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File No. 214824

DELIVERED

Ontario Securities Commission
20 Queen Street West
P.O. Box 55, Suite 1903
Toronto, ON M5H 3S8

Attention: Mr. John Stevenson
Secretary to the Commission

Dear Sir:

Sears Holdings Corporation and Sears Canada Inc.
Application for Orders under Sections 104 and 127 of the *Securities Act* (Ontario)

We are counsel to Hawkeye Capital Management, LLC ("**Hawkeye**"), Knott Partners Management LLC ("**Knott Partners**"), and Pershing Square Capital Management, L.P. ("**Pershing Square**") (collectively the "**Complainants**"). The Complainants, in their capacities as shareholders of Sears Canada Inc. ("**Sears Canada**"), are applying to the Ontario Securities Commission (the "Commission") for the relief requested herein in connection with the pending take-over bid (the "**Offer**") for Sears Canada by Sears Holdings Corporation and its subsidiary SHLD Acquisition Corp. (collectively, "**Holdings**") and the proposed second step going private transaction (the "**Expropriation Transaction**" and, collectively with the Offer, the "**Pending Transaction**").

It is respectfully submitted that actions taken and proposed to be taken by Holdings in connection with the Pending Transaction breach, and otherwise offend the policy rationale underlying, fundamental aspects of Ontario securities laws. These acts, and the Pending Transaction, are coercive and prejudicial to the minority shareholders of Sears Canada, including the Complainants, and are contrary to the public interest.

The facts relating to the Pending Transaction set out herein are accurate to the knowledge of the Complainants based on information available to the Complainants on the date hereof. However, in certain instances, assumptions have been made as certain critical information has not yet been made available by Holdings, Sears Canada or others.

Background Information

The Offer

On December 4, 2005, Holdings advised the directors of Sears Canada, for the first time and without prior discussion, at least to the knowledge of the independent directors of Sears Canada, of its intention to take Sears Canada private.

On December 5, 2005, Holdings announced publicly its intention to make an offer to acquire all of the outstanding common shares (the "**Target Shares**") of Sears Canada not owned by it at a price of $16.86 per share. The announcement indicated that the proposed offer would be subject to the typical condition that a majority (on a fully diluted basis) of the Target Shares not owned by Holdings be tendered. At that time, Holdings owned 57,732,517 Target Shares (53.8% on an undiluted basis). Holdings also disclosed that, on December 3, 2005, it had entered into a lock-up agreement with Natcan Investment Management, Inc. ("**Natcan**") pursuant to which Natcan agreed to tender 9,699,862 Target Shares (9.06% on an undiluted basis) into any such offer. Scotia Capital Inc. ("**Scotia Capital**") was and is the financial advisor to Holdings in connection with the Pending Transaction.

On December 6, 2005, the board of directors of Sears Canada formed a special committee (the "**Special Committee**"), consisting of the six independent directors of Sears Canada, to supervise the preparation of a formal valuation and to review and make a recommendation to the board of directors of Sears Canada with respect to the proposed offer. The Special Committee retained Genuity Capital Markets ("**Genuity**") to prepare the formal valuation required pursuant to Ontario Securities Commission Rule 61-501 ("**Rule 61-501**") and to provide a fairness opinion with respect to the proposed offer.

Further to its engagement of The Bank of Nova Scotia ("**BNS**" and collectively with its subsidiary Scotia Capital, the "**Scotia Parties**") in November of 2005, on December 22, 2005, Sears Canada entered into a secured $200 million three-year revolving credit facility and a secured US $260 million seven-year term loan with a syndicate of lenders. BNS is the administrative agent, lead arranger, bookrunner for and lender under the facilities.

On January 10, 2006, Holdings applied to the Commission for exemptive relief from the requirement to include a formal valuation of the Target Shares or a summary thereof in its take-over bid circular. Under the direction of the Special Committee, Sears Canada resisted the application and ultimately the application was denied.

On February 7, 2006, Genuity delivered its Valuation and Inadequacy Opinion to the Special Committee indicating that, in its view, the fair market value of the Target Shares was in the range of $19.00 to $22.25 and that the consideration under the proposed offer was inadequate, from a financial point of view, to the minority shareholders of Sears Canada.

