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 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.

APPLICANTS

JOINT FACTUM OF THE APPLICANTS AND THE MONITOR

(Appointment of the Honourable Justice James Farley as Arbitrator and other Ancillary Relief -- Upper Canada Mall)

(Motion Returnable September 20, 2018)

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PART I – NATURE OF THE MOTION

1. This joint factum is filed in support of a cross-motion brought by Sears Canada Inc. ("**Sears Canada**") and the other applicants listed above (the "**Applicants**") and FTI Consulting Canada Inc. (the "**Monitor**") seeking the appointment of the Honourable Justice James Farley as arbitrator to determine the current value (the **"Current Value"**) of the Sears Canada property

located at the Upper Canada Mall, Newmarket, Ontario (the "**Newmarket Property**") pursuant to the terms of an Option Agreement (the "**Option Agreement**") between Sears Canada and Oxford Properties Group ("**Oxford**") and concurrently, as Claims Officer, to determine Oxford's $7 million set-off Claim against the same Newmarket Property. This factum is also filed in response to the motion brought by Oxford seeking the appointment of Mr. John Keefe to determine Current Value under the Option Agreement.

2. For the reasons set out below, the efficient and fair resolution of all issues related to the sale of the Newmarket Property requires that Current Value be determined at the same time as Oxford's disputed claim (the **"Claim"**) against the Applicants under the CCAA claims process along with related set-off rights (if any).

3. Case law supports the jurisdiction of the CCAA Court to order that arbitration related to issues arising in a CCAA proceeding be carried out under the umbrella of the CCAA. In this case, the Option Agreement confers jurisdiction on a court to appoint the arbitrator where the parties cannot agree. This Court therefore has the authority to appoint Justice Farley as arbitrator. This Court also has the discretion to order that Justice Farley concurrently determine the validity and quantum of the Claim asserted by Oxford and any set-off rights on the basis that it furthers the objectives of this CCAA proceeding and is otherwise appropriate.

4. Having the same experienced insolvency adjudicator resolve all the issues in a co-ordinated fashion under the CCAA umbrella will assist in achieving a prompt, global resolution of all the issues between the parties in relation to the Newmarket Property, avoiding duplication, potential inconsistent results and unnecessary expense. This is particularly important in light of

the ongoing carrying costs to the Applicants of the Newmarket Property, as well as the need to preserve as much value as possible for the Applicants' stakeholders.

5. There can be no doubt that Justice Farley is eminently qualified to act as arbitrator for commercial disputes and that he is a highly experienced adjudicator of insolvency disputes. Oxford raises no credible objection to the credentials of Justice Farley or to his ability to fully and fairly resolve all outstanding issues between these parties in relation to the Newmarket Property. Nor does Oxford demonstrate any prejudice that would justify concluding that Current Value should be resolved outside the CCAA or by someone other than the Claims Officer who has already been appointed pursuant to an order of this Court to act as neutral arbiter of all claims disputes between creditors and the Applicants.

6. By contrast, Oxford's proposed arbitrator has no authority to determine Oxford's Claim or whether set-off is available under the CCAA in these circumstances, nor does Oxford suggest that he does. Both the Claim and any set-off rights need to be resolved in order to conclude the sale transaction for the Newmarket Property and to be in a position to seek this Court's approval under s. 36 of the CCAA. Appointing Oxford's proposed arbitrator is inefficient and can only lead to additional delay and expense.

7. If this Court concludes that Justice Farley should not be appointed to resolve all issues in relation to the Newmarket Property, the Applicants and the Monitor request in the alternative that this Court direct either that Justice Hainey or another available Commercial List judge be appointed to resolve all the issues relating to the Newmarket Property on a global, co-ordinated basis.

