

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.

(each an "**Applicant**", and collectively, the "**Applicants**")

NOTICE OF MOTION
(Motion re. Removal of Board of Directors)

Representative Counsel to the court-appointed representatives of the non-unionized Active Employees and Former Employees of the Applicants ("**Employee Representative Counsel**"), will make a motion to the court on a date to be established by the Commercial List Office, at the Courthouse, 330 University Avenue, Toronto, Ontario.

PROPOSED METHOD OF HEARING: The motion is to be heard orally.

THE MOTION IS FOR:

1. an Order, substantially in the form included in the motion record, to be filed:
 - (a) if necessary, abridging the time for service of this motion and dispensing with service on any person other than those served;
 - (b) removing the directors of Sears Canada Inc. ("**Sears Canada**") effective as of July ●, 2018 or such other date as counsel may advise;

- (c) expanding the powers of FTI Consulting Canada Inc., in its capacity as Court-appointed monitor in the proceedings of the Applicants pursuant to the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. c-36, as amended (the "**CCAA**") to oversee the remaining operations, management and wind-down of the Applicants and SearsConnect (the "**Sears Canada Entities**") in accordance with the terms of the Order;
2. Such further and other relief as counsel may request and this Honourable Court may deem just.

THE GROUNDS FOR THIS MOTION ARE:

Background

1. The Applicants were granted protection from their creditors under the *Companies' Creditors Arrangement Act*, R.S.C. 1985 c. C-36, as amended (the "**CCAA**") pursuant to the Initial Order of the Ontario Superior Court of Justice (Commercial List) dated June 22, 2017, as amended and restated.
2. FTI Consulting Canada Inc. was appointed to act as the Monitor (the "**Monitor**") in the CCAA proceeding.
3. Pursuant to the Employee Representative Counsel Order issued by the Court on July 13, 2017 (the "**Employee Representative Counsel Order**"), Ursel Phillips Fellows Hopkinson LLP was appointed as Employee Representative Counsel to represent the interests of the non-unionized Active Employees and Former Employees of the Sears Canada Entities (as each such term is defined in the Employee Representative Counsel Order, collectively, the "**Employees**") for the purposes set out in the Employee Representative Counsel Order.
4. Following the Initial Order, the Applicants, with the assistance of BMO Nesbitt Burns Inc. (the "**Sale Advisor**"), engaged third party liquidators to assist the Applicants in the liquidation of the inventory and furniture, fixtures and equipment ("**FF&E**") at 45 retail store locations that were identified for closure at the outset of the CCAA

proceedings (the “**Initial Liquidation**”). The Initial Liquidation was approved by the Court on July 18, 2017.

5. On July 13, 2017, the Court approved a sale process (the “**SISP**”) in which the Sale Advisor on behalf of Sears Canada under the supervision of the Special Committee of the Board of Directors and the Monitor sought bids and proposals for a range of transactions, including for a going concern transaction for Sears Canada.

6. Although the Sears Canada subsidiaries Corbeil Electric Inc. and S.L.H. Transport Inc. were each sold in transactions approved by the Court on October 4, 2017, attempts at executing a going concern transaction for the remainder of the Sears Canada enterprise were unsuccessful.

7. As a result, on October 13, 2017, the Court issued an order approving an agreement and process for the liquidation of the inventory and FF&E at all remaining Sears Canada retail locations (the “**Second Liquidation**”).

8. The liquidation of assets at Sears Canada’s retail locations is now completed, all retail locations are closed, and leases in respect of such locations have been disclaimed or otherwise dealt with in the CCAA Proceedings. The Applicants’ remaining assets that are yet to be realized upon are the Remaining Real Estate Assets (as defined in the Nineteenth Report of the Monitor).

9. A general claims process for the identification, determination and adjudication of claims of creditors against the Applicants was approved and endorsed by the Court on December 8, 2017 (the “**Claims Procedure Order**”). In addition, the Court issued an Employee and Retiree Claims Procedure Order (the “**E&R Claims Procedure Order**”), which approved a process for the identification, determination and adjudication of claims of employees and retirees of the Applicants.

10. Both claims procedures are well underway with all claims bar dates already passed. The Monitor is currently in the process of reviewing claims and must provide all Notices of Revision or Disallowance by July 31, 2018.

