

**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., INITIUM
COMMERCE LABS 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

**FIRST REPORT OF LAX O'SULLIVAN LISUS GOTTLIEB LLP
IN ITS CAPACITY AS LITIGATION INVESTIGATOR
NOVEMBER 5, 2018**

LAX O'SULLIVAN LISUS GOTTLIEB LLP
Counsel
Suite 2750, 145 King Street West
Toronto, ON M5H 1J8

Matthew P. Gottlieb LSO#: 32268B
mgottlieb@counsel-toronto.com

Tel: 416 644 5353

Andrew Winton LSO#: 54473I
awinton@counsel-toronto.com

Tel: 416 644 5342

Philip Underwood LSO#: 73637W
punderwood@counsel-toronto.com

Tel: 416 645 5078

Fax: 416 598 3730

Litigation Investigator

TO: **THE SERVICE LIST**

TABLE OF CONTENTS

	Page No.
I. OVERVIEW	2
II. BACKGROUND TO APPOINTMENT	2
III. PURPOSE OF THIS REPORT	3
IV. LI'S MANDATE AND REPORT UNDER THE LI ORDER	3
V. THE WORK OF THE LI	4
VI. LI'S RECOMMENDATION CONCERNING FURTHER STEPS	5
A. The LI Order Contemplates Further Steps	5
B. Litigation Should Be Pursued on Behalf of the Sears Canada Entities and Their Creditors	6
1. Appointment of Litigation Trustee to Pursue Sears Canada Claims	6
2. The Monitor Should Pursue a Transfer at Undervalue Claim	7
3. Pension Administrator and Superintendent of FSCO to Pursue Pension Claims	8
4. Franchisee Class Action Should be Transferred to the Commercial List	9
C. Claims Should Be Pursued in a Common Issues Trial	9
D. LT Claims and Monitor's Claim to be Funded by the Estate	10

I. OVERVIEW

1. This is the first report of Lax O’Sullivan Lisus Gottlieb LLP (“**LOLG**”), in its capacity as Litigation Investigator (“**LI**”). It outlines the background to its appointment, the terms of the LI Order (defined below), the work done by the LI, and relief sought by the LI pursuant to the LI’s recommendation.

II. BACKGROUND TO APPOINTMENT

2. 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 (“**CCAA**”). The relief granted under the Initial Order was later extended to SearsConnect, a partnership forming part of the operations of the Applicants (together with the Applicants, the “**Sears Canada Entities**”). The proceeding commenced under the CCAA by the Applicants are referred to in this report as the “**CCAA Proceeding**”.

3. Among other things, the Initial Order:

- (a) appointed FTI Consulting Canada Inc. as monitor of the Sears Canada Entities (the “**Monitor**”) in the CCAA Proceeding; and
- (b) granted an initial stay of proceedings against the Sears Canada Entities until July 22, 2017.

4. The Court has subsequently extended the stay period, most recently by order dated July 24, 2018, to December 18, 2018.

5. Pursuant to an order of this Court dated March 2, 2018, LOLG was appointed as LI to investigate, identify and report on certain potential rights and claims of the Sears Canada Entities and/or creditors of the Sears Canada Entities. The order was amended on April 26, 2018 (the “**LI Order**”).

6. The LI Order provides, among other things, that the LI shall be an officer of this Court.

III. PURPOSE OF THIS REPORT

7. The purpose of this first report is to provide the Court with information regarding:

- (a) the work done by the LI to discharge its Mandate under the LI Order;
- (b) the LI’s recommendation of a course of action in accordance with its Report to the Creditors’ Committee (the “**Report**”) provided pursuant to the LI Order; and
- (c) the LI’s request for an order authorizing the appointment of a litigation trustee to pursue the relief recommended in the Report, and related relief.

