Court File No. CV-18-00611214-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

B E T W E E N:

SEARS CANADA INC., by its Court-appointed Litigation Trustee,
J. DOUGLAS CUNNINGHAM, Q.C.

Plaintiff

and

ESL INVESTMENTS INC., ESL PARTNERS, LP, SPE I PARTNERS, LP,
SPE MASTER I, LP, ESL INSTITUTIONAL PARTNERS, LP,
EDWARD S. LAMPERT, EPHRAIM J. BIRD, DOUGLAS CAMPBELL,
WILLIAM CROWLEY, WILLIAM HARKER, R. RAJA KHANNA, JAMES
MCBURNEY, DEBORAH ROSATI and DONALD ROSS

Defendants

STATEMENT OF DEFENCE OF ESL INVESTMENTS, INC., ESL PARTNERS, LP, SPE I PARTNERS, LP, SPE MASTER I, LP, ESL INSTITUTIONAL PARTNERS, LP and EDWARD S. LAMPERT

1. The defendants ESL Investments, Inc., ESL Partners, LP, SPE I Partners, LP, SPE Master I, LP, ESL Institutional Partners, LP and Edward S. Lampert (together the "**ESL Parties**") deny the allegations contained in the amended amended statement of claim.

Overview

2. This claim is a bold and unprecedented attempt to claw back a dividend lawfully declared and paid by a public corporation to all of its shareholders in circumstances that did not remotely render the company insolvent. Sears Canada Inc. ("**SCI**") declared the dividend in reasonable and unremarkable circumstances—it had over $1 billion in cash, it had virtually no debt, and its business was considered to be in recovery. The Litigation Trustee now seeks to enrich the SCI

estate on behalf of SCI's creditors by reaching beyond the long-expired limitation period to claim that certain defendants conspired to sell assets and declare a dividend that caused unspecified "serious harm" to SCI.

3. There was no conspiracy. The Litigation Trustee's attempt to build a circumstantial case for a conspiracy rests on three key assumptions: that the ESL Parties "controlled" SCI; that certain defendants conspired to sell SCI's "crown jewels"; and that these actions were taken to benefit the ESL Parties because they had an "immediate need for cash" to fund redemption obligations from the hedge funds operated by them (the "**ESL Funds**"). Each of these is false.

4. First, neither Edward S. Lampert ("**Lampert**") nor any of the other ESL Parties controlled, directed, or unduly influenced any of the decisions taken by the SCI board or its management. SCI was, at all times, an independently-run public company whose board comprised eight directors. six of whom had no connection whatsoever to Lampert or the other ESL Parties. Although Sears Holdings Corporation ("**SHC**"), which was at times majority-owned by the ESL Parties and was the largest (indirect) shareholder of SCI, had a total of two nominees on the eight-member board, neither of them remained employed by SHC or the ESL Parties at the time of the dividend.

5. Second, the stores SCI sold in 2013 were not SCI's "crown jewels" as the Litigation Trustee alleges. Although they may have had that appearance—many were large stores located in prime urban locations—they were in fact selected by SCI for liquidation because they produced among the lowest returns of all of SCI's stores. Their sale was part of a well-considered strategy to reduce SCI's retail footprint to allow SCI to concentrate on more profitable locations. After the 2013 sales, SCI continued to operate over 100 full-line stores in Canada. The Litigation Trustee's

"crown jewels" myth is founded on this basic misconception of SCI's retail strategy, which was—and continues to be—well-accepted and common in the retail industry.

6. Third, the Litigation Trustee's alleged motive for the "conspiracy"—that the ESL Funds were facing a "liquidity crisis" and were desperate for cash—is a bald fabrication. The ESL Funds had no need for cash. They had the option to distribute securities they owned in fulfilment of their redemption obligations, which, in part, they did. At the time of the dividend, the ESL Funds had far more cash and securities on hand than they needed to satisfy the outstanding redemptions. By the end of 2013, the ESL Funds had **US$1.433 billion** in residual cash.

7. Far from the alleged motive to strip assets to remedy this fabricated "liquidity crisis", Lampert's own actions demonstrate the opposite intention—to support SCI's long-term viability as a significant Canadian retailer. Lampert's commitment to SCI began in 2002, and his stake in SCI, through one or more of the ESL Parties, only grew over time. In October, 2014, Lampert increased the ESL Parties' shareholdings in SCI to their highest level ever, namely 49.5%. Given that stake, as well as Lampert's role as CEO of SHC, no one had a greater interest in the success of SCI as a continuing retail business than Lampert and the ESL Parties.

