



November 9, 2020

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Via Regular Mail

TO: Sears Canada Retirees

Dear Sir/Madam:

**Re: Sears Canada Inc.
Sears Canada Inc. Registered Retirement Plan and OPEB Claims
CCAA Plan of Compromise and payments to creditors**

We are writing to you to provide an update on the status of Sears Canada Inc. in its proceedings under the *Companies' Creditors Arrangement Act* ("CCAA"), and the payments to be made to retirees and former employees for their pension and benefit claims.

Background

As you are likely aware, on June 22, 2017, Sears Canada was insolvent and applied to the Ontario Superior Court of Justice (Commercial List) for protection from its creditors under the CCAA. The Court granted Sears Canada's request and issued an initial CCAA Court order.

The Court appointed the accounting firm of FTI Consulting Inc. as the Monitor in the CCAA proceedings. Generally, a Monitor is an independent party whose role is to oversee the company's activities that are relevant to its CCAA proceedings. The Monitor's duties include monitoring the business during the period of CCAA protection, interacting with creditors, and reporting to the Court on major events involving the company and its creditors.

On the same day, the Court appointed our firm as Representative Counsel for all Sears Canada non-union retirees and employees in respect of their pension and other post-retirement benefits such as health benefits (known as "other post-employment benefits" or "OPEBs") that were earned while they were employees of Sears Canada.¹

The formal Representation Order was issued by the Court on July 13, 2017. Retirees Ken Eady, Larry Moore, and Bill Turner were also appointed as Representatives under the *Rules of Civil Procedure* of all Sears Canada non-union retirees and non-union employees with respect to

¹ Separate counsel was appointed to represent non-union active and former employees with respect to other termination and severance claims. If you have such a claim, you will be hearing from other lawyers in a separate communication.

pension and OPEB entitlements for the purpose of Sears Canada's CCAA proceeding. They formed a committee to liaise with our firm.

Sears Canada was unable to restructure its business. Instead, while under CCAA protection, it closed down its operations, liquidated all of its store inventories, terminated its employees, and sold its real estate. The liquidation of all of Sears Canada's assets is now complete. The next major step is to distribute the sale proceeds to its creditors.

For payment purposes, all creditors of Sears Canada are being treated as "unsecured creditors", which means that they have to share equally in the cash available from Sears Canada. Unfortunately, the claims of all the creditors of Sears Canada are much greater than the amount of cash that Sears Canada has available to distribute, meaning that creditors are facing shortfalls on the recovery of the amounts owing to them. Based on the estimates provided by the Monitor at this time, the payments to unsecured creditors will be paid at approximately 8 cents to 10 cents on the dollar of their claim amounts. However, the pension wind up deficit claim, which is discussed in greater detail below, will receive a higher recovery due to the deemed trust priority claim that we advanced (referred to as the "**Pension Deficit Claim**").

The settlement that we achieved for the Pension Deficit Claim will result in a recovery of approximately 22 cents on the dollar payable to the fund of the Sears Canada Plan, as compared to 8 cents to 10 cents on the dollar for all other creditors. This will translate to a payment of approximately \$55 million to the pension plan. That payment will help improve the amount of pension benefits that are paid each month to many retirees, in particular those outside of Ontario who do not benefit from the PBGF payment (also discussed below).

The payments to creditors are currently expected to be made in the early New Year.

With respect to the former employees of SLH Transport Inc., the Monitor estimates that their claims will be paid at approximately 20 to 24 cents on the dollar. Unsecured creditors of Corbeil Electrique Inc. will be paid in full as the proceeds from the sale of that standalone business are sufficient to pay out all creditor claims against it.

The payments to creditors will be facilitated through an agreement called the CCAA Plan of Compromise (the "**CCAA Plan**") prepared by Sears Canada following negotiations with its major creditor groups, described further below.