Notwithstanding the Valuation and Inadequacy Opinion of Genuity, on February 9, 2006, Holdings commenced its Offer for the Target Shares at $16.86 per share. Despite Holdings' prior public statements, the Offer was not subject to a condition that a majority (on a fully diluted basis) of the Target Shares not owned by Holdings be tendered. At that time, it was disclosed that Scotia Capital is the dealer manager for the Offer.

In response to the Offer, on February 22, 2006, Sears Canada mailed its Directors' Circular in which the voting members of the board of directors (being the six independent directors comprising the Special Committee) recommended unanimously that shareholders reject the Offer. The Directors' Circular noted that the Special Committee believed that the offer was inadequate and opportunistically timed and that it exerted pressure on Sears Canada and the minority shareholders as evidenced by (i) Holdings' application for exemptive relief from the requirement to include a formal valuation of the Target Shares in the take-over bid circular and (ii) the absence of a minimum tender condition.

On February 27, 2006, Sears Canada disclosed by press release that all of the independent directors of the board of Sears Canada had given notice that they would not stand for re-election to the board of Sears Canada.

On March 14, 2006 Holdings issued a press release stating that five of eight senior officers of Sears Canada had indicated that they would either accept the Offer and tender all of their Target Shares to the Offer or sell Target Shares into the market prior to the expiration of the Offer, or a combination of both. The five senior officers who declared their intentions were David Merkley, Senior Vice President and Chief Financial Officer; Rudi Vezer, Senior Vice President and Senior Legal Officer (and, since the May 9, 2006 shareholders meeting, a member of the board of directors of Sears Canada); Richard Brown, Senior Vice President, Merchandising and Marketing; Frank Rocchetti, Senior Vice President and Operations Officer; and Ethel Taylor, Senior Vice President, Corporate Store Sales.

On March 17, 2006, the initial expiration date of the Offer, Holdings took up 10,161,968 Target Shares of which 9,699,862 had been deposited pursuant to the lock-up agreement with Natcan. At this time, Holdings owned 67,894,485 Target Shares (63.2% on an undiluted basis).

On March 21, 2006, Holdings mailed a Notice of Extension extending the Offer to March 31, 2006. In its Notice of Extension, Holdings stated that if it did not acquire a majority of the minority of Sears Canada, it would support the elimination of Sears Canada's practice of paying quarterly dividends. Holdings also advised the shareholders of Sears Canada that (i) it had initiated a search for three new independent directors for Sears Canada, (ii) at the next annual meeting of Sears Canada it would nominate and elect employees of Holdings and Sears Canada who would constitute a majority of the board of Sears Canada, and (iii) it would not support any extraordinary dividend or distribution to the public by Sears Canada in 2006.

On March 31, 2006 the first extension of the Offer expired.

On April 1, 2006, Holdings entered into a deposit agreement with Vornado Realty L.P. ("**Vornado**") pursuant to which, among other things, Vornado agreed to deposit 7,500,000 Target Shares into the Offer at $18 per share no later than April 7. These Target Shares were subsequently deposited and taken up such that Holdings owned 75,441,763 Target Shares (70.2% on an undiluted basis). As part of its deposit agreement, Vornado required, and Holdings agreed to, a purchase price "top-up" mechanism which, in essence, obligates Holdings to pay to Vornado any greater consideration paid by Holdings to acquire Target Shares at any time prior to December 31, 2008, together with the amount of any dividends paid thereon. In accordance with Ontario securities law, this top-up mechanism was extended to all holders of Target Shares whose shares are acquired in the Offer. Commenting on the decision to enter into a deposit agreement with Holdings, Steven Roth, Chief Executive Officer of Vornado, acknowledged that Holdings' offer was inadequate at $18 per share, stating the following in Vornado's 2005 Annual Report (at p. 13):

> "With respect to Sears Canada, sure there's more value there than the offered price, but we made a fine profit here and fighting for a few more bucks is not our game. In this case, we'll leave that to others. Our shares have been tendered and taken up, we have received our $118 million cash and enjoy price protection through December 31, 2008."

On April 4, 2006, Sears Holdings extended the Offer to April 19, 2006 and increased the consideration under the Offer to $18.00 per share. At the same time, the Offer was revised to require tendering shareholders to remit to Holdings any dividends paid on the Target Shares by Sears Canada after the date of the initial Offer, including the regular quarterly dividend.

