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., 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.

FACTUM OF THE MONITOR
(Transfer at Undervalue Claim Motion)
(returnable December 3, 2018)

November 20, 2018

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TO: THE SERVICE LIST

TABLE OF CONTENTS

PART I - INTRODUCTION

1 The insolvency proceedings of Sears Canada Inc. ("**Sears Canada**") and certain of its affiliates began in June 2017. Substantially all tangible assets of these entities have been monetized and a claims process is ongoing.

2 The Monitor has undertaken a detailed review of material transactions of interest occurring in the period leading up to these insolvency proceedings to determine if any such transactions were preferences, transfers at undervalue or other reviewable transactions that should be remedied.

3 Through its review, the Monitor has identified sufficient evidence to conclude that additional estate resources should be invested to commence a formal claim under Section 36.1 of the *Companies' Creditors Arrangement Act*, RSC 1985, c C-36 (the "***CCAA***") seeking a determination that a 2013 dividend in the aggregate amount of over $500 million was:

(a) a transfer at undervalue, as defined in Section 96 of the *Bankruptcy and Insolvency Act*, R.S.C 1985, c B-3 (the "***BIA***");

(b) a non-arm's length transaction; and

(c) undertaken with the intention of delaying, defeating or defrauding creditors of Sears Canada,

and should be remedied as a result.

4 The Monitor now seeks authorization to pursue this claim (the "**2013 Dividend Claim**").

5 If the 2013 Dividend Claim is successful, the value removed from the estate of Sears Canada through the 2013 dividend should be returned by any non-arm's length parties who either, directly or indirectly, benefited from that dividend or caused that dividend to be paid.

These parties are: Edward S. Lampert, ESL Investments Inc. and certain of its affiliates, William Harker and William Crowley.[1]

6 The potential award from this claim represents the largest source of recovery in an estate that otherwise is projected to return not more than $160 million to its creditors, whose claims may exceed $2 billion.

7 The Court is not being asked at this time to rule on the validity of the claim. In the Monitor's view, the Court needs only to be satisfied at this time that: (i) it has jurisdiction to authorize the Monitor to proceed with the claim; and (ii) the Monitor has shown that, in the circumstances of this case, there is a reasonable basis to conclude that further estate resources should be invested in pursuing the claim.

8 The Monitor submits that the Court clearly has jurisdiction to grant the authorization sought by the Monitor, which is expressly contemplated by the *CCAA.*

9 Further, the Monitor submits that the claim should be pursued. The evidence at this time shows that the 2013 dividend was approved through a materially deficient process that led to the diversion of significant liquidity to shareholders, largely benefitting insiders at the expense of creditors, while the corporation proceeded inevitably to an insolvent liquidation in which the substantial shortfalls to creditors are and should have been clear.

10 The cost of pursuing the Monitor's claim relative to the benefit of a successful outcome also favours allowing the claim to proceed.

11 The Monitor believes there is substantial creditor support for this claim based upon numerous discussions with stakeholders. However, if any creditors do not support the pursuit of

[1] For reasons set out below, the Monitor is not at this time seeking approval to pursue a claim against Sears Holdings Corporation, though this party did receive a substantial portion of the dividend.

the Monitor's claim, the Monitor proposes to establish an opt-out mechanism that ensures those creditors are not impacted positively or negatively by the decision to proceed with this litigation.

12 As identified in the Litigation Investigator's parallel motion, a number of other parties have claims that overlap with the Monitor's claim and seek recovery of the same amounts, in many cases for the benefit of substantially the same parties. The Monitor supports the pursuit of these claims and agrees with the Litigation Investigator that all efforts should be made to streamline the litigation process through a common issues protocol.

PART II - THE FACTS

13 Sears Canada filed for protection under the *CCAA* on June 22, 2017. FTI Consulting Canada Inc. was appointed as Monitor (the "**Monitor**") in these proceedings.

14 Following its appointment, the Monitor commenced a review of certain material transactions by Sears Canada in the period prior to its filing for protection under the *CCAA.*

15 Three potentially reviewable transactions were identified: (i) a dividend totalling over $100 million paid by Sears Canada in 2012; (ii) a surrender by Sears Canada of its exclusive right to use the Craftsman trademark in Canada for the benefit of Sears Holdings Corporation in 2017; and (iii) the 2013 dividend totalling over $500 million.

> Twenty-Seventh Report of FTI Consulting Canada Inc., as Monitor dated November 5, 2018 (**27th Report**) at para 21, Motion Record of the Monitor (Transfer at Undervalue Proceeding Approval) (**Monitor's Motion Record**), p 17.

16 The Monitor concluded that neither the 2012 dividend nor the surrender of the right to the Craftsman trademark should be pursued further following a detailed review of the circumstances of these transactions.

27th Report at paras 26 and 28, Motion Record of the Monitor (Transfer at Undervalue Proceeding Approval) (**Monitor's Motion Record**), Tab 2, pp 18-19.

17 The circumstances of the 2013 dividend were materially different, leading the Monitor to conclude that it should seek to remedy this transaction. These circumstances are described below.

