*, SO 2002, c 24, Sch B.

~~76.~~77. In the alternative, the quantum of any damages suffered by the class is limited to the amount each class member would have received in the 2013 Wishart Action, and must be assessed on an individual basis. Any other remedy would put class members in a better position than they would have been in had the payment of the 2013 dividend not occurred, which is not permitted under the oppression remedy.

~~77.~~78. Moreover, the class has a duty to mitigate losses. Losses have been mitigated by way of an agreement reached with the Monitor dated December 14, 2018, which entitles the class to share in the SCI estate.

ESL Investments is not liable to the plaintiff

~~78.~~79. Even if the directors' declaration and payment of the 2013 dividend was oppressive to the interests of the class and caused it to suffer damages, which is denied, setting aside the declaration of the 2013 dividend and requiring ESL Investments to repay the dividend would be unjust in the circumstances. ESL Investments did not receive any of the 2013 dividend. Moreover, it did not know, and ought not reasonably to have known, that the declaration and payment of the 2013 dividend would be oppressive to the interests of the plaintiff. Nor did ESL Investments cause the 2013 dividend to be declared and paid. ESL Investments is not an affiliate

of SCI, nor is it a shareholder. In these circumstances, a remedy in oppression against ESL Investments is unavailable.

Damages limited to those attributable to the liability of ESL Investments alone

80. By reason of the orders of the Honourable Justice McEwen dated March 17, 2020 and the Honourable Justice Hainey dated August 25, 2020, the class is prevented from seeking from ESL Investments damages attributable to the liability of SHC, William Harker, William Crowley, Donald Ross, Ephraim J. Bird, Deborah Rosati, R. Raja Khanna, James McBurney or Douglas Campbell.

81. ESL Investments denies all liability in the action. In the alternative, in the event that ESL Investments is found liable in the action, it requests that the Court apportion liability among it and the parties listed in the paragraph directly above, and award recovery or damages attributable only to ESL Investments' own liability.

82. ESL Investments pleads and relies on the *Negligence Act*, R.S.O. 1990, c. N.1.

Requested resolution

~~79.~~83. ESL Investments asks that this action be dismissed with costs.

~~June 29, 2019~~September 10, 2020

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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

AMENDED STATEMENT OF DEFENCE OF ESL INVESTMENTS, INC.

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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 R. HARKER and WILLIAM C. CROWLEY
Defendants

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

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

Overview

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

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

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

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

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

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

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

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

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

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

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

The parties

The plaintiff

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

The ESL Parties

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

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

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

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

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

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

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

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

Lampert's investment strategy

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

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

The ESL Parties' early indirect investment in SCI

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

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

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

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

SHC nominates Crowley and Harker to the SCI board

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

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

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

The ESL Parties' acquisition of a direct interest in SCI

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

Project Matrix

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

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

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

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

The 2013 dividend

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

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

or direct Crowley, Harker or any other person to exert any pressure or influence on other members of the board.

ESL had no need for cash prior to the 2013 dividend

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

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

SCI declares a dividend of $509 million

36. On November 19, 2013, the SCI board approved the declaration of an extraordinary dividend of $509 million. Lampert believed, and public records confirmed, that the financial position of SCI could reasonably have supported a larger dividend. The dividend was in fact

conservative in light of the disparity between SCI's significant cash on hand and the much smaller amount that SCI required for its ongoing operations.

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

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

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

39. According to a December 31, 2010 actuarial report—the most recent triennial actuarial report at the time the dividend was declared—the Plan complied with the regulations. Like many

defined benefit pension plans at the time, it had under-funded liabilities: on a going concern basis of $68 million, on a solvency basis of $206 million and on a hypothetical wind-up basis of $307 million. As a result of the report, SCI was required to make payments of approximately $29 million per year in 2012 and 2013. These payments specified in the actuarial report were the only payments SCI was legally required to make into the Plan. There was no legislative requirement that SCI immediately eliminate any funding deficiency. SCI made the required payments in 2012 and 2013 and also remitted an additional $15 million in 2013.

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

Pension Plan Funded Surplus / (Deficit)

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

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

42. Although the December 31, 2013 report was prepared after the declaration of the 2013 dividend, members of SCI's board and management knew at the time of the declaration of the 2013 dividend that the Plan's financial position was improving. In particular, Crowley, Harker and Bird sat on an investment committee that oversaw the Plan's investments. The investment committee received regular reports regarding the performance of the Plan's investments, and estimates from SCI management about the Plan's position on a going concern basis, solvency basis and hypothetical wind-up basis. These reports and estimates showed Bird and the Directors that the position of the Plan continuously improved between 2010 and the time the dividend was declared in late 2013.

No dividend in 2014

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

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

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

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

46. SHC first sought offers for all of the outstanding shares of SCI. In June and July, 2014, Bank of America Merrill Lynch solicited a number of bids for SCI on behalf of SHC. Offers

were made by at least three potential buyers, namely Kohlberg Kravis Roberts (“**KKR**”), Sycamore Partners Management, LLC (“**Sycamore**”) and Hudson’s Bay Company (**“HBC”**). KKR offered a purchase price of $14 to $15 per share; Sycamore offered $16 to $18 per share; and HBC offered $14 to $16 per share. These values represented a premium of up to 33% over the shares’ trading value, and suggested a valuation of SCI of between $1.4 and $1.8 billion.