On April 6, 2006 Holdings entered into support agreements with unnamed shareholders in respect of 7,611,000 Target Shares (the "**Support Agreements**") pursuant to which the unnamed shareholders agreed to support a second step going private transaction at $18 per share. The second step transaction was to be effected either as a share consolidation in which untendered Target Shares would be converted into the right to receive $18 per share or a plan of arrangement in which untendered Target Shares would be acquired by Holdings or Sears Canada for $18 per share. In the days preceding April 6, the Target Shares consistently traded above $18 per share and, on April 6, 2006, closed at $18.50. Holdings announced publicly that, giving effect to the Support Agreements and together with the Target Shares taken up in the Offer, it owned or had support commitments for sufficient shares to assure the necessary shareholder approval of the second step going private transaction at $18 per share. Neither the press release nor the Offer circular described the identity of the parties to the Support Agreements. It was only after the Complainants first complained to the OSC concerning this matter that they learned that BNS and Scotia Capital are, in fact, parties to the Support Agreements in respect of

4,000,000 and 511,000 Target Shares, respectively, and that Royal Bank of Canada is party to a Support Agreement in respect of 3,100,000 Target Shares.

On April 7, 2006, Holdings formally extended the expiration date of the Offer to August 31, 2006 and indicated that the Expropriation Transaction would not be completed until December 2006.

On April 10, 2006, Sears Canada announced that Brent Hollister, its President and Chief Executive Officer, would be stepping down on May 9, 2006, would not stand for re-election to the board of directors of Sears Canada and would be replaced by Dene Rogers, an employee of Holdings.

On April 12, 2006, after receiving an updated Valuation and Inadequacy Opinion from Genuity that confirmed their prior analysis as to value and their opinion as to inadequacy, the board of directors of Sears Canada advised by a Notice of Change to the Directors' Circular that they would not be making a recommendation to shareholders on the revised Offer. In the Notice of Change to the Directors' Circular it was disclosed that the Special Committee had requested copies of the Support Agreements from Holdings, that copies were not provided and that, accordingly, the Special Committee was unable to assess whether the Target Shares subject to such agreements could be voted as part of the minority in connection with the Expropriation Transaction.

On May 9, 2006, Sears Canada held its annual meeting at which Holdings elected four of its employees and an employee of Sears Canada to the board. At the meeting, management emphasized, both in its oral remarks and in its slide presentation, the futility of pursuing the appraisal remedy. This served to underscore the similar warning issued by Holding in its April 7, 2006 press release. There it warned holders that "any pursuit of a higher price through the long and costly process of appraisal rights will be unsuccessful".

The Scotia Parties

Scotia Capital is and has been the financial advisor to Holdings in connection with the Pending Transactions and is the dealer manager for the Offer. While all of the facts surrounding the financial advisory role of Scotia Capital have not been disclosed to the public or to the Complainants, it is known that on January 6, 2006 Holdings formalized Scotia Capital's role as financial advisor in connection with the Pending Transaction by entering into an engagement agreement and that for some time prior to that date Scotia Capital and Holdings had been communicating in connection with the Pending Transaction. Under the engagement agreement, Scotia Capital was entitled to a success fee as financial advisor if the Offer was completed at $16.86 per Target Share and remains eligible for a success fee payable at the discretion of Holdings. In addition, as dealer manager for the Offer Scotia Capital is entitled to be paid $0.10 for each share acquired in the take-over bid.

Scotia Capital and BNS are shareholders of Sears Canada. Between August 31, 2005 and December 16, 2005, Scotia Capital acquired 511,000 Target Shares. The Complainants understand that prior to entering into the BNS Swaps (as defined below) in November and December 2005, BNS acquired at least 4,000,000 Target Shares and that these Target Shares were acquired by BNS through "market on close" transactions that were prearranged with SunTrust Capital Markets ("Sun Trust"). In November and December 2005, BNS entered into total return swap contracts with SunTrust, representing the economic equivalent of being short 5,300,000 Target Shares, pursuant to which BNS eliminated its economic exposure to the Target Shares owned by it while maintaining ownership of them (the "**BNS Swaps**"). It appears that the Target Shares were acquired by BNS as a partial hedge against the BNS Swaps. Based on available information, it appears that BNS is presently not fully hedged with respect to the BNS Swaps: while BNS is "long" 4,000,000 Target Shares it is also synthetically "short" the economic equivalent of 5,300,000 Target Shares and therefore is presently synthetically net short the economic equivalent of 1,300,000 Target Shares.