PART II – FACTS

8. The facts with respect to this motion are more fully set out in the Affidavit of Phil Mohtadi[1] and in the Twenty-third Report of the Monitor.[2]

The Option to Purchase

9. Sears Canada formerly operated the Newmarket Property as a full-line department store. The Newmarket Property been vacant since early 2018.[3]

10. Sears Canada is party to an operating agreement dated July 25, 1973 (as amended, the "**Operating Agreement**") with Oxford, the registered owner of Upper Canada Mall, in respect of the Newmarket Property. Among other things, the Operating Agreement provides Oxford with a right of first refusal ("**ROFR**") to purchase the Newmarket Property at the price and upon the terms and conditions contained in any offer received by Sears Canada that Sears Canada is willing to accept. The ROFR is to be exercised by written notice to Sears Canada (the "**ROFR Notice**"), within 15 days of receipt of notice of any offer.[4]

11. Sears Canada is also party to the Option Agreement with Oxford. Pursuant to the Option Agreement, Oxford has an option to purchase the Newmarket Property if it is not operated as a department store by Sears Canada for a period of 91 consecutive days (the "**Option**"). Upon

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1 Affidavit of Phil Mohtadi, affirmed September 10, 2018 [Mohtadi Affidavit], Motion Record of the Applicants ("Applicants' Motion Record) at Tab 2. Capitalized terms not defined herein have the meaning ascribed to them in the Mohtadi Affidavit.

2 See Twenty-Third Report, of the Monitor, dated September 10, 2018, paras. 13-25 [Monitor's Report].

3 Mohtadi Affidavit at para. 5, Applicants' Motion Record at Tab 2.

4 Mohtadi Affidavit at para. 6 and Exhibit A, Applicants' Motion Record at Tab 2.

the exercise of the Option, the purchase price is to be calculated in accordance with Sections 11 and 12 of the Option Agreement.[5]

12. On June 13, 2018, as a result of the Court-approved sales process in these CCAA proceedings, Sears Canada entered into an agreement of purchase and sale with 1979353 Ontario Inc. (an affiliate of Liberty Developments) (the "**Liberty APS**") for the sale of the Newmarket Property. The Liberty APS was expressly made subject to the ROFR and the Option.[6]

13. On June 14, 2018, Sears Canada provided Oxford with the ROFR Notice. After bringing and withdrawing a motion to declare that the Liberty APS did not constitute a "bona fide" offer for the purpose of the ROFR, Oxford elected not to exercise the ROFR.[7] Instead, on June 29, 2018, after several court appearances, Oxford provided notice to Sears Canada and the Monitor by letter of its exercise of the Option (the "**Option Notice**").[8]

Requirement to Determine Current Value

14. The Option Agreement provides that, at the closing of the sale of the Newmarket Property, the purchase price is to be equal to the Current Value, subject to the usual adjustments and less the amount of any other liens, financial encumbrances and work orders that have not been removed on the closing. All amounts due by Sears Canada to Oxford or by Oxford to Sears Canada

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5 Mohtadi Affidavit at para. 7 and Exhibit B, Applicants' Motion Record at Tab 2.

6 Mohtadi Affidavit at para. 8, Applicants' Motion Record at Tab 2.

7 Mohtadi Affidavit at paras. 9-13, Applicants' Motion Record at Tab 2.

8 Mohtadi Affidavit at para. 13 and Exhibit C, Applicants' Motion Record at Tab 2.

in respect of the Upper Canada Mall and the Newmarket Property are to be settled and set-off or paid in full.[9]

15. The process by which the parties are to attempt to reach agreement on Current Value is set out in Section 12 of the Option Agreement. In short, if agreement cannot be reached within 7 days of the delivery of the Option Notice, each party may appoint an appraiser to determine Current Value. If the appraisals are within 5% of each other, Current Value will be the average of those appraisals. Otherwise, the Current Value is to be determined in accordance with the terms of the Option Agreement by a single arbitrator appointed by agreement of the parties or pursuant to court order.[10]