8. As for the allegation that the directors breached duties they owed to SCI, the fact is that the 2013 dividend was a reasonable exercise of business judgment at a time when SCI was clearly solvent. The 2013 dividend, which had been anticipated by market analysts who covered the company, was publicly announced in November, 2013. After the dividend was declared, the market continued to ascribe substantial value to SCI as a going concern: in 2014, arm's-length bidders for SCI offered between $14 and $18 per share to purchase the company, valuing SCI at

between $1.4 and $1.8 billion. SCI's market capitalization on the day after the dividend was paid was over $1 billion.

9. Further, no stakeholders were harmed by the 2013 dividend. SCI had virtually no long-term debt in December, 2013 and continued to discharge its current obligations in the ordinary course. The trade creditors the Litigation Trustee claims were oppressed or harmed by the dividend extended credit to SCI only after the dividend was announced, and therefore *with full knowledge that it had been paid*. Not only does this demonstrate the futility of the Litigation Trustee's claim; the facts also show the arrant hindsight on which the claim is founded. SCI continued to operate, pay its debts, employ and pay benefits to its personnel and fund its pension liabilities for three and a half years after it paid the 2013 dividend. The Litigation Trustee does not seek to prove that the 2013 dividend caused SCI's 2017 insolvency because doing so would be impossible—the causes of SCI's 2017 insolvency had nothing to do with the 2013 dividend and certainly nothing to do with the ESL Parties.

10. This claim should be dismissed because its allegations are unfounded and because of the expiration of the limitation period by November, 2015. Its unprecedented attempt to reverse a solvent public company's more than five-year-old dividend would compromise corporate decision making, undermine investment and create confusion and uncertainty in the Canadian capital markets.

The parties

The plaintiff

11. The Litigation Trustee, the Honourable J. Douglas Cunningham Q.C., was appointed by this Court to pursue various claims on behalf of the creditors of the SCI estate. The Litigation Trustee purports to bring this claim on behalf of SCI and all of its "stakeholders".

12. SCI was a Canadian retailer and publicly traded company. It is incorporated under the *Canada Business Corporations Act*, RSC, 1985, c. C-44 (the "**CBCA**"). On June 22, 2017, SCI and its related entities made an initial application and were granted protection from creditors under the *Companies' Creditors Arrangement Act*, RSC, 1985, c. C-36 (the "**CCAA**").

The ESL Parties

13. The defendants Edward S. Lampert ("**Lampert**"), ESL Investments, Inc. ("**ESL Investments**"), ESL Partners, LP, SPE I Partners, LP, SPE Master I, LP, and ESL Institutional Partners, LP (all of these, together, the "**ESL Parties**") operate investment funds that make a limited number of long-term investments (the "**ESL Funds**").

14. In 1988, Lampert established ESL Investments, which is registered as an investment advisor with the U.S. Securities and Exchange Commission. ESL Investments is the promoter of the ESL Funds.

15. Lampert is the chair and CEO of ESL Investments. From 2005 to February 14, 2019, Lampert was the chair of the board of directors of SHC, which was the indirect majority shareholder of SCI at the time of SCI's 2013 dividend. He was also the CEO of SHC from 2013 to 2018. He was never a director or officer of SCI.

16. ESL Investments is the general partner of RBS Partners, LP. RBS Partners, LP is the general partner of ESL Partners, LP, SPE I Partners, LP, and SPE Master I, LP. ESL Institutional Partners, LP is associated with the ESL Funds.

17. At the time of the 2013 dividend the ESL Parties were, collectively, direct minority shareholders of SCI. Furthermore, the ESL Parties have had an indirect interest in SCI since 2002 through their ownership stake in SCI's American parent corporations, Sears, Roebuck & Co. ("**Sears, Roebuck**") and later in SHC. At the time of the declaration of the 2013 dividend, the ESL Parties controlled 55.4% of the outstanding shares of SHC. On December 2, 2013, the ex-dividend date for the 2013 dividend, the ESL Parties' interest in SHC dropped to 48.4%.

18. Through the 2013 dividend, the ESL Parties cumulatively received $140,790,245. The ESL Parties received the following amounts individually:

ESL Party	Amount
Lampert	$52,165,440
ESL Investments, Inc.	$0
ESL Partners, LP	$79,106,030
ESL Institutional Partners, LP	$21,905
SPE I Partners, LP	$4,154,260
SPE Master I, LP	$5,342,610

19. Another entity within the ESL Funds, CRK Partners, LLC, received $1,595 as a result of the dividend. CRK Partners is not named in these proceedings.

Sears Holdings Corporation

20. SHC is an American holding company. It is the parent company of Kmart Holding Corporation ("**Kmart**") and Sears, Roebuck. Through its interest in Sears, Roebuck and a number

of wholly owned subsidiaries, SHC was the majority shareholder of SCI at the time of SCI's declaration of the 2013 dividend.