IV. LI’S MANDATE AND REPORT UNDER THE LI ORDER

8. The LI Order required the LI to do the following:

- (a) Investigate claims and possible claims that the Sears Canada Entities and/or their creditors may have against any parties (“**Mandate**”); and
- (b) Report to the Creditors’ Committee with such details as the LI considers advisable, with such reporting to include recommendations regarding a proposed litigation plan that includes (but is not limited to):
 - (i) the potential rights or claims of Sears Canada Entities or their creditors that should be pursued, if any; and
 - (ii) a description of how and by whom such rights and claims, if any, can best be pursued or continued, including:

- (1) the coordination of the prosecution of such rights or claims with other rights or claims that may be asserted by different parties;
- (2) if necessary or desirable, a proposed governance structure for the Creditors' Committee for the purpose of providing input to the LI in the prosecution of such rights, claims or causes of action; and
- (3) consideration of various options for funding the prosecution of such rights, claims or causes of action.

9. As set out below, the LI has now completed its Mandate and the Report.

V. THE WORK OF THE LI

10. Pursuant to the LI Order, a Creditors' Committee was established. The members of the Creditors' Committee executed confidentiality agreements and the persons to whom they reported signed non-disclosure agreements.

11. Following its appointment, and in accordance with the LI Order and the Mandate, the LI investigated claims and possible claims of the Sears Canada Entities and/or their creditors and the Monitor. During the course of this investigation, the LI:

- (a) met with the Monitor and its counsel for the purpose of receiving a confidential briefing from the Monitor, as contemplated in the LI Order;
- (b) reviewed documents provided to it by the Applicants concerning possible claims the Sears Canada Entities may have against various potential defendants;
- (c) met with the Applicants and their counsel;
- (d) conducted extensive legal research;

- (e) met with members of the Creditors' Committee, both individually and as a group, to discuss the members' views of possible claims the Applicants or creditors might advance;
- (f) met with the Creditors' Committee, the Monitor and the Monitor's counsel on multiple occasions to keep them apprised of the progress of the LI's investigation; and
- (g) considered how claims and possible claims may best be pursued, and how to coordinate various streams of potentially overlapping claims by different claimants.

12. On July 5, 2018, the LI presented a confidential interim report to the Creditors' Committee. On September 11, 2018, the LI presented a confidential final report to the Creditors' Committee ("**Report to Committee**"). At these meetings, the LI provided recommendations, discussed the basis for those recommendations, and answered questions. The members of the Creditors' Committee also discussed the recommendations and Report to Committee.

13. The Creditors' Committee unanimously accepted the LI's recommendation as set out in its Report to Committee.

VI. LI'S RECOMMENDATION CONCERNING FURTHER STEPS

A. The LI Order Contemplates Further Steps

14. The LI Order expressly provides that the LI shall be at liberty, and is authorized, at any time, to apply to the Court for advice and directions in respect of its Mandate or any variation or expansion of the powers and duties of the LI.

15. The LI Order also provides that, following delivery of a Report to the Creditors' Committee in accordance with its Mandate, the LI shall not take any further steps without a further order of

the Court. The LI Order expressly provides that nothing in it shall prevent the LI from seeking an order of the Court authorizing it to pursue any claims identified pursuant to the Mandate.

B. Litigation Should Be Pursued on Behalf of the Sears Canada Entities and Their Creditors

16. The LI recommends that litigation should be pursued on behalf of and for the benefit of the Sears Canada Entities and their creditors. As set out below, it is recommended that the defendants to the claims be the members of the Sears Canada Board of Directors as of November 2013 (the “**Directors**”), Edward Lampert (“**Lampert**”) and ESL Investments Inc., and certain of its affiliates who were shareholders of Sears Canada (collectively, “**ESL**”). But for the recent Chapter 11 filing of Sears Holdings Corp. (“**Holdings**”), the LI would recommend that Holdings also be a defendant in the litigation. Given the filing, the LI recommends that, at this time, litigation not be commenced against Holdings but that the Monitor consider the steps that should or could be taken regarding Holdings in the Chapter 11 proceeding or otherwise.

17. The LI’s view is that this litigation should be co-ordinated with the parties and counsel, to the extent practicable, for the sake of fairness to the parties, including the proposed defendants, and efficiency.