The Complainants

The Complainants are privately offered investment funds which manage capital on behalf of individuals, pension funds, charitable organizations, educational endowments and other institutional and corporate investors. Together, they represent more than 660 investors and have funds under management in excess of US$5 billion. The Complainants first invested in Sears Canada in early 2005, in the case of Pershing Square and Knott Partners, and late 2004, in the case of Hawkeye.

On April 14, 2006, Good Friday, the Complainants formed a group and began to work together with their advisors to oppose the Pending Transaction. Notwithstanding that they were under no legal obligation to do so, the Complainants issued a press release the next business day disclosing their joint actor status and ownership position.

As at April 14, Hawkeye owned or controlled 1,525,872 Target Shares, Knott Partners owned or controlled 1,114,300 Target Shares and Pershing Square owned or controlled 5,601,400 Target Shares. In addition, pursuant to cash settled total return swap contracts entered into between Pershing Square and SunTrust, Pershing Square is synthetically entitled to the economic benefit of 6,900,000 Target Shares (the "**Pershing Swaps**"). Under the Pershing Swaps, Pershing is entitled to receive a cash payment from or obligated to make a cash payment to Sun Trust, and Sun Trust is obligated to make a cash payment to or entitled to receive a cash payment from Pershing, in each case depending on the value of a specific number of Target Shares at the relevant time. None of the Complainants have acquired or disposed of Target Shares since April 6, 2006.

The Pershing Swaps were entered into with SunTrust with respect to the economic equivalent of 5,300,000 Target Shares in November and December of 2005 and with respect to 1,600,000 Target Shares in April of 2006. In anticipation of entering into the

Pershing Swaps in November and December of 2005, Pershing Square disposed of legal and beneficial ownership of the Target Shares owned by it through "market on close" transactions that were prearranged by SunTrust.

The Complainants understand that when SunTrust entered into the Pershing Swaps, as a full hedge against its economic exposure under the Pershing Swaps, SunTrust entered into the BNS Swaps described above. The Complainants further understand that the "market on close" transactions pursuant to which BNS acquired legal and beneficial ownership of the Target Shares disposed of by Pershing Square were facilitated by SunTrust at the request of BNS.

Summary of Complaints

On April 6, 2006, Holdings issued a press release announcing that it had entered into the Support Agreements with unnamed shareholders of Sears Canada and, as a result thereof, Holdings owned or had support commitments assuring it the necessary shareholder approval to effect the Expropriation Transaction at $18 per share. Holdings did not disclose publicly in the press release, or at any time prior to May 1, 2006 – when it was essentially forced to do so in connection with these proceedings – the identities of the parties to the Support Agreements or the complete terms thereof. Accordingly, it has not been possible for minority shareholders of Sears Canada to judge whether, in fact, majority of minority approval is so assured. On May 1, 2006, the Complainants learned that Holdings' financial advisor and dealer manager, Scotia Capital, and Scotia Capital's parent, BNS, are parties to Support Agreements in respect of 511,000 and 4,000,000 Target Shares, respectively. The Complainants have also learned that Holdings is party to a Support Agreement with Royal Bank of Canada in respect of 3,100,000 Target Shares, however, this fact has not been publicly disclosed by Holdings.

The Pending Transactions and the events surrounding them, including the manner in which the Special Committee of Sears Canada and representatives of Genuity were dealt with by representatives of Holdings, the undisclosed Support Agreements, and the nature of the relationship between Holdings and the Scotia Parties, present a complex tapestry of public interest, regulatory policy, compliance and disclosure issues that strike at the core of the regulation of take-over bids and going private transactions in Canada.

The issues include:

- Holdings has violated section 97(2) of the *Securities Act* (the "Act") by entering into a "collateral agreement, commitment or understanding" with a holder or beneficial owner of Target Shares that has the effect of providing to that holder or owner a consideration of greater value than that offered to the other holders of the same class of securities.
- By entering into the Support Agreements, Holdings has violated section 94(2) of the Act. Such agreements, which have the effect of ensuring that the Target Shares

controlled by the counterparties to the agreements will be acquired outside of the bid, are effectively an "agreement, commitment or understanding" on the part of Holdings to acquire beneficial ownership of such shares made during the course of the bid in contravention of section 94(2) of the Act.