11. On May 9, 2018, the Court approved an order (the “**Mediation Order**”) that provided an outline for the mediation of significant outstanding issues in these CCAA proceedings (the “**Mediation**”). The Mediation took place on June 13-14, 2018 before the Honourable Regional Senior Justice Morawetz.

12. The goal of the Mediation is to achieve consensus on preliminary proceeds allocation issues necessary to allow the Applicants, in consultation with the Monitor, to pursue a proposed CCAA plan for the purpose of dividing and distributing estate proceeds as efficiently and quickly as possible. The Mediation process has not formally concluded.

13. Sears Canada has terminated the majority of its employees. As of June 1, 2018, there were approximately 35 employees remaining.

14. The following individuals currently serve as directors of Sears Canada:

- (i) R. Raja Khanna;
- (ii) Deborah E. Rosati;
- (iii) Graham Savage; and
- (iv) Heywood Wilansky.

(Collectively referred to herein as the “**Directors**”).

15. As the Sears Canada operations have been wound down after an unsuccessful SISP; the Initial Liquidation and Second Liquidation of assets at Sears Canada’s retail locations are now completed; all retail locations are closed; leases in respect of such locations have been disclaimed or otherwise dealt with in the CCAA Proceedings; Sears Canada has terminated the vast majority of its employees; the Claims Procedure and E&R Claims Procedure processes are well underway with relevant claims bar dates passed; discussions amongst stakeholders are continuing following the Mediation; and the only remaining assets yet to be realized upon are the Remaining Real Estate Assets, there is no longer a need for the services of the Directors.

The Shortfall on Creditor Claims

16. The Monitor expects creditors of Sears Canada will receive significantly less than the value of their claims. In its Thirteen Report, the Monitor stated that the potential claim recoveries for general unsecured creditors, which include Active and Former Employees, could range from 0% to 10% of the face value of claims.

17. The details of the remuneration of the Directors are not known; however, the remuneration is within the knowledge of the Monitor. Employee Representative Counsel estimates the monthly cost of the Directors to be in excess of \$60,000.00.

18. In addition, legal counsel and financial advisors to the Directors are paid from the proceeds of the estate. According to the Eleventh Report of the Monitor, of January 6, 2018 (over six months ago), the Directors' legal counsel had been paid \$783,000 from the estate and the Directors' financial advisor had been paid \$326,000 from the estate. Total professional fees in service of Board of Directors paid from the estate since Jan. 6, 2018 are \$629,000.

19. The shortfall in paying creditors' claims will only be exacerbated by the continued service of the Directors and payment of its legal counsel. Sears Canada continues to pay the Directors a significant amount, draining the company's remaining resources at the expense of unsecured creditors, in particular vulnerable creditors like the Employees. The current state of Sears Canada does not warrant the continued service of the Directors.

Litigation against Sears Canada Directors

20. On Friday, March 2, 2018, the Court issued an Order appointing Lax O'Sullivan Lissus Gottlieb LLP as Litigation Investigator (the "**Litigation Investigator Order**").

21. The Litigation Investigator was appointed for the benefit of the estates of the Sears Canada Entities and its creditors. The purpose of the Litigation Investigator is to investigate, consider, and report to the Creditors' Committee (as defined in the Litigation Investigator Order) regarding any rights or claims, whether legal, equitable, statutory, or

otherwise, that the Sears Canada Entities and/or any creditors of the Sears Canada Entities may have against any parties, including, but not limited to, current and former directors, officers, shareholders and advisors of any of the Sears Canada Entities. Claims pursued by the Litigation Investigator may include claims related to the actions of the Directors prior to Sears Canada filing for CCAA protection.

22. In the Eleventh Report of the Monitor, the Monitor stated:

Reviewable Transactions

50. The Monitor is carrying out a review (the “Review”) of certain material transactions, payments and dividends entered into, made or declared by the Sears Canada Entities in the period prior to their filing for protection under the CCAA. The Review is focused primarily on potential reviewable transactions and transfers at undervalue pursuant to sections 95 and 96 of the *Bankruptcy and Insolvency Act* (Canada) and section 36.1(1) of the CCAA.