18. As a result of the recommendations contained herein, the LI believes and recommends that its mandate as LI should come to an end.

1. Appointment of Litigation Trustee to Pursue Sears Canada Claims

19. The LI recommends that a litigation trustee should be appointed with a mandate to pursue certain claims on behalf of and for the benefit of the Sears Canada Entities and their creditors (the “**LT Claims**”) with respect to the \$509 million dividend declared by Sears Canada’s Board of

Directors in November 2013 and paid to its shareholders, including Holdings and ESL, in December 2013 (the “**Dividend**”).

20. The LT Claims would be for oppression, breach of fiduciary duty and breach of the standard of care (against the Directors), conspiracy (against the Directors, ESL and Lampert, the principal of ESL), and unjust enrichment, knowing assistance, and knowing receipt.

21. In the LI’s view, appointment of an experienced litigation trustee would likely facilitate the efficient management and prosecution of litigation for the benefit of the Sears Canada Entities and their creditors.

22. The litigation trustee would be a court officer whose role would be to act on behalf of the Sears Canada Entities to prosecute and, where appropriate, resolve claims. The litigation trustee would also coordinate with other stakeholders.

23. The LI recommends that the Honourable J. Douglas Cunningham, Q.C. be appointed as the litigation trustee. The Creditors’ Committee and the Monitor support this recommendation.

24. The LI further recommends that LOLG be appointed as counsel to the LT to pursue the LT Claims and to co-ordinate the pursuit of claims with other counsel. The Creditors’ Committee and the Monitor also support this recommendation.

25. The reasonable fees and disbursements of the LT and his counsel would be paid by the Sears Canada Entities from the fund described below.

2. The Monitor Should Pursue a Transfer at Undervalue Claim

26. The LI recommends that the Monitor pursue a transfer at undervalue (“**TUV**”) claim under section 96 of the *Bankruptcy and Insolvency Act*, as incorporated into the CCAA pursuant to

section 36.1 with the respect to the CCAA (the “**Monitor’s Claim**”). Through this Claim, the Monitor would seek to set aside the Dividend on the basis that it was a gratuitous transfer to non-arm’s-length parties (specifically, ESL, Lampert, and Holdings) and that Sears Canada intended to defraud, defeat or delay creditors by paying it.

3. Pension Administrator and Superintendent of FSCO to Pursue Pension Claims

27. The LI recommends that certain creditors pursue claims directly. In particular, the LI understands that the Pension Administrator (defined below) and the Superintendent of the Financial Services Commission of Ontario wish to and intend to pursue pension claims, as follows:

- (a) A claim by Sears Canada’s pension administrator, Morneau Shepell Ltd. (the “**Pension Administrator**”) for breach of fiduciary duty, knowing assistance, knowing receipt and conspiracy. This claim would be brought against those persons who were directors of Sears Canada at the time the Dividend was declared, for breach of their obligations in their capacity as directors of the pension administrator of the Sears Canada pension plan at that time. The claim against ESL and Lampert would be for knowing assistance, knowing receipt and conspiracy; and
- (b) A claim for oppression, breach of fiduciary duty, breach of standard of care, knowing assistance, knowing receipt and conspiracy to be brought by Sears Canada’s Pensioners against the directors of Sears Canada at the time the 2013 Dividend was declared. The claim against ESL and Lampert would be for knowing assistance, knowing receipt and conspiracy.

28. The LI recommends that these claims be pursued in concert with the LT Claims and the Monitor’s Claim.

4. Franchisee Class Action Should be Transferred to the Commercial List

29. The LI recommends that an existing proposed class proceeding commenced in October 2015 by former “Sears Hometown” store franchisees (the “**Proposed Class Action**”) for oppression on the basis of the payment of the Dividend in the face of their previous suit for breaches of contract and the *Arthur Wishart Act (Franchise Disclosure)*, 2000, S.O. 2000, c. 3, for damages continue. It is recommended that Sotos LLP/Blaney McMurtry LLP, as class action counsel, in conjunction with the recommendation and the support of the LI, and with the support of the Monitor, seek an order of the Court transferring the Proposed Class Action (Court File No. 4114/15 commenced in Milton, Ontario) to the Commercial List and promptly seek an Order certifying the action as a class action under the *Class Proceedings Act, 1992*, S.O. 1992, c. 6.