16. Following delivery of the Option Notice, the parties could not reach agreement on Current Value. The parties accordingly obtained appraisals. The appraisals were more than 5% apart, thus triggering the arbitration clause under the Option Agreement.[11] Oxford brought its motion to appoint its own arbitrator on August 29, 2018. The Applicants and the Monitor had earlier communicated to Oxford that their choice of arbitrator was the Honourable Justice Farley.[12]

Oxford's Proof of Claim

17. By proof of claim dated March 2, 2018 (the "**Proof of Claim**"), Oxford claimed in relation to the Newmarket Property: (a) $1,821,178 in respect of alleged site work and repair costs pursuant to the Operating Agreement, approximately $1.77 million of which relates to projected

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9 Mohtadi Affidavit at para. 15, Applicants' Motion Record at Tab 2.

10 Mohtadi Affidavit at para. 14, Applicants' Motion Record at Tab 2.

11 Mohtadi Affidavit at para. 16, Applicants' Motion Record at Tab 2.

12 Mohtadi Affidavit at para. 18, Applicants' Motion Record at Tab 2.

parking lot repairs; and (b) $5,596,026 in respect of the present value of alleged lost annual common area maintenance and promotion fund contributions under the Operating Agreement.

18. Oxford's Proof of Claim was rejected by the Monitor's Notice of Revision or Disallowance dated July 27, 2018 (the "**NORD**"). In response, Oxford submitted its Notice of Dispute in respect of claims in the amount of $7,397,241. The Notice of Dispute was made "expressly without prejudice to all rights of [Oxford] pursuant to (i) the provisions of the Option Agreement, including as it relates to the closing of the APA; and (ii) Section 21 of the CCAA".

PART III – ISSUES AND THE LAW

19. The issues on this cross-motion are as follows:

(a) should this Court appoint Justice Farley to arbitrate Current Value, to be resolved concurrently with the validity and quantum of Oxford's Claim and any set-off rights that may be asserted in the context of these CCAA proceedings?

(b) in the alternative, should this Court appoint a Commercial List judge to resolve all the issues between the parties related to the Newmarket Property on a co-ordinated basis?

(c) is the amount of Oxford's proposed purchase price for the Newmarket Property, as set out in the Option Notice, subject to settlement privilege?

Jurisdiction to Appoint Justice Farley

20. Section 12(d)(ii) of the Option Agreement specifies that, where the parties do not agree on the arbitrator, he or she "shall be appointed by a judge of the Ontario Court (General

Division)" (now the Ontario Superior Court of Justice, which includes the Commercial List). This Court therefore has the authority to appoint the arbitrator under the Option Agreement.

21. There are numerous examples of CCAA courts making orders designed to facilitate the resolution of disputes within CCAA proceeding where such disputes would otherwise be subject under contract or otherwise to arbitration. The Court's authority to make such orders is grounded in the Court's jurisdiction under s. 11 of the CCAA to make "make any order that it considers appropriate in the circumstances."[13]

22. These cases support the jurisdiction of the CCAA Court to make such orders where they further the objectives of the CCAA, including facilitating the efficient, cost-effective resolution of the dispute on a timely basis, in a manner that is co-ordinated with the CCAA proceeding.

23. Thus, for example, in *Smoky River Coal*, the Alberta Court of Appeal held that the CCAA stay precluded a dispute under a shareholders' agreement that would otherwise have been subject to arbitration from proceeding before an arbitrator. Instead, the Court held that a process for resolving the dispute under the CCAA should be established. Although arbitration can be an efficient procedure for resolving a dispute, the implications of requiring the debtor company to participate in an extra-CCAA proceeding were such that it was consistent with the CCAA objectives to make the requested order.[14]

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[13] *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended, s. 11.

[14] *Re Smoky River Coal Ltd.*, 1999 ABCA 179 at para. 33, Joint Book of Authorities of the Applicants and the Monitor ("BOA") at Tab 5.