18 From 2010 onward, Sears Canada's operations were in a declining state.

19 The chart below illustrates the rapid deterioration of Sears Canada's financial condition:

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%
2014	3,424.5	(407.3)	32.6%
2015	3,145.5	(298.3)	31.8%
2016	2,613.6	(422.4)	27.3%

27th Report at para 68, Monitor's Motion Record, Tab 2, pp 28-29.

20 Analyst reports suggest that the market did not attach any material value to Sears Canada's ongoing operations in 2012 and 2013.

27th Report at para 69, Monitor's Motion Record, Tab 2, p 29.

21 Over 2012 and 2013, Sears Canada engaged in several high-profile monetization transactions for key retail assets and the cessation of operations at key retail locations, namely: Yorkdale Shopping Centre; Square One Mississauga; Toronto Eaton Centre, Sherway Gardens,

Markville Shopping Centre, Masonville Place and Richmond Centre. Certain parties knowledgeable about the 2013 real estate monetizations advised the Monitor that the 2013 real estate transactions appear to have been undertaken on an expedited basis, which may have materially depressed the sale values received. It should have been clear that Sears Canada would continue to experience increasing operational losses as it sold off valuable key assets.

27th Report at para 65, Monitor's Motion Record, Tab 2, p 28.

22 If then existing trends continued during and after 2014, Sears Canada would have reasonably projected exhausting its cash reserves by 2016 (absent additional inflows from asset sales or debt financing). Even after accounting for asset realizations, normalized projections indicate that based upon then existing trends, Sears Canada would have forecasted to have negative cash of $430 million by 2019.

27th Report at para 70, Monitor's Motion Record, Tab 2, pp 29-30.

23 By the end of 2013, Sears Canada was proceeding along a path to inevitable insolvency but appears to have sought to deliver as much value as possible to shareholders through a process of liquidating key assets and delivering the proceeds to shareholders. The 2013 dividend is the clearest example of this.

24 Despite the bleak outlook for Sears Canada's future, it proceeded in 2013 with a $500 million gratuitous dividend payment to shareholders. There is no evidence available to the Monitor at this time to show that Sears Canada considered in detail whether, after paying the dividend to shareholders in 2013, sufficient funds would remain to satisfy all liabilities. In fact, there is no evidence of advance notice, analysis or consideration of the 2013 dividend at all before the board meeting at which the dividend was approved. It is now clear that there would have been no reasonable basis to conclude that sufficient value would be available to pay creditors after paying this dividend and after the process of liquidating all assets was complete.

Monetizing assets and distributing proceeds to shareholders shifted risk to creditors and away from shareholders.

27th Report at para 73, Monitor's Motion Record, Tab 2, p 30.

25 The decision to pay the 2013 dividend appears to have been influenced by key shareholders: Edward S. Lampert ("**Lampert**"), ESL Investments Inc. and certain of its affiliates (collectively, "**ESL**") and Sears Holdings Corporation; and by two directors of Sears Canada having links to those shareholders: William Harker and William Crowley. These non-arm's length parties appear to have been motivated by liquidity pressures in the form of redemption requests from ESL's investors, which may have created an urgent need for the cash provided by the 2013 dividend.

27th Report at paras 39-40, Monitor's Motion Record, Tab 2, pp 21-22.

PART III - THE ISSUES

26 The issues on this motion and the position of the Monitor are as follows:

(a) whether the Court has jurisdiction to authorize the Monitor to proceed with the 2013 Dividend Claim at this time. The Monitor takes the position that the Court has this jurisdiction;

(b) whether the Court should authorize the Monitor to proceed with the 2013 Dividend Claim at this time. The Monitor takes the position that it should be authorized to proceed with the 2013 Dividend Claim and that the Monitor's proposed opt-out mechanism should be approved.

PART IV - LAW & SUBMISSIONS

A. The Monitor's Claim

27 The Monitor's claim, in summary, is that the 2013 dividend was a transfer to shareholders at undervalue that was undertaken, at least in part, with non-arm's length parties (Sears Holdings Corporation, ESL and Lampert) and with an intention to defeat, delay or defraud creditors. The transaction occurred within five years prior to the commencement of *CCAA* proceedings and is, as a result, subject to a possible remedy under Section 96 of the *BIA*, as incorporated into the *CCAA* pursuant to Section 36.1 thereof.

28 The Monitor's claim is advanced against ESL and Lampert, as recipients of the 2013 dividend. The Monitor's claim is also advanced against William Harker and William Crowley, two directors of Sears Canada at the relevant time who had significant ties to ESL and Lampert.

29 While the Monitor believes a claim could be advanced against Sears Holdings Corporation, as the largest direct individual recipient of 2013 dividend, the Monitor is not recommending or seeking authority to advance such claim at this time in view of the recent filing by Sears Holdings Corporation for protection under Chapter 11 of the United States Bankruptcy Code and the stay of proceedings triggered by that filing. The Monitor is currently considering next steps regarding this claim against Sears Holdings Corporation.

27th Report at para 47, Monitor's Motion Record, Tab 2, p 23.