- The Target Shares committed by the Scotia Parties to be voted in support of the Expropriation Transaction do not qualify as "minority" shares for purposes of Rule 61-501 in that the Scotia Parties are "joint actors" with Holdings.
- The public interest requires that a party as intimately linked to a bidder as the Scotia Parties are to Holdings should not be able to determine the outcome of a vote that, as a matter of both law and policy, is required to be determined by the true "minority" shareholders of the target.
- In light of the relationship between Holdings and the Scotia Parties, if the Scotia Parties owned or acquired, at any time after it was contacted by Holdings in connection with Scotia Capital's engagement, voting rights in a sufficient number of Target Shares to affect materially the outcome of the vote on the second step going private transaction, Holdings ought to have disclosed that fact in its take-over bid circular or in an amendment to the circular. The failure to disclose that fact constitutes a misrepresentation.
- The Offer is coercive. Holdings is forcing on the minority shareholders of Sears Canada an insider bid that has been rejected by the Special Committee and deemed inadequate by the independent valuator. Holdings has essentially forced the independent directors of Sears Canada to step down, and is now forcing its insider bid on the minority shareholders through the unusual device of locking up sufficient votes to force through the majority of the minority vote on the Expropriation Transaction through agreements with shareholders that have different interests in the outcome of the Expropriation Transaction than other shareholders. By extending the Offer to August 31, 2006, proposing an Expropriation Transaction to close in December 2006 and advising shareholders that it has locked up sufficient votes to cram down the Expropriation Transaction, Holdings is coercing shareholders of Sears Canada into tendering into the Offer in order to receive $18 now rather than wait seven months to receive $18 or to commence the dissent and appraisal process.
- If parties to the Support Agreements have, by virtue of swap transactions, merely the voting rights but no real economic interest in the Target Shares, or, worse, a synthetic short economic position in the Target Shares, the votes relating to its Target Shares should not be counted with the votes of the minority shareholders in determining the outcome of an expropriation transaction that has been rejected by the Special Committee and deemed inadequate by the independent valuator.

Submissions

1. The Support Agreements Confer Collateral Benefits in Violation of Section 97(2) of the Act

(a) Overview

Section 97(2) of the Act prohibits an offeror from entering into any

> "collateral agreement, commitment or understanding with any holder or beneficial owner of securities [that are the subject matter of the offeror's bid] that has the effect of providing to the holder or owner a consideration of greater value than that offered to the other holders of the same class of securities."

In orders granted pursuant to section 104(2) of the Act, the Commission has recognized that this fundamental protection will permit only rare exceptions – where an agreement (i) is entered into in contemplation of a take-over bid, (ii) is a condition to the offeror proceeding with the bid and essential to the offeror's business plan for the target going forward, (iii) is on commercially reasonable terms and (iv) is not intended to increase the price offered to a shareholder in the bid.

The Support Agreements are agreements between an offeror and holders of securities that are subject to the offeror's bid. Contrary to the prohibition in section 97(2) of the Act, the Support Agreements appear to have been negotiated, and the Offer and Expropriation Transaction restructured, to achieve a specific economic benefit to the shareholders party to the Support Agreements, a benefit that represents consideration of greater value than that offered to other holders of the same class of securities. The benefit under the Support Agreements is not analogous to those in respect of which the Commission has historically granted exemptions under section 104(2) of the Act.

The collateral benefit arising as a result of the restructuring of the Offer and the Expropriation Transaction (and the synthetic net short position of BNS pursuant to the BNS Swaps) creates a situation where the Scotia Parties would view the Offer and such Expropriation Transaction favourably for reasons other than the value of the consideration being offered to shareholders generally. A finding of a collateral benefit in contravention of section 97(2) of the Act necessitates that the Commission take remedial action against Holdings and the Pending Transaction.

(b) The Nature of the Collateral Benefit

It is clear that, in normal circumstances, it would not be rational or in a shareholder's economic interest to enter into a Support Agreement to receive $18 per share in late

December 2006 when it could tender into the Offer today and receive $18 per share or sell into the market today and receive more than $18 per share. (The Target Shares have consistently traded above the Offer price and closed between $18.50 and $18.75 on each of April 3rd through 6th.) The refusal of Holdings to disclose the Support Agreements (publicly or to the Special Committee) leaves many unanswered questions, such as why BNS, Scotia Capital and Royal Bank would voluntarily choose to pursue an apparently economically irrational result. The fact that BNS, Scotia Capital and Royal Bank apparently did so strongly suggests that something in the nature of the structural changes to the Offer and Expropriation Transaction that was required pursuant to the Support Agreements has the effect of providing to BNS, Scotia Capital and Royal Bank consideration of greater value than is being offered generally. Moreover, the fact that these shareholders agreed to vote their Target Shares in favour of the Expropriation Transaction at $18 per share and restrict their ability to dispose of their Target Shares in the market for greater than $18 per share suggests that they received a valuable benefit.