47. Ultimately, no transaction came to fruition.

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

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

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

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

Circumstances leading to SCI's insolvency

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

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

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

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

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

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

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

SCI borrowed on punitive terms

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

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

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

SCI experienced a liquidity crisis

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

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

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

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

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

The 2013 dividend is not a transfer at undervalue

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

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

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

The elements of s. 96 are not met

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

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

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

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

The 2013 dividend was not a transfer at undervalue

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

The 2013 dividend was transferred at arm's length

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

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

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

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

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

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

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

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

The ESL Parties are not privies to the 2013 dividend

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

Damages limited to those attributable to the liability of the ESL Parties alone

74. By reason of the orders of the Honourable Justice McEwen dated March 17, 2020 and the Honourable Justice Hainey dated August 25, 2020, the Monitor is prevented from seeking from the ESL Parties damages attributable to the liability of SHC, William Harker, William Crowley, Donald Ross, Ephraim J. Bird, Deborah Rosati, R. Raja Khanna, James McBurney or Douglas Campbell.

75. The ESL Parties deny all liability in the action. In the alternative, in the event that the ESL Parties are found liable in the action, they request that the Court apportion liability among them and the parties listed in the paragraph directly above, and award recovery or damages attributable only to the ESL Parties' own liability.

Requested resolution

~~74.~~76. The ESL Parties ask that this action be dismissed with costs on a substantial indemnity basis.

~~May 10, 2019~~September 10, 2020

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COPY TO: **THE LITIGATION SERVICE LIST**

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

-and-

ESL INVESTMENTS INC. et al.
Defendants

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

ONTARIO
SUPERIOR COURT OF JUSTICE
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AMENDED STATEMENT OF DEFENCE OF ESL INVESTMENTS INC., ESL PARTNERS, LP, SPE I PARTNERS, LP, SPE MASTER I, LP, ESL INSTITUTIONAL PARTNERS, LP and EDWARD S. LAMPERT

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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 S. LAMPERT, EPHRAIM J. BIRD, DOUGLAS CAMPBELL,
WILLIAM CROWLEY, WILLIAM HARKER, R. RAJA KHANNA, JAMES
MCBURNEY, DEBORAH ROSATI, ~~and~~ DONALD ROSS and SEARS
HOLDINGS CORPORATION

Defendants

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

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

Overview

2. This claim is a bold and unprecedented attempt to claw back a dividend lawfully declared and paid by a public corporation to all of its shareholders in circumstances that did not remotely render the company insolvent. Sears Canada Inc. ("**SCI**") declared the dividend in reasonable and unremarkable circumstances—it had over $1 billion in cash, it had virtually no debt, and its business was considered to be in recovery. The Litigation Trustee now seeks to enrich the SCI

estate on behalf of SCI's creditors by reaching beyond the long-expired limitation period to claim that certain defendants conspired to sell assets and declare a dividend that caused unspecified "serious harm" to SCI.

3. There was no conspiracy. The Litigation Trustee's attempt to build a circumstantial case for a conspiracy rests on three key assumptions: that the ESL Parties "controlled" SCI; that certain defendants conspired to sell SCI's "crown jewels"; and that these actions were taken to benefit the ESL Parties because they had an "immediate need for cash" to fund redemption obligations from the hedge funds operated by them (the "**ESL Funds**"). Each of these is false.

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

5. Second, the stores SCI sold in 2013 were not SCI's "crown jewels" as the Litigation Trustee alleges. Although they may have had that appearance—many were large stores located in prime urban locations—they were in fact selected by SCI for liquidation because they produced among the lowest returns of all of SCI's stores. Their sale was part of a well-considered strategy to reduce SCI's retail footprint to allow SCI to concentrate on more profitable locations. After the 2013 sales, SCI continued to operate over 100 full-line stores in Canada. The Litigation

Trustee's "crown jewels" myth is founded on this basic misconception of SCI's retail strategy, which was—and continues to be—well-accepted and common in the retail industry.

6. Third, the Litigation Trustee's alleged motive for the "conspiracy"—that the ESL Funds were facing a "liquidity crisis" and were desperate for cash—is a bald fabrication. The ESL Funds had no need for cash. They had the option to distribute securities they owned in fulfilment of their redemption obligations, which, in part, they did. At the time of the dividend, the ESL Funds had far more cash and securities on hand than they needed to satisfy the outstanding redemptions. By the end of 2013, the ESL Funds had **US$1.433 billion** in residual cash.

7. Far from the alleged motive to strip assets to remedy this fabricated "liquidity crisis", Lampert's own actions demonstrate the opposite intention—to support SCI's long-term viability as a significant Canadian retailer. Lampert's commitment to SCI began in 2002, and his stake in SCI, through one or more of the ESL Parties, only grew over time. In October, 2014, Lampert increased the ESL Parties' shareholdings in SCI to their highest level ever, namely 49.5%. Given that stake, as well as Lampert's role as CEO of SHC, no one had a greater interest in the success of SCI as a continuing retail business than Lampert and the ESL Parties.

8. As for the allegation that the directors breached duties they owed to SCI, the fact is that the 2013 dividend was a reasonable exercise of business judgment at a time when SCI was clearly solvent. The 2013 dividend, which had been anticipated by market analysts who covered the company, was publicly announced in November, 2013. After the dividend was declared, the market continued to ascribe substantial value to SCI as a going concern: in 2014, arm's-length bidders for SCI offered between $14 and $18 per share to purchase the company, valuing SCI at

between $1.4 and $1.8 billion. SCI's market capitalization on the day after the dividend was paid was over $1 billion.