B. Jurisdiction To Authorize The 2013 Dividend Claim

30 In the Monitor's view, the *CCAA* expressly grants the Court jurisdiction to authorize the Monitor to proceed with the 2013 Dividend Claim.

31 Section 36.1 of the *CCAA* states:

> **36.1**(1) Sections 38 and 95 to 101 of the *Bankruptcy and Insolvency Act* apply, with any modifications that the circumstances require, in respect of a compromise or arrangement unless the compromise or arrangement provides otherwise.

32 Decisions of this Court have recognized that the above provision of the *CCAA* provides the Monitor with the power to pursue a claim that would otherwise be available to a trustee in bankruptcy under Sections 95 through 101 of the *BIA*. This would include a transfer at undervalue claim pursuant to Section 96 of the *BIA*.

> *Verdellen v. Monaghan Mushrooms Ltd.*, [2011] ONSC 5820 (Ont. S.C.J.) at para 46, Book of Authorities of the Monitor (**Monitor's Authorities**), Tab 1.
>
> *Cash Store Financial Services (Re)*, [2014] ONSC 4326 (Ont. S.C.J.) at para 108, Monitor's Authorities, Tab 2.

33 The Monitor recognizes that Section 36.1 of the *CCAA* could be interpreted to require a plan of compromise or arrangement to be pursued concurrent with the 2013 Dividend Claim. However, the Monitor submits this would be an incorrect interpretation. The absence of a plan of compromise or arrangement at this time should not impede the Monitor's use of Section 36.1 of the *CCAA* to remedy the 2013 dividend. Delaying the Monitor's claim until any plan of compromise or arrangement is eventually presented could reduce the likelihood of recovery of the proceeds of a transaction that occurred almost five years ago. Further, converting the current proceeding to a bankruptcy at this time to pursue the 2013 Dividend Claim could materially affect the determination and priority of certain creditors' claims in the estate and derail the steps that are currently underway to consensually resolve claim and priority issues in the estate, particularly regarding the pension and landlord claims.

34 The Monitor submits that Section 36.1 of the *CCAA* should be an available tool to the Monitor in any circumstance where a *CCAA* proceeding is continuing and a plan of compromise or arrangement remains a possibility. As noted in *Tucker v. Aero Inventory (UK) Limited*, the

Court's approach should be pragmatic when determining issues that arise in proceedings where the *CCAA* overlaps with the *BIA*. The policy objective should be to ensure that there is an appropriate review mechanism for pre-filing transaction in all circumstances. In the current case, practicality demands that the 2013 dividend be reviewed within the *CCAA* proceedings even if no plan of compromise or arrangement has been proposed at this time.

> *Tucker v. Aero Inventory (UK) Limited,* [2011] ONSC 4223 (Ont. S.C.J.) [***Aero Inventory***] at paras 156-157 and 163, Monitor's Authorities, Tab 3.

35 The Monitor's proposed use of Section 36.1 of the *CCAA* is consistent with the clause-by-clause analysis of the 2009 amendments to the *CCAA* published by Industry Canada, which explained the rationale for Section 36.1 of the *CCAA* as follows:

> Subsection (1) is added in order to ensure that the provisions of the BIA relating to preferences and transfer at undervalue would apply in CCAA matters. The purpose is to prevent forum shopping, where the debtor would choose the CCAA because preferences and transfer at undervalue transactions could not be attacked.
>
> > Office of the Superintendent of Bankruptcy. "Bill C-12: Clause by Clause Analysis - Clause No. 78, s. 36.1 of the CCAA", (24 March 2015), online: SME research and statistics <https://www.ic.gc.ca/eic/site/bsf-osb.nsf/eng/br01986.html#a86>, Monitor's Authorities, Tab 12.

C. The Court Should Utilize Its Jurisdiction To Authorize The Monitor's Claim To Proceed

36 No specific test has developed in *CCAA* jurisprudence to determine when a Monitor should be authorized to pursue a claim under Section 36.1.

37 The order sought is a discretionary order and the Monitor submits the requested order requires the Court to assess whether the order sought advances the policy objectives underlying the *CCAA* and usefully furthers efforts to achieve the remedial purpose of the *CCAA*.

Century Services Inc. v. Canada (Attorney General), [2010] 3 SCR 379 [***Century Services***] at para 70, Monitor's Authorities, Tab 4.

38 In the current case, the Monitor seeks the return of very substantial assets that were removed from the debtor's estate so that those assets can be redistributed fairly among the creditors of the debtor in accordance with applicable priorities. This is a remedial purpose that is expressly contemplated by the legislation and is entirely consistent with the policy objectives of the legislation. This purpose is also consistent with the guidance of the Court in *Aero Inventory* that the policy should be to ensure an appropriate review mechanism is in place for such transactions.

39 The consideration of appropriateness also extends to the means that the proposed order seeks to employ. In the current context, it is submitted that this requires a preliminary consideration of the merits of the Monitor's claim and the costs associated with that claim to determine if there is a *prima facie* case that warrants further expenditure of estate resources.

Century Services at para 70, Monitor's Authorities, Tab 4.