* * * * *

The balance of this letter is divided into the following sections to explain the Pension Deficit Claim, the different unsecured claims that we filed on behalf of the retirees, and the litigation brought against various parties that resulted in settlements that will benefit retirees and other creditors:

- a) Pension Deficit Claim;
- b) Retiree unsecured claims:

- i) OPEB Claim;
 - ii) Supplemental Pension Plan Claim;
 - iii) Lifetime Purchase Discount Claim; and,
- c) lawsuits filed in respect of the 2013 dividend paid by Sears Canada for \$509 million.

a) The Pension Deficit Claim and the deemed trust priority claim

Sears Canada sponsored the Sears Canada Inc. Registered Retirement Plan ² (the "**Sears Canada Plan**") under which employees earned pension benefits to be paid to them on their retirement for their lifetimes. The Sears Canada Plan has a pension fund that is a separate account into which both Sears Canada and employees paid contributions to fund the payment of pension benefits. Sears Canada paid into the fund in accordance with the advice of its actuary and the pension regulations under the Ontario *Pension Benefits Act*, and employees contributed a portion of their pay. The pension fund is a separate fund exclusively for the purpose of paying monthly pension benefits and is protected from the claims of other creditors of Sears Canada.

Unfortunately, the pension fund was not funded adequately (it is "underfunded"). This means that at the time that Sears Canada obtained CCAA protection and was unable to restructure, there was not enough money in the fund to pay all pension benefits in full for their lifetimes that were owing to Sears Canada retirees. It was determined that the plan is underfunded on a "wind up basis" by approximately \$260 million. A claim for this wind up deficit was filed in that amount with the Monitor as a creditor claim.

While it was an active company, Sears Canada was the administrator of the Sears Canada Plan, meaning it was responsible for its administration and funding. Once Sears Canada obtained CCAA protection and started to liquidate, a new administrator needed to be appointed to take over the administration of the plan and to terminate it (known as "winding up").

On October 17, 2017, the Ontario Superintendent of Financial Services (the "**Superintendent**") appointed the actuarial firm of Morneau Shepell Ltd. ("**Morneau**") as the replacement administrator to wind up the Sears Canada Plan. Due to the underfunding in the plan and to protect the remaining assets so that the fund could continue paying benefits for the lifetimes of all retirees, in August 2018, Morneau reduced pension benefits by 30%. The cutback has since been reduced, and Morneau is currently reducing pension benefits by 20%. Benefits for most Ontario retirees were not reduced due to the expected future payment to be made to the pension fund from the Ontario Pension Benefits Guaranty Fund ("**PBGF**"), which is described below.

² Registration Number 0360065.

The deemed trust priority claim

As mentioned above, we as Representative Counsel asserted that the Pension Deficit Claim should be paid in priority to the claims of other creditors based on the pension wind up deemed trust provisions in the Ontario *Pension Benefits Act* and the 2013 decision of the Supreme Court of Canada in the case of *Indalex*.³

On December 7, 2017, we filed a motion before the CCAA Court to determine this issue. Shortly thereafter, the Superintendent and Morneau also filed a motion asserting the deemed trust priority (collectively, the "**Deemed Trust Motions**"). The Deemed Trust Motions were opposed by the Monitor and other creditors, and were proceeding toward a hearing before the Court to decide.

The mediation of the deemed trust priority claim and the settlement

On October 18, 2018, with the assistance of Regional Senior Justice Geoffrey Morawetz, we attended a mediation with the Monitor, the company, the Superintendent, Morneau and the Representatives to try and settle the Deemed Trust Motions without litigation. The mediation resulted in a settlement and we are pleased to report that the Pension Deficit Claim will be treated, for CCAA distribution purposes, as an unsecured claim but valued at 2.5 times the amount of the actual pension deficit or approximately \$650 million (instead of \$260 million), subject to an adjustment for the additional recoveries obtained through separate litigation (discussed below).

It is expected that this settlement will translate into a payment to the Sears Canada Plan from the estate of Sears Canada of approximately \$55 million, instead of the \$25 million it would have received if the Pension Deficit Claim was treated as an ordinary unsecured claim. The deemed trust settlement is set out in an agreement called the Pension Support Agreement.