9. Further, no stakeholders were harmed by the 2013 dividend. SCI had virtually no long-term debt in December, 2013 and continued to discharge its current obligations in the ordinary course. The trade creditors the Litigation Trustee claims were oppressed or harmed by the dividend extended credit to SCI only after the dividend was announced, and therefore *with full knowledge that it had been paid*. Not only does this demonstrate the futility of the Litigation Trustee's claim; the facts also show the arrant hindsight on which the claim is founded. SCI continued to operate, pay its debts, employ and pay benefits to its personnel and fund its pension liabilities for three and a half years after it paid the 2013 dividend. The Litigation Trustee does not seek to prove that the 2013 dividend caused SCI's 2017 insolvency because doing so would be impossible—the causes of SCI's 2017 insolvency had nothing to do with the 2013 dividend and certainly nothing to do with the ESL Parties.

10. This claim should be dismissed because its allegations are unfounded and because of the expiration of the limitation period by November, 2015. Its unprecedented attempt to reverse a solvent public company's more than five-year-old dividend would compromise corporate decision making, undermine investment and create confusion and uncertainty in the Canadian capital markets.

The parties

The plaintiff

11. The Litigation Trustee, the Honourable J. Douglas Cunningham Q.C., was appointed by this Court to pursue various claims on behalf of the creditors of the SCI estate. The Litigation Trustee purports to bring this claim on behalf of SCI and all of its "stakeholders".

12. SCI was a Canadian retailer and publicly traded company. It is incorporated under the *Canada Business Corporations Act*, RSC, 1985, c. C-44 (the "**CBCA**"). On June 22, 2017, SCI and its related entities made an initial application and were granted protection from creditors under the *Companies' Creditors Arrangement Act*, RSC, 1985, c. C-36 (the "**CCAA**").

The ESL Parties

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

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

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

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

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

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

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

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

Sears Holdings Corporation

20. SHC is an American holding company. It is the parent company of Kmart Holding Corporation ("**Kmart**") and Sears, Roebuck. Through its interest in Sears, Roebuck and a

number of wholly owned subsidiaries, SHC was the majority shareholder of SCI at the time of SCI's declaration of the 2013 dividend.

The ESL Funds' investment strategy

21. The ESL Funds invested in corporations that faced business challenges but could be made viable in the long term through the implementation of strategies carefully tailored to their circumstances. The ESL Funds' turn-around strategies did not generally involve significant corporate restructuring. Instead, Lampert encouraged the companies within the ESL Funds' portfolio to test limited initiatives to determine which, if any, produced positive results. Those that succeeded would be adopted on a larger scale. Underlying the ESL Funds' strategy was the view that well-judged changes implemented by strong, independent leadership could produce major improvements in revenues and long-term results. The ESL Parties believed that this strategy, if employed with SHC and with SCI, would produce good results.

The ESL Parties' early indirect investment in SCI

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

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

23. In 2002, the ESL Parties also acquired a substantial minority position in Sears, Roebuck the then-controlling shareholder of SCI. Then, following the acquisition of the controlling

majority interest in Kmart, Lampert and the other ESL Parties caused Kmart to acquire all of Sears, Roebuck, with the objective of building a great combined retail operation. The deal was announced November 17, 2004 and closed on March 24, 2005, resulting in a new corporation, SHC. SHC continued to operate stores under both the Sears and Kmart brands.

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

SHC nominates Crowley and Harker to the SCI board

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

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

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

The ESL Parties' acquisition of a direct interest in SCI

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

Project Matrix

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

considered for sale, thereby reducing SCI's portfolio of under-performing stores and allowing it to concentrate its efforts on those stores that could generate a higher ROI.

30. The stores with particularly poor ROI tended to be those in large, urban locations for which the value of the store's lease was highest. The retail market in such locations was shifting to a more upscale consumer that attracted retailers such as Nordstrom, Saks Fifth Avenue and the newly-transformed Hudson's Bay Company. The Sears brand, on the other hand, was perceived to appeal to middle-market consumers and to be, increasingly, incompatible with pricier urban locations. The SCI stores identified as having among the lowest ROI were locations such as the Eaton Centre in Toronto (which became a Nordstrom), Sherway Gardens in Mississauga (which became a Saks Fifth Avenue) and the Pacific Centre in Vancouver (which became a Nordstrom).

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

The 2013 dividend

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

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

ESL had no need for cash prior to the 2013 dividend

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

35. The Litigation Trustee's assertion that the ESL Funds had a "desperate" need for cash is demonstrably false. Prior to the declaration of the 2013 dividend on November 19, 2013, the ESL Funds had received all of the redemption requests from unitholders they had to satisfy by the end of the year.

36. While the standard terms of unitholder agreements permitted each of the ESL Funds to satisfy redemption requests either with cash or through the transfer of securities, the other terms applicable to redemptions vary by fund, as follows:

(a) Within the ESL Funds, ESL Partners, LP ("**ESL Partners**") is the main investment fund. Certain investors' investments in ESL Partners may be gated. The gate allows the general partner to limit redemptions in relation to the gated investors. Despite having access to

this gate, ESL Partners funded all redemption requests in 2013. After doing so, ESL Partners had retained cash of **US$1.433 billion.**

(b) SPE I Partners, LP, and SPE Master I, LP (together, the "**SPE Funds**") were special purpose vehicles set up by ESL Partners in 2012 to allow investors in the ESL Partners fund to reinvest in SHC as a partial alternative to redemptions from the ESL Partners fund. Under the standard terms of the SPE Funds, redemptions from the SPE Funds would occur in 2014 and 2015 for all investors—no redemptions occurred in 2012 or 2013.

(c) ESL Institutional Partners, LP ("**ESL Institutional**"), is a fund that primarily invests on behalf of individuals connected with the ESL Parties, including former employees of ESL Investments. In 2012, after paying the redemptions, ESL Institutional had retained cash of US$26,794. In 2013, there were no redemptions.