24. Similarly, in *Re Hayes Forest Services Ltd.*,[15] an application was made to lift the stay of proceedings to allow a party to a logging contract to commence arbitration proceedings to determine whether it was reasonable to withhold its consent to the assignment of the logging contract. In refusing this relief, the CCAA Court held that the CCAA allowed the Court to substitute a decision in the CCAA proceedings for the arbitration process contemplated under the contract.[16] On the facts of that case, Burnyeat J. held that the determination of this issue would be less expeditious and more expensive under the arbitration provisions, as well as carrying the risk of further delay and cost.[17]

25. In *Bloom Lake*,[18] the CCAA Court held that, in principle, all issues relating to a debtor's insolvency should be decided before a single court. This rule is based on the "public interest in the expeditious, efficient and economical clean-up of the aftermath of a financial collapse." This public interest favours a "single control" of insolvency proceedings by one court as opposed to their fragmentation among several courts.

26. Further, there is no legal impediment to conferring jurisdiction on a claims officer and/or providing for a process under the CCAA to adjudicate claims that would otherwise be subject to arbitration. To the contrary, CCAA Courts have previously granted claims procedure

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15 2009 BCSC 1169 [*Hayes*], BOA at Tab 4.

16 *Hayes*, above note 15 at para. 25, BOA at Tab 4.

17 *Hayes*, above note 15 at para. 30, BOA at Tab 4.

18 2017 QCCS 284 at paras 29-33, BOA at Tab 2; See also *Re Essar Steel Algoma Inc.*, 2016 ONSC 595 at paras 9 and 30-33, BOA at Tab 3.

orders appointing claims officers to act as labour arbitrators under a grievance arbitration process and providing for the resolution of such claims under the umbrella of the CCAA.[19]

27. In the present case, there is nothing in the Claims Procedure Order that would preclude a claims officer such as Justice Farley from acting as an arbitrator of a commercial dispute that is relevant to the recovery of the debtor's estate under the CCAA, at the same time that he determines the creditor's claim against the debtor's estate and the availability of any resulting set-off rights.

Discretion to Appoint Justice Farley

i. The Outstanding Issues are Inextricably Linked

28. In order for any transaction to be completed in respect of the Option, the following issues must be determined: (i) the Current Value of the Newmarket Property; (ii) whether there are any valid and enforceable rights of set-off in the context of these CCAA proceedings; and (iii) if valid, the quantum of such set-offs. Subsequently, the entire transaction must be brought to the CCAA Court for approval pursuant to section 36 of the CCAA.[20]

29. The Option Agreement provides that at closing "all amounts due by Sears to [Oxford] or by [Oxford] to Sears in respect of the [Newmarket Property] shall be settled and set-off or paid in full". The Option Agreement further provides that Oxford "shall assume, from and

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[19] See *e.g.*, *Re AbitibiBowater Inc.*, Claims Procedure Order, dated January 18, 2010 (Court File No. 500-11-036-133-094) (Superior Court of Quebec) at paras. 18-20, BOA at Tab 7.

[20] Mohtadi Affidavit at para. 20, Applicants' Motion Record at Tab 2.

after the Closing, all liabilities and obligations of Sears in connection with the [Newmarket Property] being acquired".[21]

30. The determination of the Current Value and the disputes in relation to the Claim, together with any related set-off, are therefore inextricably linked and should be resolved by the same adjudicator in one coordinated proceeding. The resolution of these issues is a pre-condition for the Applicants to be in a position to seek this court's approval of the sale transaction and to close the transaction for the benefit of all stakeholders.

31. For the sake of efficiency and consistency, these issues should not be determined in a piecemeal fashion. Separate proceedings to determine these interrelated issues would result in additional cost and delay.[22] Delay has already occurred, to the detriment of the Applicants' stakeholders. It has already been over three months since Sears Canada signed the Liberty APS and provided the ROFR Notice and over two and a half months since Oxford provided the Option Notice.[23]

32. The costs of further delay and inefficiency include not only the expense of preparing for and litigating two separate proceedings, with the attendant risks of inconsistent results, but also the carrying costs of the Newmarket Property while the issues are resolved. In addition to costs associated with litigation, Sears Canada incurs monthly carrying costs of approximately $107,000, incurred on the first day of each month.[24]

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21 Monitor's Report, above note 2 at para. 31.