It appears likely that the Scotia Parties were motivated to enter into Support Agreements by Holdings' promise to vary the Offer and Expropriation Transaction to accommodate the tax objectives of the Scotia Parties. Holdings' April 7, 2006 Notice of Variation and Change of Information disclosed that, pursuant to the Support Agreements, there will be a lengthy extension of the Offer to August 31, 2006 (and, in turn, the delay of the Expropriation Transaction to December 2006) and that the nature of the Expropriation Transaction will be restructured. As a result, the Scotia Parties will likely be entitled to a very significant tax loss deduction in connection with their Target Shares, notwithstanding that they received an extraordinary tax free dividend on their Target Shares in December 2005 and they will likely have no economic loss (*i.e.*, because of the BNS swaps). The tax loss deduction will be available to the Scotia Parties because they will have held the relevant Target Shares for more than 365 days and are Canadian corporate tax payers.[1] To achieve this result, Holdings agreed to postpone the Expropriation Transaction until December 2006. As a result, to be able to effect a second step going private transaction under Rule 61-501 without having to obtain a new independent valuation and to be able to count shares tendered under the Offer in the minority for majority of minority purposes, Holdings also had to extend the expiration of the Offer to August 31, 2006 to ensure that no more than 120 days elapsed between the expiry of the Offer and the Expropriation Transaction. The extension and restructuring of the Pending Transaction to achieve a

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[1] In December 2005, the Scotia Parties and other shareholders of Sears Canada received a distribution of $18.64 per share consisting of a return of capital of $4.38 per share and a dividend of $14.26 per share. The dividend was tax free to Canadian corporate shareholders. The dividend paid presumably reduced the trading value of a Sears Canada common share by approximately the amount of the dividend, but did not reduce the tax cost of the common shares to the Scotia Parties. Thus, on the subsequent disposition of the Sears Canada common shares by the Scotia Parties, the Scotia Parties will realize a very significant tax loss. However, the so-called stop loss rules in the *Income Tax Act* (Canada) will generally not permit the deduction of the tax loss unless the Sears Canada common shares have been held for at least 365 days at the time of disposition.

particular tax benefit was done at the expense of the minority shareholders by unduly and unreasonably delaying the ability of the minority shareholders to exercise their dissent and appraisal remedy.

It is also noted that the Scotia Parties may be able to obtain an additional tax benefit under the Support Agreement. The Support Agreements limit the Expropriation Transaction to one of two possible forms. One of those permitted forms is a share consolidation which is treated as a redemption for tax purposes. This would result in a substantial deemed dividend which would be tax free to the Scotia Parties and may create a further loss for tax purposes. If available, this would approximately double the tax benefit to the Scotia Parties arising from the transaction.

In addition, if BNS is synthetically net short the economic equivalent of 1,300,000 shares then, by entering into the Support Agreement, it has capped its exposure to the risk of the Target Shares increasing in value. Depending upon the price at which the relevant swap agreements were entered into, BNS may also have profited on its synthetic short position as a result of entering into Support Agreements which will result in the acquisition of its shares at $18, a price below the market price at the time the Support Agreements were entered into. These are additional collateral benefits to BNS.

At this time the Complainants do not have access to information or documentation disclosing when RBC purchased the Target shares it committed to vote under the Support Agreements. If RBC acquired shares on a timeline similar to BNS then it is also the recipient of a collateral benefit.

The Commission has in the past recognized that an agreement by an offeror and the shareholder of the target in connection with a take-over bid to facilitate a tax benefit for such holder is prohibited on the basis that it confers a collateral benefit. In the matter of *Re Royal Trustco Ltd. and Campeau Corporation (No. 2)* (1980), 11 B.L.R. 298, the Commission considered an agreement between the offeror, Campeau Corporation ("**Campeau**"), and Unicorp Financial Corporation ("**Unicorp**"), a shareholder of Royal Trustco Ltd. ("**Royal Trustco**"). The agreement, among other things, enabled Unicorp to receive a tax-free rollover of its shares tendered into Campeau's bid for Royal Trustco. The Commission held that "[t]he onus was on Campeau to demonstrate that the special features of the arrangement with Unicorp did not give rise to a consideration of greater value than was offered to the other shareholders of the class." In this matter the Commission found that when the agreement facilitating the tax-free rollover was examined "it was apparent that Unicorp could receive advantages for benefits not offered to the other shareholders of the class." The Commission's reasons went on to state "it was the opinion of the Commission that it was not in the public interest that the Campeau offer to the Royal Trustco shareholders should be permitted to proceed until this situation was corrected."