37. In comparison to the significant amount of retained cash in the ESL Funds, the funds received little proceeds from the 2013 dividend, equivalent to approximately US$83 million. The dividend accounted for less than 6% of the ESL Funds' retained cash.

SCI declares a dividend of $509 million

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

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

The SCI pension plan was appropriately funded at the time of the 2013 dividend

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

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

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

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

Pension Plan Funded Surplus / (Deficit)

Basis	December 31, 2010	December 31, 2013	Improvement
Going Concern	($68 million)	$15 million	$83 million
Solvency	($206 million)	($76 million)	$129 million
Wind-Up	($307 million)	($133 million)	$174 million
Solvency Ratio	86%	95%	9%

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

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

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

No dividend in 2014

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

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

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

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

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

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

49. Ultimately, no transaction came to fruition.

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

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

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

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

Circumstances leading to SCI's insolvency

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

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

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

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

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

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

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

SCI borrowed on punitive terms

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

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

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

SCI experienced a liquidity crisis

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

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

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

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

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

The directors complied with their fiduciary duties at all times

65. In approving the declaration of the 2013 dividend, the directors properly exercised their power under the common law, the articles and by-laws of SCI, and ss. 42, 43(1) and 102(1) of the CBCA. It is undisputed that the declaration and payment of the 2013 dividend accorded with both of the requirements in s. 42 of the CBCA. First, SCI was solvent at the time of the declaration of the dividend and it would remain so after the payment of the dividend. Second, after the payment of the dividend the realizable value of SCI's assets exceeded the aggregate of its liabilities and the stated capital of all classes of its shares.

66. The directors complied with their fiduciary duty to SCI by taking into account the fact that the payment of the dividend would satisfy the requirements of s. 42 of the CBCA. In addition to considering the solvency test in that provision, SCI's directors and Bird:

- received and considered extensive information about the performance of SCI and its progress in achieving the goals set out in Project Matrix;
- knew that as a result of the divestitures of real estate assets SCI had cash on hand that was surplus to its contemplated requirements and, as a result, that the health of the continuing business of SCI would not be impaired by the payment of a dividend; and

- specifically obtained a solvency certificate from management confirming the solvency of SCI both before and after the payment of the 2013 dividend.

67. It was, at the same time, reasonable for the directors to believe that the cash that SCI had on hand after the sales of the real estate assets was surplus to its contemplated requirements and that, as a result, the payment of the dividend would not impair the health of the continuing business of SCI in any way that would enure to the detriment of the shareholders and other stakeholders. The decision to approve the dividend in these circumstances was a legitimate exercise of business judgment on the part of the directors.

68. In approving the 2013 dividend, the directors owed no fiduciary or other duty to SCI's creditors. Directors owe a statutory duty to act in the best interests of the corporation of which they are directors. The Litigation Trustee improperly asserts the best interests of the corporation primarily from the point of view of trade creditors. These comprise only one stakeholder group, and it is not their interest exclusively, or in ordinary circumstances at all, to which directors must have regard in exercising their duties in the corporation's best interests. A corporation's interests are not co-extensive with the interests of its creditors.

69. Even supposing a duty was owed to the creditors, which is denied, it was reasonable for the directors to believe that the creditors' interests would not be impaired by the payment of the dividend, in particular because SCI retained assets whose value was, by a considerable margin, more than adequate to satisfy the liabilities it had in late 2013. The decision to approve the dividend was accordingly a legitimate exercise of business judgment on the part of the directors.

No knowing assistance or knowing receipt

70. The ESL Parties did not knowingly assist in a breach by the directors of fiduciary duties or knowingly receive funds paid as a result of a breach.

71. The declaration and payment of the 2013 dividend did not constitute a breach of the directors' fiduciary duty to SCI. The ESL Parties could therefore not have assisted in a breach of fiduciary duty or received funds that arose out of a breach.

72. In any event, and regardless of whether the directors breached their duties, the ESL Parties did not induce the alleged breach. The ESL Parties were not in need of cash in late 2013 and were perfectly capable of satisfying investors' redemptions, as a result of which they had no urgent need for the payment of a dividend by SCI. The Litigation Trustee's allegations to the contrary are false.

73. Moreover, and regardless of whether the directors breached their duties, the ESL Parties had no actual or constructive knowledge of the alleged breach. Nor were they wilfully blind or reckless as to the existence of the alleged breach.

No unjust enrichment

74. The ESL Parties were not unjustly enriched by the payment of the 2013 dividend, because they were not enriched at all. Immediately following the payment, and in all likelihood on that account, the company's share price declined by a slightly greater amount than the amount of the dividend, leaving the shareholders no better off.

75. If, as the Litigation Trustee alleges, the payment of the 2013 dividend represented an enrichment, which is denied, there was a juristic basis for the ESL Parties' receipt and retention of their portion thereof. The receipt of dividends is a normal incident of the ownership of shares. The declaration of dividends was within the legal powers of the directors of SCI. The directors exercised this power in declaring the 2013 dividend. Once it was declared, SCI was legally obliged to pay it to the shareholders and the shareholders were legally entitled to receive it.

No oppression

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

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

No oppression of SCI

78. SCI cannot claim relief for itself under the oppression remedy for the 2013 dividend because it was not a security holder, creditor, director or officer of SCI at the time of the 2013 dividend. These defendants plead and rely upon the plain meaning of ss. 238 and 241 of the CBCA.