30. The LI believes that it is important to co-ordinate the Proposed Class Action with the other proposed proceedings referred to herein as all of the proceedings deal with a significant overlap of critical facts. It would be inefficient for the Proposed Class Action to proceed in a different forum and could potentially lead to inconsistent findings on the same issues.

C. Claims Should Be Pursued in a Common Issues Trial

31. The LI recommends that the claims listed above (the “**Claims**”) be heard by this Court—to the extent possible—in a single joint issues trial to ensure efficiency in cost and time.

32. The LI proposes that the Claims be pursued through four separate actions (i.e., separate statements of claim), in which the Monitor, Pension Administrator, Litigation Trustee and the representative plaintiff are the respective plaintiffs, each to be represented by separate counsel. It is recommended that the Pension Administrator and Pensioners have one counsel appointed to deal with pension claims, with an assignment of claims being made as necessary.

33. Because an overwhelming majority of the facts and legal issues in the Claims overlap, the Claims should be joined into a single “common issues trial” to be case managed by a single judge on the Commercial List of the Superior Court of Justice. The LI’s proposed order seeks this relief.

34. It is recommended that meetings be convened by the Litigation Trustee on a periodic basis with the Creditor’s Committee and the Monitor to discuss the progress of the Claims and matters related to the Claims.

35. Other elements of the Claims which are specific to particular claims, claimants, or defendants should be heard separately as required.

D. LT Claims and Monitor’s Claim to be Funded by the Estate

36. The LI recommends that the LT Claims and the Monitor’s Claim be funded by the Estate, and that a fund totalling \$12 million be established for this purpose. The LI and the Monitor both agree that this amount represents a conservative estimate, including a buffer, for the contemplated fees and disbursements to be incurred by the LI, the Litigation Trustee, and the Monitor.

37. Management of Sears Canada, with oversight by the Monitor, would review the accounts and arrange for payment of those accounts.

38. This would necessarily include a mechanism to allow creditors to opt out of litigation funding. The Litigation Investigator has reviewed and supports the Monitor’s proposed opt-out mechanism.

39. The LI recommends that the remaining claims *not* be funded by the estate.
40. The LI respectfully submits to the Court this, its First Report.

Dated this 5th day of November, 2018.

A handwritten signature in blue ink, appearing to read "Jay O'Sullivan", is written over a horizontal line. To the right of the signature, the initials "LLP/MLG" are written in blue ink.

LAX O'SULLIVAN LISUS GOTTLIEB LLP
In its capacity as court-appointed Litigation
Investigator

IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, R.S.C. 1985 c. C-36, AS AMENDED
AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF SEARS CANADA INC., 9370-2751 QUEBEC INC., 191020 CANADA INC., THE CUT INC., SEARS CONTACT SERVICES INC., INITIUM LOGISTICS SERVICES INC., INITIUM COMMERCE LABS 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.

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

**ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST**

PROCEEDING COMMENCED AT TORONTO

**FIRST REPORT TO THE COURT
OF LAX O'SULLIVAN LISUS GOTTLIEB LLP
IN ITS CAPACITY AS LITIGATION INVESTIGATOR
NOVEMBER 5, 2018**

LAX O'SULLIVAN LISUS GOTTLIEB LLP

Counsel

Suite 2750, 145 King Street West

Toronto, ON M5H 1J8

Matthew P. Gottlieb LSO#: 32268B

mgottlieb@counsel-toronto.com

Tel: 416 644 5353

Andrew Winton LSO#: 54473I

awinton@counsel-toronto.com

Tel: 416 644 5342

Philip Underwood LSO#: 73637W

punderwood@counsel-toronto.com

Tel: 416 645 5078

Fax: 416 598 3730

Litigation Investigator