Ernst & Young Inc v Essar Global Fund Limited, 2017 ONCA 1014 at para 124, Monitor's Authorities, Tab 5.

40 The maximum value of the Monitor's claim is over $500 million. Assuming no creditors opt out of participation in the claim, the net impact on an individual creditor of unsuccessfully pursuing these claims is estimated to be a decrease of less than 10% of such creditor's overall recovery. By contrast, the net impact on an individual creditor of a fully successful claim is to increase such creditor's recovery by many multiples relative to the current estimated recoveries.

41 In order for the Monitor's claim under Section 36.1 of the *CCAA* to succeed, the Monitor will need to show, as required under Section 96 of the *BIA*:

(a) the 2013 dividend was a transfer at undervalue as defined in the *BIA* to which Section 96 of the *BIA* applies;

(b) the 2013 dividend was at least in part a transaction with non-arm's length parties;

(c) the 2013 dividend was undertaken with an intention to defeat, defraud or delay creditors.

42 As set out below, the Monitor has a reasonable basis to conclude that the 2013 Dividend Claim can succeed.

i. Is The 2013 Dividend A Transfer At Undervalue To Which Section 96 Of The *BIA* Applies?

43 A transfer at undervalue is defined in Section 2 of the *BIA* as: "a disposition of property or provision of services for which no consideration is received by the debtor or for which the consideration received by the debtor is conspicuously less than the fair market value of the consideration given by the debtor."

44 A transfer at undervalue may be remedied under Section 96 of the *BIA*, which states, in part, with necessary modifications for a *CCAA* context:

> 96 (1) On application by the [Monitor], a court may declare that a transfer at undervalue is void as against … the [Monitor] … or order that a party to the transfer or any other person who is privy to the transfer, or all of those persons, pay to the estate the difference between the value of the consideration received by the debtor and the value of the consideration given by the debtor — if
>
> …
>
> (b) the party was not dealing at arm's length with the debtor and
>
> (i) the transfer occurred during the period that begins on the day that is one year before the [day on which proceedings commence under the CCAA] and that ends on the [day on which proceedings commence under the CCAA], or

> (ii) the transfer occurred during the period that begins on the day that is five years before [day on which proceedings commence under the CCAA] and ends on the day before the day on which the period referred to in subparagraph (i) begins and
>
> (A) the debtor was insolvent at the time of the transfer or was rendered insolvent by it, or
>
> (B) the debtor intended to defraud, defeat or delay a creditor.
>
> …
>
> (3) In this section, a person who is privy means a person who is not dealing at arm's length with a party to a transfer and, by reason of the transfer, directly or indirectly, receives a benefit or causes a benefit to be received by another person.

45 While a dividend is received as a result of shareholdings in a corporation, there is no concurrent transfer of consideration by the recipient of a dividend in return for the receipt of that dividend. The payment of the dividend is dependent upon the legal status of a shareholder and is not dependent upon any shareholder's conduct in relation to the corporation. Stated differently, the shareholder does not give anything up in return for the dividend and has no independent enforceable right to a dividend until such dividend is declared. Arguably, a dividend is always received by the shareholder for no consideration.

46 Both Section 101 and Section 96 of the *BIA* could potentially apply to the payment of a dividend by a debtor company.

47 Section 101 states, in part:

> (1) Where a corporation that is bankrupt has paid a dividend, other than a stock dividend, or redeemed or purchased for cancellation any of the shares of the capital stock of the corporation within the period beginning on the day that is one year before the date of the initial bankruptcy event and ending on the date of the bankruptcy, both dates included, the court may, on the application of the

> trustee, inquire into the transaction to ascertain whether it occurred at a time when the corporation was insolvent or whether it rendered the corporation insolvent.
>
> (2) If a transaction referred to in subsection (1) has occurred, the court may give judgment to the trustee against the directors of the corporation, jointly and severally, or solidarily, in the amount of the dividend or redemption or purchase price, with interest on the amount that has been paid to the corporation if the court finds that:
>
> (a) the transaction occurred at a time when the corporation was insolvent or the transaction rendered the corporation insolvent; and
>
> (b) the directors did not have reasonable grounds to believe that the transaction was occurring at a time when the corporation was not insolvent or the transaction would not render the corporation insolvent.

48 This section specifically addresses the payment of dividends within one year prior to the commencement of a *CCAA* proceeding and defines a narrow set of circumstances in which remedies for improper dividends will clearly be available.

49 Section 96, in contrast to the specific narrow circumstances contemplated by Section 101, provides additional remedies that can apply over a five year lookback period for transactions engaged in with non-arm's length parties while the debtor company was insolvent or had the intent to defeat, delay or defraud creditors. In other words, Section 96 provides a broader set of protections to the estate for a wide variety of transactions, including dividends, provided that the key statutory criteria are met. The Monitor does not believe there is any principled reason why Section 96 should not apply to all transfers at undervalue, including dividends which, by their nature, are gratuitous transfers, provided that the ancillary requirements of that section are met.