The ESL Funds' investment strategy

21. The ESL Funds invested in corporations that faced business challenges but could be made viable in the long term through the implementation of strategies carefully tailored to their circumstances. The ESL Funds' turn-around strategies did not generally involve significant corporate restructuring. Instead, Lampert encouraged the companies within the ESL Funds' portfolio to test limited initiatives to determine which, if any, produced positive results. Those that succeeded would be adopted on a larger scale. Underlying the ESL Funds' strategy was the view that well-judged changes implemented by strong, independent leadership could produce major improvements in revenues and long-term results. The ESL Parties believed that this strategy, if employed with SHC and with SCI, would produce good results.

The ESL Parties' early indirect investment in SCI

22. The retailer Kmart filed for Chapter 11 protection in the United States in 2002. Shortly afterwards, the ESL Parties acquired a substantial amount of its debt. As part of the plan of reorganization, the ESL Parties' debt holdings were converted to equity. On May 6, 2003, following the implementation of the plan, the ESL Parties held over 51% of Kmart's shares and Lampert became the chairman of Kmart's board.

The ESL Parties' acquisition of an interest in Sears, Roebuck and SCI

23. In 2002, the ESL Parties also acquired a substantial minority position in Sears, Roebuck the then-controlling shareholder of SCI. Then, following the acquisition of the controlling

majority interest in Kmart, Lampert and the other ESL Parties caused Kmart to acquire all of Sears, Roebuck, with the objective of building a great combined retail operation. The deal was announced November 17, 2004 and closed on March 24, 2005, resulting in a new corporation, SHC. SHC continued to operate stores under both the Sears and Kmart brands.

24. Around the time the deal closed and until October, 2014, SHC held a majority of the shares of SCI. Public shareholders held the balance of the shares.

SHC nominates Crowley and Harker to the SCI board

25. Because of his positions with SHC, Lampert was entitled to exercise a degree of oversight over the affairs of SCI and to be kept informed by its management and to be consulted by them. However, Lampert was primarily focused on the management responsibilities he owed to SHC and the challenges it faced. He accepted that SCI had its own board of directors exercising oversight over its affairs. SCI, moreover, represented a relatively small part of SHC's business and an insignificant part of the portfolios of the ESL Funds.

26. Lampert also relied upon two trusted and highly competent individuals nominated to SCI's board by SHC. William Crowley was a Yale-educated lawyer, with a master's degree from Oxford, who came to ESL in 1999 from his position as a Managing Director of Goldman Sachs. He joined SHC in 2005 as EVP and CFO and served on the SCI board from March, 2005 until April, 2015. William Harker was a University of Pennsylvania-educated Wall Street lawyer who served as SHC's SVP and General Counsel from 2005 to 2012. He served as SHC's nominee to the SCI board from November, 2008 until April, 2015. In or about late 2012, both Crowley and Harker left SHC and ESL to found Àshe Capital Management, LP, an investment fund unaffiliated with ESL, SHC or SCI.

27. Lampert never demanded that Crowley or Harker take specific positions in board votes or in other functions related to SCI. He respected their counsel. Lampert knew that Crowley and Harker exercised regular oversight over SCI as members of its board. He and they communicated irregularly concerning SCI's affairs. Crowley and Harker would, at their own instance, solicit Lampert's views on operational and strategic issues. Their relationship with Lampert was consultative and collaborative.

The ESL Parties' acquisition of a direct interest in SCI

28. The ESL Parties acquired a direct interest in SCI in 2012 and, in the years after the 2013 dividend, continued to invest more in SCI. The ESL Parties first acquired their direct interest in SCI through a partial spin-off of SCI by SHC in 2012. In connection with the 2012 spin-off, SHC distributed approximately 45 million common shares of SCI on a *pro rata* basis to holders of SHC's common stock. As a result, the ESL Parties acquired approximately 27% of the shares of SCI.

Project Matrix

29. Starting in March, 2012, SCI's management embarked on a strategic plan that would later be named "**Project Matrix**". The project called for an evaluation of which stores should continue to be operated as retail, or "trading", stores and which the company would be better off selling, with a view to the most efficient use of capital. As part of Project Matrix, management prepared recommendations to the board that included the identification of those stores whose "four-wall EBITDA" demonstrated the lowest return on investment ("**ROI**") as compared to the stores' underlying asset value. A store's four-wall EBITDA represented that store's net earnings before interest, taxes, depreciation and amortization. Those stores with the lowest ROI would be

considered for sale, thereby reducing SCI's portfolio of under-performing stores and allowing it to concentrate its efforts on those stores that could generate a higher ROI.