79. Even if SCI can claim relief for itself under the oppression remedy, which is denied, its reasonable expectations necessarily coincide with the duties owed to it by the directors, as set out herein. By complying with their duties, as they did, the directors acted in accordance with SCI's reasonable expectations. Accordingly, SCI was not oppressed.

No oppression of the creditors

80. The declaration and payment of the 2013 dividend were not oppressive to the interests of creditors of SCI, these were not unfairly prejudicial to such interests, and they did not unfairly disregard such interests.

81. The reasonable expectations that the Litigation Trustee alleges the creditors to have had would attribute to the directors a fiduciary duty to:

- manage the affairs of the corporation to the benefit of the creditors, as the stakeholder group whose interests the Litigation Trustee identifies with those of the corporation; and
- reserve assets of the corporation sufficient to ensure the payment of, presumably, any actual or eventual creditors' claims, whenever such claims may arise in the future.

82. Neither such duty exists at law, so neither can be said to ground the creditors' purported expectations.

83. In any event, and even assuming the existence of such duties, the directors determined, in good faith and on reasonable grounds, that the payment of the 2013 dividend satisfied the solvency requirements of s. 42 of the CBCA and would not impair the creditors' interests. The decision was therefore a legitimate exercise of their business judgment and as such could not have unfairly disregarded the interests of SCI's creditors.

84. Additionally, the Litigation Trustee fails to plead the date on which creditors' claims against SCI arose or plead whether some or any of those claims were satisfied before SCI entered into CCAA proceedings. For those creditors of SCI who had claims that arose before or after the declaration of the 2013 dividend, but which were subsequently satisfied, the declaration and

payment of the 2013 dividend cannot have frustrated any reasonable expectation or caused any harm. Such creditors have suffered no monetary loss.

85. Those creditors of SCI who had claims against SCI that arose after the declaration of the 2013 dividend are not “creditors” within the meaning of s. 241(2) of the CBCA, and the Litigation Trustee can advance no oppression claim with respect to or on behalf of such creditors.

86. In any event, such creditors cannot have had any reasonable expectation at the time their claims against SCI arose that SCI would not declare the 2013 dividend. It was a past event. Moreover, such creditors entered into commercial arrangements with SCI on the basis of its then-existing financial state. The 2013 dividend had been publicly disclosed and was known to them. By choosing nonetheless to extend credit to the corporation, on whatever terms they were able to negotiate, they assumed any risk that resulted from its prior payment.

87. Moreover, even if the directors’ declaration and payment of the 2013 dividend was oppressive to the interests of any of SCI’s creditors, which is denied, setting aside the declaration of the 2013 dividend and requiring the ESL Parties to repay their share of it to SCI would be unjust in the circumstances. As pleaded, the ESL Parties did not know, and ought not reasonably to have known, that the declaration and payment of the 2013 dividend constituted a breach of the fiduciary duties the directors owed to SCI. Moreover, the ESL Parties did not know, and ought not reasonably to have known, that the declaration and payment of the 2013 dividend would be oppressive to the interests of SCI’s creditors. Nor did the ESL Parties have any involvement in the declaration and payment of the 2013 dividend. In these circumstances, granting a remedy in oppression against the ESL Parties would be inequitable.

88. Finally, the declaration of the 2013 dividend did not cause harm to the creditors of SCI that remained unpaid by SCI when it entered into CCAA proceedings. The 2013 dividend did not cause SCI's insolvency, which occurred over three-and-a-half years after the declaration of the 2013 dividend, which was not a foreseeable consequence of the declaration and payment of the 2013 dividend, and which would have occurred regardless of the declaration and payment of the 2013 dividend.

No conspiracy

89. The statement of claim fails to allege facts which, if proven, establish the existence of a tortious conspiracy. The facts pleaded are consistent with an intention on the part of the alleged conspirators to secure SCI's best interests.

90. In any event, Lampert, Crowley, Harker and Bird came to no agreement in 2012 or 2013, or at any time, pursuant to which SCI would dispose of assets and distribute the proceeds by way of a dividend. In respect of such matters, and all matters, Crowley, Harker, Bird and the remaining SCI directors acted completely independently of the ESL Parties and with a view to SCI's best interests.

91. Lampert, Crowley, Harker and Bird did not know, nor ought they reasonably to have known, that the actions impugned by the plaintiff would cause harm to SCI. Nor did they.

92. Moreover, even if Lampert, Crowley, Harker and Bird came to such an agreement, which is denied, the conspiracy claim relies exclusively on causes of action pleaded elsewhere in the amended amended statement of claim. The Litigation Trustee does not plead damages arising out of the alleged conspiracy that are separate and apart from the damages arising from the causes of

action pleaded elsewhere in the amended amended statement of claim. The Litigation Trustee's conspiracy claim is redundant and unnecessary, and the doctrine of merger applies.

Shareholder immunity

93. Under s. 45(1) of the *Canada Business Corporations Act*, R.S.C. 1985, c. C-44, the ESL Parties are not liable for any liability, act or default of SCI, including the declaration and payment of a dividend, other than by reason of exceptions that do not apply in this case. This legislative provision is a full defence to the action.

The action is time-barred

~~93.~~94. The declaration of the 2013 dividend occurred on November 19, 2013. This action was commenced on December 19, 2018. This was over three years after the expiration of the two-year limitation period under s. 4 of the *Limitations Act*, 2002, SO 2002, c. 24, Sch. B. This action is time-barred.