(c) The Collateral Benefit is Not Available to All

The collateral tax benefit to be enjoyed by the Scotia Parties is not available to all shareholders of Sears Canada. The collateral tax benefits are not available to shareholders who are individuals or to shareholders that are non-residents. In addition, it cannot be argued that the collateral tax benefits are even generally available to Canadian resident corporate shareholders of Sears Canada. Holdings' Offer and Expropriation Transaction were not restructured to create the collateral tax benefits until April 7, 2006. By this date, shareholders had tendered, and Holdings has taken up and paid for, 17,709,246 Target Shares; the former holders of these shares were afforded no opportunity to take advantage of the collateral tax benefits and tendering shareholders who had not held their shares for at least 365 days lost any ability to arrange their affairs to take advantage of the collateral tax benefit. This is fatal to any claim that the collateral tax benefits were offered to, or are otherwise generally available to, all of the holders of Target Shares.

It should also be noted that Holdings has made no effort to communicate any information relating to the tax benefits to Sears Canada shareholders. Nowhere in Holdings' disclosure is there any description (i) of the collateral tax benefits, (ii) that tendering into the Offer could result in a shareholder being unable to take advantage of the collateral tax benefits, or (iii) of how shareholders could arrange their affairs to obtain the collateral tax benefits. This is also fatal to any claim that the collateral tax benefits were offered to, or are otherwise generally available to, all of the holders of Target Shares.

It is useful to contrast Holdings' treatment of the collateral tax benefits to the "holding company alternative" that is commonly used to permit shareholders to access safe income in connection with a transaction involving the disposition of their shares. Where a holding company alternative is offered (i) it is offered at the outset of the transaction, (ii) it is described in the disclosure documents relating to the transaction, and (iii) shareholders are provided with a detailed description of how they may organize their affairs to take advantage of this alternative. Holdings did none of this in respect of the collateral tax benefits conferred upon the Scotia Parties in connection with the Support Agreements.

It should also be noted that, not only are the collateral tax benefits conferred upon an advantaged few, but they are also provided at the expense of non-tendering shareholders. The lengthy delay in the Expropriation Transaction that is necessary to achieve the collateral tax benefits significantly delays the ability of other Sears Canada shareholders to commence the dissent and appraisal process, unreasonably delaying their ability to exercise their statutory rights in connection with the Expropriation Transaction and exposing such shareholders to the risk of diminishment in value of their shares during the delay.

(d) The Prohibition in Section 97(2) Applies Notwithstanding that the Target Shares may be Acquired Outside the Offer

The collateral benefit being conferred by Holdings on the parties to the Support Agreements is being conferred pursuant to agreements entered into during the course of a take-over bid that contemplate the acquisition of the holders' securities outside of the bid. This scenario is no different than in *Re Royal Trustco* (see above), in which the Commission found there was a prohibited collateral benefit where Campeau, the offeror, proposed to acquire the shares of Royal Trustco held by Unicorp, outside of Campeau's bid for Royal Trustco, pursuant to a call agreement entered into between Campeau and Unicorp in connection with Campeau's bid.

Even apart from the prior decision of the Commission in *Re Royal Trustco*, as a matter of policy it should not be possible to avoid the prohibition in section 97(2) by agreeing, in contravention of section 94(2) (as discussed below), to deliver the collateral benefit to a shareholder whose securities are acquired outside of the bid in a second step or other transaction. There is nothing in the wording of section 97(2) that implies that the shares at issue must be acquired under, and the collateral benefit conferred in, the subject bid. It would be an overly narrow reading of section 97(2), not supported by the plain language of the section, to suggest that it only applies if the shareholder actually tenders to the bid and does not apply if his or her shares are otherwise acquired. To read the section this narrowly, where avoidance, as Holdings' actions demonstrate, would appear to be so easily achieved, would be to vitiate the prohibition entirely and to completely undermine the fundamental principle of equal treatment of shareholders. Section 97(2) should be read in conjunction with section 94(2) to preserve this fundamental principle.