The PBGF payment to the Sears Canada Plan for Ontario members

For Ontario retirees, the Ontario PBGF is required to make a payment to the Sears Canada Plan to improve the underfunding and guarantee the pension benefits of up to a maximum of \$1,500/month for each Ontario Plan member. Since the amount of the typical pension benefit owing to most Sears Canada retirees is less than \$1,500/month, the PBGF payment will result in the majority of Ontario retirees not having any reduction to their pension benefits. We are in discussions with Morneau about the PBGF payment and the next steps for the wind up of the Sears Canada Plan. The PBGF is administered by the Financial Services Regulatory Authority of Ontario ("**FSRA**").

³ We were counsel to the retirees in the *Indalex* case. A copy of the *Indalex* decision can found at this address:
<https://www.canlii.org/en/ca/scc/doc/2013/2013scc6/2013scc6.html?autocompleteStr=indalex&autocompletePos=1>

Unfortunately, the Ontario PBGF payment is only available to Ontario members and will not assist retirees who worked for Sears Canada in other provinces.

In addition, the entitlement of the SLH Transport Inc. employees, who are also members of the Sears Canada Plan, to a share of the PBGF payment is currently unresolved and we are in ongoing discussions in this regard. We will communicate with the SLH members separately about this issue.

b) Retiree unsecured claims

i) The OPEB Claim

As of October 1, 2017, while under CCAA protection, Sears Canada terminated health and life insurance benefits coverage to eligible retirees. We calculated the OPEB claim with the advice of an actuary and filed it in the creditors' claims process administered by the Monitor. The amount of this claim was settled and accepted by the Monitor in the amount of \$417 million. Under current law, the OPEB claim is an unsecured claim and will be paid at approximately 8 cents to 10 cents on the dollar.

ii) The Supplemental Pension Plan Claim

Sears Canada provided Supplemental Pension Plan benefits for certain of its employees, which are paid in addition to the pension benefits from the Sears Canada Plan described above.

The Supplemental Plan pays the benefits from two sources for two different groups of eligible retirees. One group, comprising most of the plan's members, have their benefits paid from a separate trust fund called the "**RCA Trust**", that was funded by contributions from Sears Canada. Nine other Supplemental Plan members had their benefits paid from the company's general revenues. Once Sears Canada became subject to CCAA protection, it rescinded its responsibility for the Supplemental Plan and stopping making contributions to the RCA Trust. It also terminated the payment of benefits to the nine retirees who received their benefits from Sears Canada directly.

There is a deficit in the RCA Trust fund, similar to the deficit in the Sears Canada Plan fund but for a smaller amount. We prepared a claim in respect of this deficit.

We also prepared a claim for the value of the terminated supplemental pension benefits for the nine retirees whose benefits are not funded by the RCA Trust.

On June 5, 2020, we reached an agreement with the Monitor to accept the total Supplemental Plan claim for both the RCA Trust fund deficit and the nine retirees in full as an unsecured claim. The distribution with respect to the RCA Trust claim will be paid to the fund of the RCA Trust. The distribution with respect to the nine retirees will be paid to those retirees directly. Separate correspondence with more details of these claims has been sent to the affected retirees.

Both the claim for the RCA Trust fund deficit and the terminated Supplemental Plan benefits for the nine retirees are treated as unsecured claims and will be paid at approximately 8 cents to 10 cents on the dollar.

iii) The Purchase Discount Claim

As part of the employment arrangement, Sears Canada provided a purchase discount benefit for employees and retirees that applied to purchases of merchandise from Sears Canada. This valuable benefit was also lost when Sears Canada became insolvent and stopped operating its stores. We calculated a claim for the present value of the lifetime purchase discount. This claim is valued at approximately \$14.8 million and was accepted by the Monitor. Under current law this is also an unsecured claim and will be paid at approximately 8 cents to 10 cents on the dollar.

c) Lawsuits in respect of the \$509 million dividend paid by Sears Canada to its shareholders in 2013

In 2013, while it was an active company, Sears Canada paid a \$509 million dividend to its shareholders.