30. The stores with particularly poor ROI tended to be those in large, urban locations for which the value of the store's lease was highest. The retail market in such locations was shifting to a more upscale consumer that attracted retailers such as Nordstrom, Saks Fifth Avenue and the newly-transformed Hudson's Bay Company. The Sears brand, on the other hand, was perceived to appeal to middle-market consumers and to be, increasingly, incompatible with pricier urban locations. The SCI stores identified as having among the lowest ROI were locations such as the Eaton Centre in Toronto (which became a Nordstrom), Sherway Gardens in Mississauga (which became a Saks Fifth Avenue) and the Pacific Centre in Vancouver (which became a Nordstrom).

31. Lampert supported Project Matrix as making sound business sense for SCI. SCI managed the process itself. Lampert and the ESL Parties provided advice from the sidelines.

The 2013 dividend

32. On November 8, 2013, Lampert received an email from Crowley seeking his view on a potential dividend being considered by the SCI board. Lampert understood that, as a result of the sale of leases for those low-ROI stores identified by Project Matrix, SCI had raised approximately $800 million in cash, leaving SCI with total cash reserves of approximately $1 billion. Lampert also understood, through his position on SHC's board and infrequent conversations with Crowley, Harker and SCI management, that SCI's business plan required only a fraction of these funds for ongoing operations. Lampert therefore expressed his view to Crowley that the SCI board should authorize as large a dividend as SCI could reasonably support.

33. Although Lampert expressed his opinion to Crowley, Lampert knew well that the SCI board would make a decision in what it determined to be the best interests of SCI and without any further input from him. Lampert had no communication at any time, let alone during the period of deliberation over the dividend, with the other six independent board members who he knew would have to consider and vote on the proposed dividend. He did not in any way request or direct Crowley, Harker or any other person to exert any pressure or influence on other members of the board.

ESL had no need for cash prior to the 2013 dividend

34. Contrary to the allegations in the statement of claim, Lampert had no motive to "conspire" with, unduly influence or direct the SCI board to declare a dividend even if, practically, he possessed particular influence over the board (which he did not).

35. The Litigation Trustee's assertion that the ESL Funds had a "desperate" need for cash is demonstrably false. Prior to the declaration of the 2013 dividend on November 19, 2013, the ESL Funds had received all of the redemption requests from unitholders they had to satisfy by the end of the year.

36. While the standard terms of unitholder agreements permitted each of the ESL Funds to satisfy redemption requests either with cash or through the transfer of securities, the other terms applicable to redemptions vary by fund, as follows:

(a) Within the ESL Funds, ESL Partners, LP ("**ESL Partners**") is the main investment fund. Certain investors' investments in ESL Partners may be gated. The gate allows the general partner to limit redemptions in relation to the gated investors. Despite having access to this

gate, ESL Partners funded all redemption requests in 2013. After doing so, ESL Partners had retained cash of **US$1.433 billion.**

(b) SPE I Partners, LP, and SPE Master I, LP (together, the "**SPE Funds**") were special purpose vehicles set up by ESL Partners in 2012 to allow investors in the ESL Partners fund to reinvest in SHC as a partial alternative to redemptions from the ESL Partners fund. Under the standard terms of the SPE Funds, redemptions from the SPE Funds would occur in 2014 and 2015 for all investors—no redemptions occurred in 2012 or 2013.

(c) ESL Institutional Partners, LP ("**ESL Institutional**"), is a fund that primarily invests on behalf of individuals connected with the ESL Parties, including former employees of ESL Investments. In 2012, after paying the redemptions, ESL Institutional had retained cash of US$26,794. In 2013, there were no redemptions.

37. In comparison to the significant amount of retained cash in the ESL Funds, the funds received little proceeds from the 2013 dividend, equivalent to approximately US$83 million. The dividend accounted for less than 6% of the ESL Funds' retained cash.

SCI declares a dividend of $509 million

38. On November 19, 2013, the SCI board approved the declaration of an extraordinary dividend of $509 million. Lampert believed, and public records confirmed, that the financial position of SCI could reasonably have supported a larger dividend. The dividend was in fact conservative in light of the disparity between SCI's significant cash on hand and the much smaller amount that SCI required for its ongoing operations.

39. According to its audited financial statements for the 2013 fiscal year, after payment of the dividend SCI retained over **$513 million** in cash on hand. This was $72.5 million more than SCI had following its payment of a dividend in 2010 (the **"2010 Dividend"**), and $276.8 million more than it had following its payment of a dividend in 2012 (the **"2012 Dividend"**). Moreover, SCI reported $2.39 billion in assets and $1.32 billion in liabilities in 2013. This compares closely to the assets reported following the 2010 and 2012 Dividends, namely $2.51 billion and $2.48 billion respectively, as well as favourably to the liabilities following the 2010 and 2012 Dividends, namely $1.51 billion and $1.40 billion respectively.