50 The Monitor has not identified any case law determining the application of Section 96 of the *BIA* to a dividend. However, the decision of the Quebec Superior Court in *Armoires de*

cuisine de Montréal ltée (Re) supports an interpretation that a dividend payment may be a transfer at undervalue under Section 96 despite the existence of a separate regime for recovering dividends under Section 101 of the *BIA*. In *Armoires de cuisine de Montréal ltée (Re)*, the Court found that a dividend payment was a "reviewable transaction" under a predecessor of Section 96 (then Section 78) despite the co-existence of another section dealing only with the payment of shareholder dividends to related shareholders (then Section 79).

> *Armoires de cuisine de Montréal ltée (Re)*, [1983] J.Q. no 192 [***Armoires de cuisine***] at para 15, Monitor's Authorities, Tab 6.

51 In considering whether a dividend payment can be a "reviewable transaction", the Court stated as follows:

> 16. One might first question whether s. 78 [reviewable transactions] should be considered to have application in the present case. This new section was enacted in 1966 at the same time as s. 79 [shareholder dividends] … It has been said that of these two "reviewable transactions", s. 78 deals with goods and services and s. 79 deals with dividends and redemption of shares. (See the decision of Moisan J. in re Tremblay; Ginras, Robert, Marcoux Ltée v. Beaudry and paradis (1981), 36 CBR(NS) 111).
>
> 17 But, on the other hand, there are other significant differences between the two sections which support a view that there could be a dual application of them in the present case. Not the least of these is that there is nothing in s. 78 as there is in s. 79 which says that "the disposal of an asset of a company must be made at a time when the company is insolvent or made in such a manner as to contribute to the insolvency before that asset can be recovered by the trustee".
>
> *Armoires de cuisine* at paras 16-17, Monitor's Authorities, Tab 6.

52 The court concluded that in the circumstances, there had been "no consideration whatsoever" for the dividend payment and ordered recovery against the shareholder under Section 78 (now Section 96).

ii. Non-arm's Length Dealings

53 Under Section 4 of the *BIA*, related parties are presumed, in the absence of evidence to the contrary, not to be dealing with each other at arm's length.

54 In the case of parties that were not related to each other at the time of the transaction, it is a question of fact whether they were dealing with each other at arm's length.

55 The recipients of the 2013 dividend would have included Sears Holdings Corporation, as a majority holder of the shares of Sears Canada at the time of the declaration of the 2013 dividend; ESL, as a direct holder of 17% of the shares of Sears Canada at that time; and Lampert, as a holder of 10% of the shares of Sears Canada at that time. As a result of Lampert's apparent control of ESL, and ESL's and Lampert's apparent control of Sears Holdings Corporation, these parties, collectively, held sufficient shares to have majority ownership, as a group, of Sears Canada at the time of the declaration of the 2013 dividend. If it is accepted that these parties operated as a group, they would be related to Sears Canada and presumed (absent evidence to the contrary) to be non-arm's length in connection with the 2013 dividend.

27th Report, at para 36, Monitor's Motion Record, Tab 2, p 21.

56 The appointment of directors and officers of Sears Canada with material links to ESL and Sears Holdings Corporation provides further evidence of the relationships between these parties at the relevant times.

57 The Monitor believes ESL, Lampert and Sears Holdings Corporation, collectively, did not deal at arm's length with Sears Canada at the relevant time based upon the foregoing information.

iii. Intention to Defraud, Defeat or Delay Creditors

58 Proof of an intention to defraud, defeat or delay creditors is often satisfied through evidence of certain indicia of fraud, such as: (i) a close relationship; (ii) entry into a risky undertaking; and (iii) unusual haste in completion of the transaction. In the case of *Indcondo Building Corp. v. Sloan*, the Ontario Superior Court of Justice determined that the analysis should involve examining all of the surrounding circumstances, including the 'critical issue' of whether the debtor knew or ought to have known that it was in serious financial jeopardy and the payment would have a 'material adverse impact' on the debtor's ability to pay its creditors.

> *Indcondo Building Corp. v. Sloan*, [2014] ONSC 4018 (Ont. S.C.J.)
> at paras 52, 85 and 136, Monitor's Authorities, Tab 7.

59 The Monitor believes that available evidence shows a reasonable basis to conclude that the 2013 dividend was at least in part a non-arm's length transaction that materially increased the financial risks faced by Sears Canada and was undertaken with unusual haste and with only unusually limited consideration at a board meeting in November 2013. The Monitor has further concluded on a preliminary basis that Sears Canada ought to have known, based upon the trends in its financial performance and a reasonable forecast of that performance as well as its decision to close key retail locations, that it was in serious financial jeopardy and that the 2013 dividend would have a material adverse impact on its ability to pay creditors. In fact, such concerns were specifically raised by certain key creditor groups at the time of the 2013 dividend.

iv. Parties Privy To The Transaction

60 Section 96(1) of the *BIA* provides that recovery may be sought against a "party to the transfer or any other person who is privy to the transfer".

61 Section 96(3) of the *BIA* defines a "privy" as "a person who is not dealing at arm's length with a party to a transfer and, by reason of the transfer, directly or indirectly, receives a benefit or causes a benefit to be received by another person".