22 Monitor's Report, above note 2 at para. 33.

23 Mohtadi Affidavit at para. 25, Applicants' Motion Record at Tab 2.

24 *Ibid.*

33. Such delay and inefficiencies, as well as the related expense, materially prejudice the creditors of Sears Canada. The Monitor specifically notes in its Twenty-third Report that because the disputes are "inextricably linked" they should be determined concurrently.[25]

ii. Justice Farley Should Decide the Issues

34. Justice Farley has both the commercial and the insolvency experience necessary to fairly and efficiently resolve all outstanding issues between the parties regarding the Newmarket Property.

35. Justice Farley is a former judge of the Superior Court of Justice, and spent many years sitting on the Commercial List as a CCAA Judge. He is one of two former judges appointed by this Court as a Claims Officer in these CCAA Proceedings.[26] Indeed, the Monitor believes that Justice Farley is *uniquely situated* to determine the interconnected issues in relation to the Newmarket Property.[27]

36. Justice Farley, in his capacity as Claims Officer, has been appointed pursuant to the Claims Procedure Order to act as neutral arbiter in claims disputes between creditors and the Applicants. There can be no realistic grounds for asserting conflict of interest or bias in favour of the Applicants. Oxford has put forward no credible evidence on which to conclude that Justice Farley is not qualified or suited to resolve the Current Value, the Claim and the applicability of set-off (if any) in the same proceeding.

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[25] Monitor's Report, above note 2 at para. 31.

[26] Mohtadi Affidavit at para. 22, Applicants' Motion Record at Tab 2.

[27] Monitor's Report, above note 2 at para. 35.

37. Oxford's proposed arbitrator, on the other hand, does not have jurisdiction to resolve issues that have been conferred on the claims officers under the Claims Procedure Order. Oxford's motion expressly supports two separate proceedings, regardless of expense or inefficiency. Oxford states in support of its motion that Oxford's proposed arbitrator is not "encumbered" by any prior involvement in this CCAA proceeding and that the arbitrator will have jurisdiction to consider the single issue of Current Value.[28] Given that the issues under the CCAA must be resolved, this lack of prior involvement in the CCAA proceeding is a disadvantage, not an advantage.

38. Having two separate "dual-track" proceedings – one inside the CCAA to resolve the Claim and the set-off and one outside the CCAA to resolve the arbitration – would be duplicative and wasteful. Oxford presents no evidence or objective justification for taking this approach and its motion should therefore be denied.

39. In the circumstances, the appointment of Justice Farley as arbitrator will ensure that the interests of Sears Canada's stakeholders in an expedited and value maximizing resolution are appropriately prioritized, while simultaneously respecting the material substantive rights of Oxford under the Option Agreement.[29]

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[28] Oxford Notice of Motion, dated August 29, 2018, Motion Record of the Respondent Oxford Properties Group at Tab 1, para. 10.

[29] Monitor's Report, above note 2 at para. 34.

The Option Notice is Not Protected by Settlement Privilege

40. Oxford has taken the position on this motion that the amount of Oxford's proposed purchase price for the Newmarket Property, as disclosed by Oxford in the Option Notice, is subject to settlement privilege and is therefore not subject to disclosure on this motion.[30]

41. Settlement privilege protects communications from disclosure where the communication was made in confidence (or "without prejudice") with a view to achieving a settlement.[31]

42. The designation "without prejudice" is not essential for settlement privilege to arise. However, it is nonetheless indicative that the Option Notice contains no such designation, despite having been drafted by experienced counsel. This is in contrast to the express "without prejudice" offer made by Oxford's counsel on August 24, 2018.[32]

43. In any event, for settlement privilege to apply, it is necessary to demonstrate that the communication was intended to be confidential and was provided for the purpose of settling an existing dispute.[33] By providing the Option Notice, Oxford was simply exercising a contractual right under the Option Agreement. At that time, there was no existing dispute to settle. Sears Canada had the contractual right under the Option Agreement to accept the value at which Oxford proposed to acquire the Newmarket Property. In such event, no dispute would ever arise.