The SCI pension plan was appropriately funded at the time of the 2013 dividend

40. At the time the 2013 dividend was declared, the defined benefit component of the SCI Pension Plan (the "**Plan**") was funded in accordance with SCI's obligations under the terms of the Plan and the *Pension Benefits Act*, RSO 1990, c P.8 ("**PBA**"). The defined benefit component of the Plan had been frozen effective July 1, 2008, meaning that although then-existing Plan members would continue to be entitled to benefits under the defined benefit component of the Plan, they would cease to accrue credited service under the Plan's defined benefit formula and no new members were allowed to join the defined benefit component. Employee contributions to the defined benefit component of the Plan ceased June 30, 2008. There was also a defined contribution component of the Plan, which was added to the Plan as of July 1, 2008.

41. According to a December 31, 2010 actuarial report—the most recent triennial actuarial report at the time the dividend was declared—the Plan complied with the regulations. Like many defined benefit pension plans at the time, it had under-funded liabilities: on a going concern basis of $68 million, on a solvency basis of $206 million and on a hypothetical wind-up basis of $307

million. As a result of the report, SCI was required to make payments of approximately $29 million per year in 2012 and 2013. These payments specified in the actuarial report were the only payments SCI was legally required to make into the Plan. There was no legislative requirement that SCI immediately eliminate any funding deficiency. SCI made the required payments in 2012 and 2013 and also remitted an additional $15 million in 2013.

42. The first actuarial report after the dividend, effective December 31, 2013 and completed in June, 2014, confirmed that as of the effective date—25 days after the payment of the dividend—SCI had properly funded the Plan and the Plan had a surplus of almost $15 million on a going concern basis. The report confirmed that the funded status of the Plan improved significantly on all measures, as shown in the following table:

Pension Plan Funded Surplus / (Deficit)

Basis	December 31, 2010	December 31, 2013	Improvement
Going Concern	($68 million)	$15 million	$83 million
Solvency	($206 million)	($76 million)	$129 million
Wind-Up	($307 million)	($133 million)	$174 million
Solvency Ratio	86%	95%	9%

43. Because of the strong position of the Plan at the time and the additional $15 million contributed in 2013, the report permitted SCI to make no contributions in 2014. Going forward, the report required SCI to contribute approximately $19 million in 2014 and approximately $20 million in 2015. It did this and in fact contributed $20 million ($1 million more than required) in 2014.

44. Although the December 31, 2013 report was prepared after the declaration of the 2013 dividend, members of SCI's board and management knew at the time of the declaration of the

2013 dividend that the Plan's financial position was improving. In particular, Crowley, Harker and Bird sat on an investment committee that oversaw the Plan's investments. The investment committee received regular reports regarding the performance of the Plan's investments, and estimates from SCI management about the Plan's position on a going concern basis, solvency basis and hypothetical wind-up basis. These reports and estimates showed Bird and the directors that the position of the Plan continuously improved between 2010 and the time the dividend was declared in late 2013.

No dividend in 2014

45. Despite further asset sales in 2013 and 2014 and despite the substantial retained cash on hand following the 2013 dividend, the board decided not to declare any dividends in 2014. Although its balance sheet was sound—it had $513 million in cash and $1.4 billion in assets—SCI had experienced disappointing fourth-quarter holiday sales in 2013, with same-store sales down 6.4%, reversing the positive trend from the prior quarter.

46. Lampert made no objection to the decision not to declare a dividend in 2014.

SCI was valued at between $1.4 and $1.8 billion by three independent bidders in 2014

47. In 2014, SHC elected to sell its stake in SCI. As chairman and CEO of SHC, Lampert was closely involved in these discussions.

48. SHC first sought offers for all of the outstanding shares of SCI. In June and July, 2014, Bank of America Merrill Lynch solicited a number of bids for SCI on behalf of SHC. Offers were made by at least three potential buyers, namely Kohlberg Kravis Roberts ("**KKR**"), Sycamore Partners Management, LLC ("**Sycamore**"), and Hudson's Bay Company (**"HBC"**). KKR offered

a purchase price of $14 to $15 per share; Sycamore offered $16 to $18 per share; and HBC offered $14 to $16 per share. These values represented a premium of up to 33% over the shares' trading value, and suggested a valuation of SCI of between $1.4 and $1.8 billion.