62 William Crowley and William Harker both acted as former officers of ESL Investments Inc. and Sears Holdings Corporation and were directors of Sears Canada at the time of approval of the 2013 dividend.

63 The Monitor has reason to believe these parties were not dealing at arm's length with ESL, Lampert and Sears Holdings Corporation and that these parties played an active role in causing the 2013 dividend to be paid. If the evidence shows that such a claim is valid, both William Crowley and William Harker would have liability under Section 96 of the BIA in connection with the 2013 dividend.

> 27th Report, at para 40 and 75, Monitor's Motion Record, Tab 2, pp 22 and 32.

v. Conclusion

64 The foregoing analysis does not represent the Monitor's final definitive legal analysis of the 2013 Dividend Claim. The analysis will necessarily evolve as additional evidence is considered. However, the Monitor has undertaken a thorough and considered preliminary review of the proposed claim and has a reasonable basis to conclude that the claim may result in recoveries to creditors. In the Monitor's view, this analysis, together with the above summary of the cost and benefit of the claim for creditors, strongly supports proceeding with this claim.

65 Any creditor who does not agree with the Monitor's position on the 2013 Dividend Claim has the right to opt not to participate in the recoveries or costs of that claim and such creditor's position will be fully protected.

D. The Stay Of Proceedings Should Be Lifted To Permit The Monitor's Claim To Proceed

66 The Initial Order granted in these proceedings provided for a stay of proceedings in favour of former, current and future directors and officers of Sears Canada with respect to any claim against such parties that arose before the date of the Initial Order and that relates to obligations of Sears Canada whereby the directors or officers are alleged under any law to be liable in their capacities as directors or officers for the payment or performance of such obligations.

67 The Monitor submits that the stay of proceedings in the Initial Order was not intended to cover the 2013 Dividend Claim. The 2013 Dividend Claim, as advanced against Mr. Harker and Mr. Crowley, is a claim that is based upon their action in causing the 2013 dividend to be paid. The payment of the 2013 dividend, and any liability that Mr. Harker and Mr. Crowley may have for that payment, does not derive from any obligation of Sears Canada. The 2013 dividend is an amount that should be returned to Sears Canada, it is not an amount that Sears Canada is liable for.

68 If the stay of proceedings in favour of Mr. Harker and Mr. Crowley does apply to the 2013 Dividend Claim, the Monitor submits this is an appropriate case to lift the stay of proceedings to allow the 2013 Dividend Claim to proceed.

69 It is necessary when considering whether to lift the stay to weigh the interests of the Applicants against the interest of those who will be affected by the stay. The Applicants in these proceedings would not be prejudiced in any material way by the lifting of the stay of proceedings to allow the Monitor's claims to proceed.

> *Nortel Networks Corp. (Re),* [2009] O.J. No. 3425 (Ont. S.C.J.) at para 36, Monitor's Authorities, Tab 8.

70 The Monitor submits that the fact that the former directors themselves may be prejudiced by the lifting of the stay is not a relevant factor unless the prejudice to the former directors results in some concurrent prejudice to the Applicants and to the restructuring. A request to lift a stay in favour of directors may be viewed differently earlier in a proceeding, where a debtor company and its directors and officers are focused upon the restructuring of the company and must be permitted to do so free from the distractions of litigation. However, where a request to lift a stay of proceedings is brought late in a case and affects parties with no active role in the case, and where substantially all assets have been liquidated, a court should be more receptive to lifting the stay of proceedings to permit the Monitor to pursue claims against former directors.

> *Puratone Corp. (Re)* [2013] M.J. No. 247 (Man. Q.B.) at para. 15, Monitor's Authorities, Tab 9.

71 The parties who would benefit from the litigation would be significantly prejudiced by the continued application of the stay as they would not be permitted to pursue their claims (including any recoveries from directors and officers insurance that may be depleting).

72 It is in the interests of justice that the Monitor's claim be fully pursued for the benefit of all creditors. Finally, as noted above, on a preliminary basis, the proposed claims appear to have merit.

> *Timminco Ltd. (Re)*, 2012 ONSC 2515 at para 17, Monitor's Authorities, Tab 10.
>
> *Canwest Global Communications Corp. (Re)*, [2009] O.J. No. 5379 at para 33, Monitor's Authorities, Tab 11.

PART V - ORDER REQUESTED

73 For the foregoing reasons, the Monitor submits that it is appropriate for the Court to authorize the 2013 Dividend Claim to proceed on the terms proposed by the Monitor.

ALL OF WHICH IS RESPECTFULLY SUBMITTED this 20th day of November, 2018.