In 2018, after Sears Canada became insolvent and obtained CCAA protection, a creditors committee was established to discuss and supervise the possibility of bringing lawsuits with respect to the \$509 million dividend and recover additional funds to compensate creditors of Sears Canada. The committee was comprised of Representative Counsel to the retirees, Representative Counsel to the employees, FSRA, Morneau, and three other major creditors of Sears Canada.

In December 2018, following extensive investigations into the affairs of Sears Canada and the \$509 million dividend, three lawsuits were commenced against various defendants, including Sears Holdings Corp., former directors of Sears Canada, ESL Investments Inc., Edward Lampert, and others. These are briefly described below.

i) Lawsuit by the CCAA Monitor: This claim was essentially based on the argument that the \$509 million dividend was an unlawful "transfer at undervalue" by Sears Canada, and contrary to the provisions of CCAA, and that its payment should be reversed or otherwise recovered from the defendants and returned to the estate of Sears Canada to be used to compensate its creditors for their losses.

ii) Lawsuit by the Litigation Trustee of Sears Canada: This claim included allegations that the directors of Sears Canada breached duties that they owed to the company by approving the payment of the \$509 million dividend. This lawsuit also sought damages payable to the estate of Sears Canada, again to compensate its creditors.

iii) Lawsuit by Morneau, as administrator of the Sears Canada Plan: This claim was essentially based on allegations that the directors of Sears Canada breached fiduciary and other duties that they owed to the Sears Canada Plan members in relation to the declaration of the \$509 million dividend. The lawsuit sought damages payable to the fund of the Sears Canada Plan to be applied toward improving the underfunding in the plan to offset the reduced pension benefits imposed on retirees due to the plan's underfunding.

The three lawsuits proceeded in tandem. In the summer of 2020, a mediation of the three lawsuits among all the parties proceeded with the assistance of Mr. Justice Glenn Hainey of the Ontario Superior Court of Justice. The three cases were settled in two stages.

First, the former directors of Sears Canada agreed to settle the lawsuits against them for CAD \$50 million. On August 25, 2020, the Court approved the settlement.

Second, Edward Lampert and his companies agreed to settle the lawsuits against them for CAD \$22.5 million. On September 18, 2020, the Court approved the settlement.

The litigation recoveries will be allocated pursuant to various formulas that have been negotiated and the Pension Support Agreement mentioned above. Approximately 36% or \$26 million is to be paid directly to the Sears Canada Plan. An additional \$40 million will be paid to Sears Canada for distribution to all unsecured creditors, including with respect to the Pension Deficit Claim and the retirees' other claims described above. This will result in an additional \$8 million being paid to the Sears Canada Plan, for a total litigation recovery to the pension plan of approximately \$34 million.

Summary of recoveries for the Sears Canada Plan

Based on the best information currently available, and after applying certain adjustments, the amounts recovered for the underfunded Sears Canada Plan are summarized below:

- Settlement of the Pension Deficit Claim: \$54 million
- Portion of the litigation settlement paid to the Sears Canada Plan: \$26 million
- Portion of the litigation settlement paid to the Sears Canada Plan via the estate distributions: \$8 million

Total: \$88 million

In addition, the PBGF payment will also be made to the pension fund in the near future, but that, as mentioned, only applies to the Ontario members.

The CCAA Plan of Compromise

Generally, a CCAA Plan is a global agreement negotiated between the company under CCAA protection and its creditors as to how the company will treat the payment of creditors' claims from the assets it has available.

Sears Canada, at the direction of the Monitor, has negotiated and proposed a CCAA Plan to deal with the distribution of the assets of Sears Canada to its creditors including the settlements from the dividend litigation.⁴ For a CCAA Plan to become valid, it must pass a vote by a required majority of creditors at a creditors meeting. If it passes that vote, it must then be approved by the Court. After that, the CCAA Plan can proceed to implementation.