49. Ultimately, no transaction came to fruition.

The ESL Parties increased their stake in SCI through a rights offering

50. In the absence of a buyer for all of its outstanding SCI shares, SHC proceeded to a rights offering on October 26, 2014 in relation to most of its 51% ownership interest in SCI. Through the rights offering, SHC sold off roughly 40% of SCI (and 75% of SHC's interest in SCI) at $10.60 per share. The price was the closing price of SCI's common shares on September 26, 2014, the last trading day before SHC requested SCI's cooperation with the filing of a prospectus for the rights offering. The rights offering was over-subscribed.

51. Through the 2014 SHC rights offering, the ESL Parties acquired a further 18 million shares of SCI, at a cost of approximately $190 million. This was the maximum allowed under the terms of the rights offering. As a result of this transaction, the ESL Parties became the holders of approximately 49.5% of the outstanding shares of SCI.

52. Lampert took this step because he believed the acquisition cost fairly reflected the value of SCI's assets. He also believed in SCI's value as a going concern. He expected its business would grow and the company would eventually conclude an advantageous sale to a third party.

Circumstances leading to SCI's insolvency

53. By April 23, 2015, Deborah Rosati and Raja Khanna were the only directors remaining from the time of the 2013 dividend. The new board members, who held six of eight positions on the board, became directors in 2014 or 2015.

54. The SCI board appointed Brandon Stranzl as acting CEO and Executive Chair on July 2, 2015. Stranzl was known to Lampert because he had worked as an analyst at ESL from 2008 to 2010.

55. Once appointed, Stranzl led SCI to change its strategic direction, through an initiative called "Sears 2.0". Sears 2.0 called for a more aggressive operating strategy to drive sales growth. The plan called for the sale of off-price discounted designer lines in apparel and home goods and new prototype stores which would feature significant changes to layout and offerings.

56. Sears 2.0 required a substantial cash infusion and, at Stranzl's direction, SCI incurred new borrowings for the first time in over a decade.

57. Lampert did not support these decisions, which involved borrowing significant amounts on punitive terms in support of a strategy that carried with it significant risk. In particular, Lampert was of the view that the company should not be taking on new debt while engaging in dramatic price reductions. In Lampert's view, Stranzl's decisions would place SCI at risk of failure. Lampert suggested to Stranzl that the better approach was to close under-performing stores.

58. Despite his concern, Lampert did not make an effort to intervene with the board, in line with his regular practice of providing input where appropriate but leaving the board to direct the

company as it saw fit. Lampert was and is of the view that if Stranzl had taken his advice, SCI would still be in operation today.

SCI borrowed on punitive terms

59. On March 20, 2017, SCI entered into a credit agreement on punitive terms with a number of parties, led by GACP Finance Co., LLC (**"GACP"**) as administrative and syndication agent. There were two available tranches. The first was advanced on March 20, 2017, in the amount of $125 million. The second tranche was originally to be in the amount of $175 million.

60. On June 5, 2017, Stranzl caused SCI to draw on an existing Wells Fargo credit facility. As a result of the GACP credit facility, SCI faced a reduction in the amount of financing available to it under the Wells Fargo credit facility. SCI was able to draw only $33 million.

61. Following that, management determined that SCI could not expect to borrow the full amount under the second tranche of the GACP credit facility. Because of this, SCI concluded that it was not prudent to encumber its assets for borrowings that were significantly less than what it had expected.

SCI experienced a liquidity crisis

62. The need for cash caused by the Sears 2.0 plan and the inability to access the full amount of funding under the GACP credit facility contributed to a liquidity crisis that precipitated SCI's CCAA filing on June 22, 2017.

63. When SCI entered CCAA protection, both its management and the Monitor expected it might continue as a going concern. The initial application suggested a plan Lampert himself had

proposed earlier: closing those stores that were underperforming in order to keep a core-retail business going. Ultimately, SCI liquidated all of its stores.

The ESL Parties incurred substantial aggregate losses from their investments in SCI

64. Far from having extracted excessive amounts of capital from SCI, the ESL Parties sustained aggregate losses of approximately $552.7 million on their investments in SCI and as a result of its insolvency.

The directors complied with their fiduciary duties at all times

65. In approving the declaration of the 2013 dividend, the directors properly exercised their power under the common law, the articles and by-laws of SCI, and ss. 42, 43(1) and 102(1) of the CBCA. It is undisputed that the declaration and payment of the 2013 dividend accorded with both of the requirements in s. 42 of the CBCA. First, SCI was solvent at the time of the declaration of the dividend and it would remain so after the payment of the dividend. Second, after the payment of the dividend the realizable value of SCI's assets exceeded the aggregate of its liabilities and the stated capital of all classes of its shares.