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30 At the request of the Court, the Option Notice has been redacted from the Mohtadi Affidavit, pending the hearing of this motion.

31 See *Bombardier Inc. v. Union Carbide Canada Inc.*, 2014 SCC 35 at para. 31, BOA at Tab 1.

32 Mohtadi Affidavit at para. 17, Applicants' Motion Record at Tab 2.

33 *Yeung v. Chan*, 2017 ONSC 3138 at para. 36, BOA at Tab 6.

44. The Option Agreement provides its own mechanism for the parties to agree on Current Value. If the parties fail to agree, and the appraisals are within 5% of each other, the Current Value is the average of the two appraisals. Again, no dispute would ever arise.

45. The Option Notice contains relevant information that is a valuable "data point" for both this motion, and eventually for the purpose of determining Current Value.

46. In respect of the determination of Current Value, this data point arises from the court-ordered sale process, which led to the Liberty APS and Oxford's decision regarding the ROFR. It demonstrates Oxford's own view of Current Value and its relationship to the values produced as a result of the SISP. It is important that whoever is appointed arbitrator have extensive expertise in supervising court-ordered sale processes under the CCAA in order to appreciate this nuance.

47. In respect of its relevance for this motion, the redacted purchase price in the Option Notice helps to demonstrate the fundamental interrelationship between the determination of Current Value under the Option and the CCAA, including the SISP and the Liberty APS. Fundamentally, it is the position of Sears Canada and the Monitor that this interrelationship between the Option, Current Value, and the CCAA are the primary reason for the need to have these issues determined concurrently, and, accordingly for the relief sought on the cross-motion. Oxford, in opposing this relief, proposes that these matters are sufficiently distinct such that Current Value can be determined independently.

PART IV – NATURE OF THE ORDER SOUGHT

48. For all of the reasons above, the Applicants and the Monitor submit that this Honourable Court should grant the relief sought by the Applicants and the Monitor in this cross-motion.

ALL OF WHICH IS RESPECTFULLY SUBMITTED:

Osler, Hoskin & Harcourt LLP

Norton Rose Fulbright LLP

Schedule "A"

LIST OF AUTHORITIES

1. *Bombardier Inc. v. Union Carbide Canada Inc.*, 2014 SCC 35.
2. *Re Bloom Lake General Partners Ltd.*, 2017 QCCS 284.
3. *Re Essar Steel Algoma Inc.*, 2016 ONSC 595.
4. *Re Hayes Forest Services Ltd.*, 2009 BCSC 1169.
5. *Re Smoky River Coal Ltd.*, 1999 ABCA 179.
6. *Yeung v. Chan*, 2017 ONSC 3138.

SUPPLEMENTARY MATERIALS

7. *Re AbitibiBowater Inc.*, Claims Procedure Order, dated January 18, 2010 (Court File No. 500-11-036-133-094) (Superior Court of Quebec).

Schedule "B"

COMPANIES' CREDITORS ARRANGEMENT ACT

R.S.C. 1985, c. C-36, as amended

General power of court

11. Despite anything in the *Bankruptcy and Insolvency Act* or the *Winding-up and Restructuring Act*, if an application is made under this Act in respect of a debtor company, the court, on the application of any person interested in the matter, may, subject to the restrictions set out in this Act, on notice to any other person or without notice as it may see fit, make any order that it considers appropriate in the circumstances.

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