Previously, Sears Canada, at the direction of the Monitor, proposed a prior version of the CCAA Plan and brought a motion to the Court on February 15, 2019 to schedule a creditors meeting. The Court granted the motion and creditors meetings were scheduled for March 28, 2019. However, issues arose with respect to certain conditions that needed to be fulfilled in the draft CCAA Plan, and the creditors meetings were cancelled pending the resolution of those issues.

The Monitor has since revised the CCAA Plan to reflect the litigation settlements, recent asset sale proceeds and other cash inflows. The CCAA Plan also addresses the distributions to the creditors of Sears Canada.

The next step is for the Monitor to hold creditors meetings to vote on and approve the CCAA Plan. Assuming the creditors vote in favour of the Plan, an approval hearing before the Court has been scheduled to be heard on November 23, 2020.

Releases

The CCAA Plan also contains releases. Generally, a "release" operates to protect a person who is subject to the release from being held liable for future, existing, or past claims or liability arising from litigation or other matters, except in cases of the person's gross negligence or wilful misconduct.

The CCAA Plan provides for releases with respect to Sears Canada and the Monitor, as well as their advisors, legal counsel, Representative Counsel, and the Representatives. Once the CCAA Plan is approved by the CCAA Court and implemented, this will mean that the parties subject to the releases are protected from future lawsuits or claims. The CCAA Plan also contains releases with respect to the defendants who have settled the dividend litigation, although these defendants also have the benefit of releases under the separate settlement arrangements.

⁴ Please note that one of the terms of the proposed CCAA Plan for Sears Canada is that it will not pay an unsecured creditor claim in the amount of \$80 or less, because the Monitor indicated it is not administratively economical for the estate to process a payment for such a small amount. We are advised that an \$80 claim would result in a payment of only about \$6.40 – \$8.00 to an individual creditor.

Voting on the Plan of Compromise

As noted above, the CCAA Plan must pass a vote of the majority of creditors at the creditors meetings. We, as Representative Counsel, have been authorized by the Court to vote on retirees' behalf in respect of the OPEB Claim, the Supplemental Pension Plan Claim, and the Purchase Discount Claim. Pursuant to our consultations with the Court-Appointed Representatives, and since the CCAA Plan reflects the provisions of the previous settlements we reached in the Pension Support Agreement, the other retiree claims, and the settlements to the Dividend Litigation, we will be voting **in favour** of the CCAA Plan.

Morneau has been authorized to vote on the Pension Deficit Claim and has advised us that it will also be voting in favour of the CCAA Plan.

You, as a retiree, do not need to do anything in respect of voting on the Plan of Compromise.

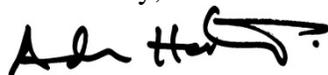
We will report on the results of the vote after the creditors meeting with an update to our website for Sears Canada retirees which can be found at: <https://kmlaw.ca/cases/sears-canada/>.

We will also provide an update on the timing of the payments to retirees and on the Sears Canada Plan wind up process.

In addition, the Monitor, Morneau, and our firm are planning to jointly hold webinars shortly after the release of the first payment to provide more information about how your payment was calculated, the impact of the payments recovered for the Sears Canada Plan, tax implications of the payment, and next steps regarding the closing of the estate of Sears Canada and the wind up of the pension plan. Details regarding the timing of these webinars will be provided in January 2021.

We hope this letter is helpful. If you have any questions, please do not hesitate to contact us at our toll-free hotline at 1-800-244-7120 or email us at searsrepcounsel@kmlaw.ca.

Yours truly,



Andrew J. Hatnay

cc. Ken Eady, Bill Turner, Larry Moore, *Court-Appointed Representatives*
Demetrios Yiokaris, Sydney Edmonds, *Koskie Minsky LLP*