51. To date, the Monitor has identified the following potential transactions of interest (the “Transactions of Interest”):

(a) the dividend paid to certain Sears Canada shareholders on December 31, 2012 in the amount of approximately \$102 million (the “2012 Dividend”);

(b) the dividend paid to certain Sears Canada shareholders on December 6, 2013 in the amount of approximately \$509 million (the “2013 Dividend”); and

(c) the surrender by Sears Canada of its exclusive right to use the Craftsman trademark in Canada in connection with the sale by Sears Holdings Corporation of the Craftsman business to Stanley Black & Decker in March 2017.

52. As part of the Review, the Monitor has obtained and reviewed documents and information from Sears Canada. The Monitor has obtained access to a large database of potentially relevant documents from the electronic records of Sears Canada and has identified a subset of the documents for comprehensive review based on their prima facie relevance to the Transactions of Interest.

53. Based on the Monitor’s preliminary findings, the Monitor is of the view that further review of the Transactions of Interest is appropriate. The Monitor is undertaking appropriate steps to gather and review additional relevant information, including engaging with certain independent

directors and senior Sears Canada management personnel, who had direct involvement in all or some of the Transactions of Interest.

54. The Monitor has not completed its review of material transactions and will report to the Court if other potentially reviewable material transactions are identified.

23. If the Directors are not removed from the Board of Directors of Sears Canada, they will be in a conflict of interest position. The Directors owe a fiduciary duty to Sears Canada to operate in the company's best interests. However, the Directors may be under investigation by the Litigation Investigator regarding the impugned transactions. The Directors cannot both act in the best interest of Sears Canada and also protect their own interests in potential forthcoming litigation.

24. If the Directors remain in place they may have access to key information about any litigation that names them as defendants. This position may allow the Directors to use this information to protect themselves, rather than act in the best interests of Sears Canada, which will seriously prejudice the creditors.

25. It is in the best interests of the creditors, and of Sears Canada, that the Directors are removed from their positions.

The Monitor is able to perform enhanced supervision

26. The Order would provide the Monitor with enhanced powers to oversee the remaining operations, management and wind-down of the Sears Canada Entities through the remainder of these CCAA proceedings.

27. The Monitor has a thorough understanding of the Applicants' estate and the remaining work that needs to be done.

Jurisdiction of the Court

28. Section 11.5(1) of the CCAA provides for the removal of directors:

11.5 (1) The court may, on the application of any person interested in the matter, make an order removing from office any director of a debtor company in respect of which an order has been made under this Act if the

court is satisfied that the director is unreasonably impairing or is likely to unreasonably impair the possibility of a viable compromise or arrangement being made in respect of the company or is acting or is likely to act inappropriately as a director in the circumstances.

29. The Order seeks the removal of the Directors for reasons including that the Directors are likely to act inappropriately as directors in these circumstances given the Litigation Investigator's appointment and investigation into the Transactions of Interest. The Order protects the confidentiality regarding forthcoming litigation undertaken by the Litigation Investigator, and avoids placing Directors in a conflict of interest.

30. In addition, the Court has a broad discretion under s. 11 of the CCAA to make "any order that it considers appropriate in the circumstances".

31. The Order sought is appropriate and advances the policy objectives underlying the CCAA. It serves the remedial purposes of the CCAA by protecting the assets of the debtor company to maximize payments to creditors, including Employees.

32. Additionally, the court also has broad inherent and equitable jurisdiction to grant the requested remedy. The court's residual source of powers may be drawn upon as necessary whenever it is just and equitable to do so, in particular, to do justice between the parties.

Other Grounds of this Motion

33. The provisions of the CCAA, in particular Section 11 and 11.5 thereof, and the inherent and equitable jurisdiction of this Honourable Court;

34. Rules 1.04, 1.05, 2.03, 3.02, 16 and 37 of the *Rules of Civil Procedure*, RRO 1990, Reg. 194;

35. Section 96 of the *Courts of Justice Act*, RSO 1990, c C-43;

36. Such further and other grounds as counsel may advise and this Court may permit.

THE FOLLOWING DOCUMENTARY EVIDENCE will be used at the hearing of the motion:

- (a) The Affidavit of Erin Epp to be filed and the Exhibits attached thereto;
- (b) Such further and other evidence as counsel may advise and this Honourable Court may permit.

Friday, June 29, 2018

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TO: SERVICE LIST

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 SERVICERS INC., INITIUM LOGISTICS SERVICE 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.

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Proceeding commenced at TORONTO

**NOTICE OF MOTION OF
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