Damages limited to those attributable to the liability of the ESL Parties alone

95. By reason of the orders of the Honourable Justice McEwen dated March 17, 2020 and the Honourable Justice Hainey dated August 25, 2020, the Litigation Trustee is prevented from seeking from the ESL Parties damages attributable to the liability of SHC, William Harker, William Crowley, Donald Ross, Ephraim J. Bird, Deborah Rosati, R. Raja Khanna, James McBurney or Douglas Campbell.

96. The ESL Parties deny all liability in the action. In the alternative, in the event that the ESL Parties are found liable in the action, they request that the Court apportion liability among

them and the parties listed in the paragraph directly above, and award recovery or damages attributable only to the ESL Parties' own liability.

97. The ESL Parties plead and rely on the *Negligence Act*, R.S.O. 1990, c. N.1.

Requested resolution

~~94.~~98. The ESL Parties ask that this action be dismissed with costs on a substantial indemnity basis.

~~July 29, 2019~~September 10, 2020

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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 STATEMENT OF DEFENCE

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

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

Overview

2. This claim is a bold and unprecedented attempt to claw back a dividend lawfully declared and paid by a public corporation to all of its shareholders in circumstances that did not remotely render the company insolvent. Sears Canada Inc. ("**SCI**") declared the dividend in reasonable and unremarkable circumstances—it had over $1 billion in cash and virtually no debt, and its business was considered to be in recovery. Morneau now seeks to reach beyond the long-expired

limitation period to claim that the ESL Parties "directed" or "induced" SCI's eight directors—six of whom were entirely independent of the ESL Parties—to sell assets and declare a dividend contrary to their fiduciary duties to SCI's pension plan.

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

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

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

myth is founded on this basic misconception of SCI's retail strategy which was—and continues to be—well-accepted and common in the retail industry.

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

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

8. As for the allegation that the directors breached duties they owed to the Pensioners, the directors did not in fact owe any fiduciary duty to the Pensioners in making decisions about dividends or making payments into the SCI pension plan (the "**Plan**"). The fact is that the 2013 dividend was a reasonable exercise of business judgment at a time when SCI was clearly solvent. The 2013 dividend, which had been anticipated by market analysts who covered the company, was publicly announced in November, 2013. After the dividend was declared, the market

continued to ascribe substantial value to SCI as a going concern: in 2014, arm's-length bidders for SCI offered between $14 and $18 per share to purchase the company, valuing SCI at between $1.4 and $1.8 billion. SCI's market capitalization on the day after the dividend was paid was over $1 billion. Morneau's attempt to attribute harm to the 2013 dividend some five years later is an exercise in arrant hindsight.

9. Further, at the time the 2013 dividend was declared, SCI had made and continued to make all payments to the Plan that it was legally required to make. The amount of these payments was a small fraction of SCI's assets after the payment of the dividend. The financial position of the Plan had improved substantially since the most recent actuarial report that gave the position of the Plan as of December 31, 2010—a fact that was known to SCI's board when it declared the 2013 dividend, and that was confirmed in a subsequent actuarial report giving the financial position of the Plan as of December 31, 2013.

10. SCI continued to operate, pay its debts and employ and pay benefits to its personnel for three-and-a-half years after it paid the 2013 dividend. Morneau does not seek to prove that the 2013 dividend caused SCI's 2017 insolvency because doing so would be impossible—the causes of SCI's 2017 insolvency had nothing to do with the 2013 dividend and certainly nothing to do with the ESL Parties.

11. This claim should be dismissed not only because its allegations are unfounded. Its unprecedented attempt to reverse a solvent public company's more than five-year-old dividend would compromise corporate decision-making, undermine investment and create confusion and uncertainty in the Canadian capital markets.

The parties

The plaintiff

12. On October 16, 2017, the Superintendent of Financial Services for Ontario appointed the plaintiff, Morneau Shepell Ltd. ("**Morneau**"), as administrator of SCI's registered defined benefit pension plan (the "**Plan**"). Prior to that date SCI was the Plan sponsor and administrator.

The ESL Parties

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

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

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

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

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

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

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

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

Lampert's investment strategy

20. The ESL Funds invested in corporations that faced business challenges but could be made viable in the long term through the implementation of strategies carefully tailored to their circumstances. The ESL Funds' turn-around strategies did not generally involve significant corporate restructuring. Instead, Lampert encouraged the companies within the ESL Funds' portfolio to test limited initiatives to determine which, if any, produced positive results. Those that succeeded would be adopted on a larger scale. Underlying the ESL Funds' strategy was the

view that well-judged changes implemented by strong, independent leadership could produce major improvements in revenues and long-term results. The ESL Parties believed that this strategy, if employed with SHC and with SCI, would produce good results.

The ESL Parties' early indirect investment in SCI

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

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

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

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

SHC nominates Crowley and Harker to the SCI board

24. Because of his positions with SHC, Lampert was entitled to exercise a degree of oversight over the affairs of SCI and to be kept informed by its management and to be consulted

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

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

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

The ESL Parties' acquisition of a direct interest in SCI

27. The ESL Parties acquired a direct interest in SCI in 2012 and, in the years after the 2013 dividend, continued to invest more in SCI. The ESL Parties first acquired their direct interest in

SCI through a partial spin-off of SCI by SHC in 2012. In connection with the 2012 spin-off, SHC distributed approximately 45 million common shares of SCI on a *pro rata* basis to holders of SHC's common stock. As a result, the ESL Parties acquired approximately 27% of the shares of SCI.

Project Matrix

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

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

Eaton Centre in Toronto (which became a Nordstrom), Sherway Gardens in Mississauga (which became a Saks Fifth Avenue) and the Pacific Centre in Vancouver (which became a Nordstrom).