Norton Rose Fulbright Canada LLP

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SCHEDULE "A"
LIST OF AUTHORITIES

1. *Verdellen v. Monaghan Mushrooms Ltd.,* [2011] ONSC 5820 (Ont. S.C.J.)
2. *Cash Store Financial Services (Re),* [2014] ONSC 4326 (Ont. S.C.J.)
3. *Tucker v. Aero Inventory (UK) Limited,* [2011] ONSC 4223 (Ont. S.C.J.)
4. *Century Services Inc. v. Canada (Attorney General),* [2010], 3 S.C.R. 379
5. *Ernst & Young Inc v Essar Global Fund Limited,* 2017 ONCA 1014
6. *Armoires de cuisine de Montréal ltée (Re),* [1983] J.Q. no 192
7. *Indcondo Building Corp. v. Sloan,* [2014] ONSC 4018 (Ont. S.C.J.)
8. *Nortel Networks Corp. (Re),* [2009] O.J. No. 3425 (Ont. S.C.J.)
9. *Puratone Corp. (Re),* [2013] M.J. No. 247 (Man. Q.B.)
10. *Timminco Ltd. (Re),* 2012 ONSC 2515
11. *Canwest Global Communications Corp. (Re),* [2009] O.J. No. 5379

Secondary Sources

12. Office of the Superintendent of Bankruptcy. "Bill C-12: Clause by Clause Analysis-Clause No. 78, s. 36.1 of the CCAA", (24 March 2015), online: SME research and statistics <https://www.ic.gc.ca/eic/site/bsf-osb.nsf/eng/br01986.html#a86>

SCHEDULE "B"
RELEVANT STATUTES

1. Section 36.1, *Companies' Creditors Arrangement Act*, R.S.C., 1985, c. C-36

Preferences and Transfers at Undervalue

Application of sections 38 and 95 to 101 of the *Bankruptcy and Insolvency Act*

36.1 (1) Sections 38 and 95 to 101 of the *Bankruptcy and Insolvency Act* apply, with any modifications that the circumstances require, in respect of a compromise or arrangement unless the compromise or arrangement provides otherwise.

Interpretation

(2) For the purposes of subsection (1), a reference in sections 38 and 95 to 101 of the *Bankruptcy and Insolvency Act*

(a) to "date of the bankruptcy" is to be read as a reference to "day on which proceedings commence under this Act";

(b) to "trustee" is to be read as a reference to "monitor"; and

(c) to "bankrupt", "insolvent person" or "debtor" is to be read as a reference to "debtor company".

2. Sections 2, 96 and 101, *Bankruptcy and Insolvency Act*, R.S.C., 1985, c. B-3

2 In this Act,

[...]

transfer at undervalue means a disposition of property or provision of services for which no consideration is received by the debtor or for which the consideration received by the debtor is conspicuously less than the fair market value of the consideration given by the debtor; (*opération sous-évaluée*)

[...]

Definitions

4 (1) In this section,

Definition of *related persons*

(2) For the purposes of this Act, persons are related to each other and are ***related persons*** if they are

(a) individuals connected by blood relationship, marriage, common-law partnership or adoption;

(b) an entity and

(i) a person who controls the entity, if it is controlled by one person,

(ii) a person who is a member of a related group that controls the entity, or

(iii) any person connected in the manner set out in paragraph (a) to a person described in subparagraph (i) or (ii); or

(c) two entities

(i) both controlled by the same person or group of persons,

(ii) each of which is controlled by one person and the person who controls one of the entities is related to the person who controls the other entity,

(iii) one of which is controlled by one person and that person is related to any member of a related group that controls the other entity,

(iv) one of which is controlled by one person and that person is related to each member of an unrelated group that controls the other entity,

(v) one of which is controlled by a related group a member of which is related to each member of an unrelated group that controls the other entity, or

(vi) one of which is controlled by an unrelated group each member of which is related to at least one member of an unrelated group that controls the other entity.

Relationships

(3) For the purposes of this section,

(a) if two entities are related to the same entity within the meaning of subsection (2), they are deemed to be related to each other;

(b) if a related group is in a position to control an entity, it is deemed to be a related group that controls the entity whether or not it is part of a larger group by whom the entity is in fact controlled;

(c) a person who has a right under a contract, in equity or otherwise, either immediately or in the future and either absolutely or contingently, to, or to acquire, ownership interests, however designated, in an entity, or to control the voting rights in an entity, is, except when the contract provides that the right is not exercisable until the death of an individual designated in the contract, deemed to have the same position in relation to the control of the entity as if the person owned the ownership interests;

(d) if a person has ownership interests in two or more entities, the person is, as holder of any ownership interest in one of the entities, deemed to be related to himself or herself as holder of any ownership interest in each of the other entities;

(e) persons are connected by blood relationship if one is the child or other descendant of the other or one is the brother or sister of the other;

(f) persons are connected by marriage if one is married to the other or to a person who is connected by blood relationship or adoption to the other;

(f.1) persons are connected by common-law partnership if one is in a common-law partnership with the other or with a person who is connected by blood relationship or adoption to the other; and

(g) persons are connected by adoption if one has been adopted, either legally or in fact, as the child of the other or as the child of a person who is connected by blood relationship, otherwise than as a brother or sister, to the other.

Question of fact

(4) It is a question of fact whether persons not related to one another were at a particular time dealing with each other at arm's length.

Presumptions

(5) Persons who are related to each other are deemed not to deal with each other at arm's length while so related. For the purpose of paragraph 95(1)(b) or 96(1)(b), the persons are, in the absence of evidence to the contrary, deemed not to deal with each other at arm's length.