66. The directors complied with their fiduciary duty to SCI by taking into account the fact that the payment of the dividend would satisfy the requirements of s. 42 of the CBCA. In addition to considering the solvency test in that provision, SCI's directors and Bird:

- received and considered extensive information about the performance of SCI and its progress in achieving the goals set out in Project Matrix;
- knew that as a result of the divestitures of real estate assets SCI had cash on hand that was surplus to its contemplated requirements and, as a result, that the health of the continuing business of SCI would not be impaired by the payment of a dividend; and

- specifically obtained a solvency certificate from management confirming the solvency of SCI both before and after the payment of the 2013 dividend.

67. It was, at the same time, reasonable for the directors to believe that the cash that SCI had on hand after the sales of the real estate assets was surplus to its contemplated requirements and that, as a result, the payment of the dividend would not impair the health of the continuing business of SCI in any way that would enure to the detriment of the shareholders and other stakeholders. The decision to approve the dividend in these circumstances was a legitimate exercise of business judgment on the part of the directors.

68. In approving the 2013 dividend, the directors owed no fiduciary or other duty to SCI's creditors. Directors owe a statutory duty to act in the best interests of the corporation of which they are directors. The Litigation Trustee improperly asserts the best interests of the corporation primarily from the point of view of trade creditors. These comprise only one stakeholder group, and it is not their interest exclusively, or in ordinary circumstances at all, to which directors must have regard in exercising their duties in the corporation's best interests. A corporation's interests are not co-extensive with the interests of its creditors.

69. Even supposing a duty was owed to the creditors, which is denied, it was reasonable for the directors to believe that the creditors' interests would not be impaired by the payment of the dividend, in particular because SCI retained assets whose value was, by a considerable margin, more than adequate to satisfy the liabilities it had in late 2013. The decision to approve the dividend was accordingly a legitimate exercise of business judgment on the part of the directors.

No knowing assistance or knowing receipt

70. The ESL Parties did not knowingly assist in a breach by the directors of fiduciary duties or knowingly receive funds paid as a result of a breach.

71. The declaration and payment of the 2013 dividend did not constitute a breach of the directors' fiduciary duty to SCI. The ESL Parties could therefore not have assisted in a breach of fiduciary duty or received funds that arose out of a breach.

72. In any event, and regardless of whether the directors breached their duties, the ESL Parties did not induce the alleged breach. The ESL Parties were not in need of cash in late 2013 and were perfectly capable of satisfying investors' redemptions, as a result of which they had no urgent need for the payment of a dividend by SCI. The Litigation Trustee's allegations to the contrary are false.

73. Moreover, and regardless of whether the directors breached their duties, the ESL Parties had no actual or constructive knowledge of the alleged breach. Nor were they wilfully blind or reckless as to the existence of the alleged breach.

No unjust enrichment

74. The ESL Parties were not unjustly enriched by the payment of the 2013 dividend, because they were not enriched at all. Immediately following the payment, and in all likelihood on that account, the company's share price declined by a slightly greater amount than the amount of the dividend, leaving the shareholders no better off.

75. If, as the Litigation Trustee alleges, the payment of the 2013 dividend represented an enrichment, which is denied, there was a juristic basis for the ESL Parties' receipt and retention of

their portion thereof. The receipt of dividends is a normal incident of the ownership of shares. The declaration of dividends was within the legal powers of the directors of SCI. The directors exercised this power in declaring the 2013 dividend. Once it was declared, SCI was legally obliged to pay it to the shareholders and the shareholders were legally entitled to receive it.

No oppression

76. The oppression remedy exists to enforce the reasonable expectations of certain enumerated corporate stakeholders in circumstances in which it is fair to require their observance by the respondents.

77. A stakeholder's expectation is reasonable if and only if it is consistent with duties recognized by the law to be owed to the stakeholder by a prospective respondent.

No oppression of SCI

78. SCI cannot claim relief for itself under the oppression remedy for the 2013 dividend because it was not a security holder, creditor, director or officer of SCI at the time of the 2013 dividend. These defendants plead and rely upon the plain meaning of ss. 238 and 241 of the CBCA.

79. Even if SCI can claim relief for itself under the oppression remedy, which is denied, its reasonable expectations necessarily coincide with the duties owed to it by the directors, as set out herein. By complying with their duties, as they did, the directors acted in accordance with SCI's reasonable expectations. Accordingly, SCI was not oppressed.

No oppression of the creditors

80. The declaration and payment of the 2013 dividend were not oppressive to the interests of creditors of SCI, these were not unfairly prejudicial to such interests, and they did not unfairly disregard such interests.

81. The reasonable expectations that the Litigation Trustee alleges the creditors to have had would attribute to the directors a fiduciary duty to:

- manage the affairs of the corporation to the benefit of the creditors, as the stakeholder group whose interests the Litigation Trustee identifies with those of the corporation; and
- reserve assets of the corporation sufficient to ensure the payment of, presumably, any actual or eventual creditors' claims, whenever such claims may arise in the future.