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

The 2013 dividend

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

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

ESL had no need for cash prior to the 2013 dividend

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

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

SCI declares a dividend of $509 million

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

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

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

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

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

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

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

Pension Plan Funded Surplus / (Deficit)

Basis	December 31, 2010	December 31, 2013	Improvement
Going Concern	($68 million)	$15 million	$83 million
Solvency	($206 million)	($76 million)	$129 million
Wind-Up	($307 million)	($133 million)	$174 million
Solvency Ratio	86%	95%	9%

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

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

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

No dividend in 2014

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

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

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

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

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

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

46. Ultimately, no transaction came to fruition.

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

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

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

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

Circumstances leading to SCI's insolvency

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

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

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

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

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

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

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

SCI borrowed on punitive terms

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

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

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

SCI experienced a liquidity crisis

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

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

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

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

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

No liability exists under the causes of action asserted by Morneau

62. The ESL Parties deny liability under each of the causes of action that Morneau asserts. Most of these causes of action, even if they had merit, would belong to SCI, and not to SCI's pensioners (the "**Pensioners**"). Moreover, the viability of each of these causes of action depends on the premises that the declaration and payment of the 2013 dividend constituted a breach of the directors' duties to the Pensioners or otherwise unfairly frustrated the reasonable expectations of the Pensioners. These premises are false.

The directors complied with their duties at all times

63. In approving the declaration of the 2013 dividend, the directors properly exercised their power under the common law, the articles and by-laws of SCI and ss. 42, 43(1) and 102(1) of the CBCA. It is undisputed that the declaration and payment of the 2013 dividend accorded with both of the requirements in s. 42 of the CBCA. First, SCI was solvent at the time of the declaration of the dividend and it would remain so after the payment of the dividend. Second, after the payment of the dividend the realizable value of SCI's assets exceeded the aggregate of its liabilities and the stated capital of all classes of its shares.

64. The directors complied with their fiduciary duty to SCI by taking into account the fact that the payment of the dividend would satisfy the requirements of s. 42 of the CBCA. In addition to considering the solvency test in that provision, SCI's directors and Bird:

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

65. It was, at the same time, reasonable for the directors to believe that the cash that SCI had on hand after the sales of the real estate assets was surplus to its contemplated requirements and that, as a result, the payment of the dividend would not impair the health of the continuing business of SCI in any way that would enure to the detriment of the shareholders and other stakeholders. The decision to approve the dividend in these circumstances was a legitimate exercise of business judgment on the part of the directors.

66. In any event, the scope of the fiduciary duty owed by SCI's directors to the beneficiaries of the Plan did not extend to the directors' business decisions made in the best interests of the corporation, such as the payment of a dividend. The directors of a corporation owe a fiduciary duty to the beneficiaries of the corporate pension plan only in respect of functions related to the *administration* of that plan. Morneau wrongly asserts in its claim that the SCI's directors' fiduciary duty extends to all decisions that directors take in fulfilling their duties to the corporation.

67. In approving the 2013 dividend, the directors owed no fiduciary or other duty to the beneficiaries of the Plan. Directors owe a statutory duty to act in the best interests of the corporation. Morneau improperly asserts the best interests of the corporation primarily from the point of view of the Plan beneficiaries. These comprise only one stakeholder group, and it is not their interest exclusively, or in ordinary circumstances at all, to which directors must have regard in exercising their duties in the corporation's best interests. A corporation's interests are not co-extensive with the interests of pension beneficiaries. Contrary to the position that Morneau pleads in its statement of claim, the SCI directors were not obliged in this situation to follow any special process or otherwise to justify the exercise of their discretion.

68. Even supposing the directors of SCI owed a duty to the Pensioners in considering and declaring the 2013 dividend, which is denied, it was reasonable for the directors to believe that the Pensioners' interests would not be impaired by the payment of the 2013 dividend, in particular because SCI retained assets whose value was, by a considerable margin, more than adequate to satisfy the liabilities it had in late 2013. The decision to approve the dividend was accordingly a legitimate exercise of business judgment on the part of the directors.

No knowing assistance or knowing receipt

69. The Pensioners have no claim in knowing assistance or knowing receipt against the ESL Parties. SCI paid the 2013 dividend from its own funds, not funds belonging to or being held in trust for the Pensioners. The claims, if any, rest with SCI and have been asserted by it.

70. In addition, the allegations Morneau makes in support of its claims in knowing assistance and knowing receipt have no merit.

71. The fact is that the declaration and payment of the 2013 dividend did not constitute a breach of the directors' fiduciary duty to SCI. The ESL Parties could therefore not have assisted in a breach of fiduciary duty or received funds that arose out of a breach.

72. In any event, and regardless of whether the alleged breach occurred, the ESL Parties did not induce the breach. The ESL Parties were not in need of cash in late 2013 and were perfectly capable of satisfying investors' redemptions, as a result of which they had no urgent need for the payment of a dividend by SCI. Morneau's allegations to the contrary are false.

73. Moreover, and regardless of whether the alleged breach occurred, the ESL Parties had no actual or constructive knowledge of the alleged breach. Nor were they wilfully blind or reckless as to the existence of the alleged breach.

No unjust enrichment

74. Morneau has no claim in unjust enrichment against the ESL Parties. SCI paid the 2013 dividend from its own funds, not funds belonging to the Pensioners. The claim, if any, rests with SCI and has been asserted by it.

75. In addition, the allegations Morneau makes in support of its claim in unjust enrichment have no merit.

76. The ESL Parties were not unjustly enriched by the payment of the 2013 dividend, because they were not enriched at all. Immediately following the payment, and in all likelihood on that account, the company's share price declined by a slightly greater amount than the amount of the dividend, leaving the shareholders no better off.