Transfer at undervalue

96 (1) On application by the trustee, a court may declare that a transfer at undervalue is void as against, or, in Quebec, may not be set up against, the trustee — or order that a party to the transfer or any other person who is privy to the transfer, or all of those persons, pay to the estate the difference between the value of the consideration received by the debtor and the value of the consideration given by the debtor — if

(a) the party was dealing at arm's length with the debtor and

(i) the transfer occurred during the period that begins on the day that is one year before the date of the initial bankruptcy event and that ends on the date of the bankruptcy,

(ii) the debtor was insolvent at the time of the transfer or was rendered insolvent by it, and

(iii) the debtor intended to defraud, defeat or delay a creditor; or

(b) the party was not dealing at arm's length with the debtor and

(i) the transfer occurred during the period that begins on the day that is one year before the date of the initial bankruptcy event and ends on the date of the bankruptcy, or

(ii) the transfer occurred during the period that begins on the day that is five years before the date of the initial bankruptcy event and ends on the day before the day on which the period referred to in subparagraph (i) begins and

(A) the debtor was insolvent at the time of the transfer or was rendered insolvent by it, or

(B) the debtor intended to defraud, defeat or delay a creditor.

Establishing values

(2) In making the application referred to in this section, the trustee shall state what, in the trustee's opinion, was the fair market value of the property or services and what, in the trustee's opinion, was the value of the actual consideration given or received by the debtor, and the values on which the court makes any finding under this section are, in the absence of evidence to the contrary, the values stated by the trustee.

Meaning of *person who is privy*

(3) In this section, a ***person who is privy*** means a person who is not dealing at arm's length with a party to a transfer and, by reason of the transfer, directly or indirectly, receives a benefit or causes a benefit to be received by another person.

Inquiry into dividends and redemptions of shares

101 (1) Where a corporation that is bankrupt has paid a dividend, other than a stock dividend, or redeemed or purchased for cancellation any of the shares of the capital stock of the corporation within the period beginning on the day that is one year before the date of the initial bankruptcy event and ending on the date of the bankruptcy, both dates included, the court may, on the application of the trustee, inquire into the transaction to ascertain whether it occurred at a time when the corporation was insolvent or whether it rendered the corporation insolvent.

Judgment against directors

(2) If a transaction referred to in subsection (1) has occurred, the court may give judgment to the trustee against the directors of the corporation, jointly and severally, or solidarily, in the amount of the dividend or redemption or purchase price, with interest on the amount, that has not been paid to the corporation if the court finds that

(a) the transaction occurred at a time when the corporation was insolvent or the transaction rendered the corporation insolvent; and

(b) the directors did not have reasonable grounds to believe that the transaction was occurring at a time when the corporation was not insolvent or the transaction would not render the corporation insolvent.

Criteria

(2.1) In making a determination under paragraph (2)(b), the court shall consider whether the directors acted as prudent and diligent persons would have acted in the same circumstances and whether the directors in good faith relied on

(a) financial or other statements of the corporation represented to them by officers of the corporation or the auditor of the corporation, as the case may be, or by written reports of the auditor to fairly reflect the financial condition of the corporation; or

(b) a report relating to the corporation's affairs prepared pursuant to a contract with the corporation by a lawyer, notary, accountant, engineer, appraiser or other person whose profession gave credibility to the statements made in the report.

Judgment against shareholders

(2.2) Where a transaction referred to in subsection (1) has occurred and the court makes a finding referred to in paragraph (2)(a), the court may give judgment to the trustee against a shareholder who is related to one or more directors or to the corporation or who is a director not liable by reason of paragraph (2)(b) or subsection (3), in the amount of the dividend or redemption or purchase price referred to in subsection (1) and the interest thereon, that was received by the shareholder and not repaid to the corporation.

Directors exonerated by law

(3) A judgment pursuant to subsection (2) shall not be entered against or be binding on a director who had, in accordance with any applicable law governing the operation of the corporation, protested against the payment of the dividend or the redemption or purchase for cancellation of the shares of the capital stock of the corporation and had thereby exonerated himself or herself under that law from any liability therefor.

Directors' right to recover

(4) Nothing in this section shall be construed to affect any right, under any applicable law governing the operation of the corporation, of the directors to recover from a shareholder the whole or any part of any dividend, or any redemption or purchase price, made or paid to the shareholder when the corporation was insolvent or that rendered the corporation insolvent.

Onus of proof — directors

(5) For the purposes of subsection (2), the onus of proving

(a) that the corporation was not insolvent at the time the transaction occurred and that the transaction did not render the corporation insolvent, or

(b) that the directors had reasonable grounds to believe that the transaction was occurring at a time when the corporation was not insolvent or that the transaction would not render the corporation insolvent lies on the directors.

Onus of proof — shareholder

(6) For the purposes of subsection (2.2), the onus of proving that the corporation was not insolvent at the time the transaction occurred and that the transaction did not render the corporation insolvent lies on the shareholder.

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

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

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

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

Proceeding commenced at TORONTO

FACTUM OF THE MONITOR
(Transfer at Undervalue Claim Motion)
(returnable December 3, 2018)

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