82. Neither such duty exists at law, so neither can be said to ground the creditors' purported expectations.

83. In any event, and even assuming the existence of such duties, the directors determined, in good faith and on reasonable grounds, that the payment of the 2013 dividend satisfied the solvency requirements of s. 42 of the CBCA and would not impair the creditors' interests. The decision was therefore a legitimate exercise of their business judgment and as such could not have unfairly disregarded the interests of SCI's creditors.

84. Additionally, the Litigation Trustee fails to plead the date on which creditors' claims against SCI arose or plead whether some or any of those claims were satisfied before SCI entered into CCAA proceedings. For those creditors of SCI who had claims that arose before or after the declaration of the 2013 dividend, but which were subsequently satisfied, the declaration and

payment of the 2013 dividend cannot have frustrated any reasonable expectation or caused any harm. Such creditors have suffered no monetary loss.

85. Those creditors of SCI who had claims against SCI that arose after the declaration of the 2013 dividend are not “creditors” within the meaning of s. 241(2) of the CBCA, and the Litigation Trustee can advance no oppression claim with respect to or on behalf of such creditors.

86. In any event, such creditors cannot have had any reasonable expectation at the time their claims against SCI arose that SCI would not declare the 2013 dividend. It was a past event. Moreover, such creditors entered into commercial arrangements with SCI on the basis of its then-existing financial state. The 2013 dividend had been publicly disclosed and was known to them. By choosing nonetheless to extend credit to the corporation, on whatever terms they were able to negotiate, they assumed any risk that resulted from its prior payment.

87. Moreover, even if the directors’ declaration and payment of the 2013 dividend was oppressive to the interests of any of SCI’s creditors, which is denied, setting aside the declaration of the 2013 dividend and requiring the ESL Parties to repay their share of it to SCI would be unjust in the circumstances. As pleaded, the ESL Parties did not know, and ought not reasonably to have known, that the declaration and payment of the 2013 dividend constituted a breach of the fiduciary duties the directors owed to SCI. Moreover, the ESL Parties did not know, and ought not reasonably to have known, that the declaration and payment of the 2013 dividend would be oppressive to the interests of SCI’s creditors. Nor did the ESL Parties have any involvement in the declaration and payment of the 2013 dividend. In these circumstances, granting a remedy in oppression against the ESL Parties would be inequitable.

88. Finally, the declaration of the 2013 dividend did not cause harm to the creditors of SCI that remained unpaid by SCI when it entered into CCAA proceedings. The 2013 dividend did not cause SCI's insolvency, which occurred over three-and-a-half years after the declaration of the 2013 dividend, which was not a foreseeable consequence of the declaration and payment of the 2013 dividend, and which would have occurred regardless of the declaration and payment of the 2013 dividend.

No conspiracy

89. The statement of claim fails to allege facts which, if proven, establish the existence of a tortious conspiracy. The facts pleaded are consistent with an intention on the part of the alleged conspirators to secure SCI's best interests.

90. In any event, Lampert, Crowley, Harker and Bird came to no agreement in 2012 or 2013, or at any time, pursuant to which SCI would dispose of assets and distribute the proceeds by way of a dividend. In respect of such matters, and all matters, Crowley, Harker, Bird and the remaining SCI directors acted completely independently of the ESL Parties and with a view to SCI's best interests.

91. Lampert, Crowley, Harker and Bird did not know, nor ought they reasonably to have known, that the actions impugned by the plaintiff would cause harm to SCI. Nor did they.

92. Moreover, even if Lampert, Crowley, Harker and Bird came to such an agreement, which is denied, the conspiracy claim relies exclusively on causes of action pleaded elsewhere in the amended amended statement of claim. The Litigation Trustee does not plead damages arising out of the alleged conspiracy that are separate and apart from the damages arising from the causes of

action pleaded elsewhere in the amended amended statement of claim. The Litigation Trustee's conspiracy claim is redundant and unnecessary, and the doctrine of merger applies.

The action is time-barred

93. The declaration of the 2013 dividend occurred on November 19, 2013. This action was commenced on December 19, 2018. This was over three years after the expiration of the two-year limitation period under s. 4 of the *Limitations Act*, 2002, SO 2002, c. 24, Sch. B. This action is time-barred.

Requested resolution

94. The ESL Parties ask that this action be dismissed with costs on a substantial indemnity basis.

July 29, 2019

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Plaintiff

-and-

ESL INVESTMENTS INC. et al.
Defendants

Court File No. CV-18-00611214-00CL

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