77. If, as Morneau alleges, the payment of the 2013 dividend represented an enrichment, which is denied, there was a juristic basis for the ESL Parties' receipt and retention of their share thereof. The receipt of dividends is a normal incident of the ownership of shares. The declaration of dividends was within the legal powers of the directors of SCI. The directors exercised this power in declaring the 2013 dividend. Once the dividend was declared, SCI was legally obliged to pay it to the shareholders and the shareholders were legally entitled to receive it.

No oppression

78. The declaration and payment of the 2013 dividend were not oppressive to the interests of the Pensioners, they were not unfairly prejudicial to such interests, and they did not unfairly disregard such interests.

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

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

81. The Pensioners' alleged reasonable expectations would attribute to the directors a fiduciary duty to manage the affairs of the corporation to the benefit of the Pensioners, as the stakeholder group whose interests Morneau identifies with those of the corporation. No such duties exist at law, so no such duties can be said to ground the Pensioners' purported expectations.

82. In any event, and even assuming the existence of such duties, the directors determined, in good faith and on reasonable grounds, that the payment of the 2013 dividend would not impair the Pensioners' interests. The decision was therefore a legitimate exercise of their business judgment and as such could not have unfairly disregarded the Pensioners' interests.

83. The only reasonable expectation of the Pensioners was that SCI would fund the Plan according to law. When SCI declared and paid the dividend, it had funded the Plan up to the amount legally required, and Morneau makes no allegation to the contrary.

84. Moreover, at the time of the declaration and payment of the 2013 dividend the Pensioners were not "creditors" of SCI within the meaning of s. 241(2) of the CBCA. At that time, SCI had complied with its obligations by funding the Plan to the level required by law and by continuing to make the payments from the Plan to which its members were entitled. It was not until 2017, over three years later, that SCI was unable to make the payments required by law.

85. In any event, even if the directors' declaration and payment of the 2013 dividend was oppressive to the interests of any of SCI's creditors, which is denied, setting aside the declaration of the 2013 dividend and requiring the ESL Parties to pay a portion of it to the Pensioners would be unjust in the circumstances. As pleaded, the ESL Parties did not know, and ought not reasonably to have known, that the declaration and payment of the 2013 dividend constituted a breach of the fiduciary duties the directors owed to the Pensioners. Moreover, the ESL Parties did not know, and ought not reasonably to have known, that the declaration and payment of the 2013 dividend would be oppressive to the interests of the Pensioners. Nor did the ESL Parties have any involvement in the declaration and payment of the 2013 dividend. In these circumstances, granting a remedy in oppression against the ESL Parties would be inequitable.

86. Finally, the declaration of the 2013 dividend did not cause harm to the Pensioners. If the 2013 dividend had not been declared the directors would not have diverted the amount of the dividend into the Plan, to which all payments required by law had been made at the time. Nor did the 2013 dividend cause SCI's insolvency, which occurred over three-and-a-half years after the declaration of the 2013 dividend, which was not a foreseeable consequence of the declaration and payment of the 2013 dividend, and which would have occurred regardless of the declaration and payment of the 2013 dividend.

Shareholder immunity

87. Under s. 45(1) of the *Canada Business Corporations Act*, R.S.C. 1985, c. C-44, the ESL Parties are not liable for any liability, act or default of SCI, including the declaration and payment of a dividend, other than by reason of exceptions that do not apply in this case. This legislative provision is a full defence to the action.

The action is time-barred

~~87.~~88. The declaration of the 2013 dividend occurred on November 19, 2013. This action was commenced on December 19, 2018. This was over three years after the expiration of the two-year limitation period under s. 4 of the *Limitations Act*, 2002, SO 2002, c. 24, Sch. B. Morneau's action is time-barred.

Failure to mitigate

~~88.~~89. Even if the Pensioners have suffered harm for which the ESL Parties are obliged to compensate them, which is denied, the recovery must be reduced to account for Morneau's

failure to mitigate damages. Morneau failed to assert the statutory trust provided for in s. 57(4) of the PBA over SCI's remaining estate.

~~89.~~90. Moreover, Morneau has not implemented pension governance and investment approaches that would provide an opportunity to recover Plan members' lost benefits. Any compensation to which the Pensioners are entitled must be reduced to account for these failures.

Damages limited to those attributable to the liability of the ESL Parties alone

91. By reason of the orders of the Honourable Justice McEwen dated March 17, 2020 and the Honourable Justice Hainey dated August 25, 2020, Morneau is prevented from seeking from the ESL Parties damages attributable to the liability of SHC, William Harker, William Crowley, Donald Ross, Ephraim J. Bird, Deborah Rosati, R. Raja Khanna, James McBurney or Douglas Campbell.

92. The ESL Parties deny all liability in the action. In the alternative, in the event that the ESL Parties are found liable in the action, they request that the Court apportion liability among them and the parties listed in the paragraph directly above, and award recovery or damages attributable only to the ESL Parties' own liability.

93. The ESL Parties plead and rely on the *Negligence Act*, R.S.O. 1990, c. N.1.

Requested resolution

~~90.~~94. The ESL Parties ask that this action be dismissed with costs on a substantial indemnity basis.

~~May 10, 2019~~September 10, 2020

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COPY TO: **THE LITIGATION SERVICE LIST**

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

-and-

ESL INVESTMENTS INC. et al.
Defendants

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

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

PROCEEDING COMMENCED AT TORONTO

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

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

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

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF SEARS CANADA INC., *et al.*

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

Proceeding commenced at TORONTO

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

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