2. The Support Agreements Were Entered into in Contravention of Section 94(2)

(a) Overview

Section 94(2) of the Act prohibits an offeror from offering to acquire or making or entering into any agreement, commitment or understanding to acquire, beneficial ownership of any securities that are subject to a take-over bid otherwise than pursuant to the bid. As set out in the *Report of the Committee to Review the Provisions of the Securities Act (Ontario) Relating to Take-Over Bids and Issuer Bids* dated September 23, 1983 (at p. 20):

> "Subsection 91(2) [94(2)] provides that an offeror making a take-over bid, or any associate or affiliate of a person or company acting jointly or in concert with the offeror, shall not ... directly or <u>indirectly offer to acquire</u>, or enter into any arrangement or, commitment or understanding to acquire, voting securities of the offeree issuer otherwise than pursuant to the take-over bid from the date of announcement or other public communication of the intention of the offeror

> to make a take-over bid until the expiration of the bid. ... *[W]e feel that this is a necessary ingredient to ensure that all holders of voting securities of the offeree issuer are treated equally.*" [emphasis added]

Pursuant to section 185(1) of the Regulation, there is only an exception from this prohibition for an agreement to tender into the subject bid.

(b) The Support Agreements are Agreements to Acquire Securities Outside of a Take-over Bid

Although as of the date hereof Holdings has not disclosed the actual Support Agreements, the summary of selected terms set out in Holdings' April 7, 2006 Notice of Variation and Change of Information discloses that each Support Agreement provides that the Expropriation Transaction may take the form of a share consolidation pursuant to which shareholders who did not tender into the Offer would be squeezed out for cash or a plan of arrangement pursuant to which Holdings or Sears Canada would acquire all of the Target Shares held by the shareholders that are party to the Support Agreement.

In its press release of April 6, 2006 Holdings states that:

> "Giving effect to the 10,209,246 common shares purchased previously in the offer, the 7,500,000 common shares committed and tendered by Vornado Realty, L.P., and the support commitments for 7,611,000 common shares announced today, *Sears Holdings and its affiliates have acquired in the offer or obtained commitments for an aggregate of 25,320,246 common shares, representing over 50% of the common shares (including Deferred Shares Units and unexercised options) that were not owned by Sears Holdings and its affiliates at the commencement of the offer. Accordingly, Sears Holdings and its affiliates will own or have support commitments for sufficient shares to assure the necessary shareholder approval of a going private transaction of Sears Canada at the offer price of C$18.00 per share.*" [emphasis added]

The same press release goes on to quote Alan Lacy, vice chairman of Sears Holdings, as commenting:

> "*With the success of our offer assured, we expect other Sears Canada shareholders to tender their common shares in order to promptly receive our offer price of C$18.00 per share.*" [emphasis added]

By Holdings own statements, it is of the opinion that it owns or controls by virtue of the Support Agreements sufficient shares to succeed in any going private transaction and that the outstanding Target Shares no longer represent an investment in Sears Canada but rather only a right to receive $18. The calling of a shareholders' meeting is a mere formality, wholly within the control of Holdings, for Holdings to effect the acquisition of the outstanding Target Shares it does not already own – success is "assured".

Regardless of the technical mechanics of acquiring the Target Shares, the Support Agreements in substance clearly fall with the scope of an "agreement, commitment or understanding" pursuant to which Holdings may acquire, outside the Offer, the Target Shares held by the parties thereto. This offends both the express wording of, and the policy and intent behind, section 94(2) and the fact that the Support Agreements contravene section 94(2) requires that the Commission take remedial action against Holdings and the Pending Transaction.

(c) The Section 185(1) Exception Does Not Apply

There is only one exception from the prohibition in section 94(2), that being section 185(1) of the Regulation. Section 185(1) of the Regulation provides that:

> "Subsection 94(2) of the Act is not applicable to an agreement between a securityholder and an offeror to the effect that the securityholder will tender the securityholder's securities to a formal take-over bid made by the offeror in accordance with the terms and conditions of the bid."

Section 185(1) of the Regulation does not apply to exempt the Support Agreements from section 94(2) of the Act because the Support Agreements are not, in form or substance, agreements to tender into Holdings' take-over bid in accordance with the terms and conditions of the bid. Unlike the deposit agreements entered into by Holdings with each of Natcan and Vornado, each of which explicitly provided that those shareholders would tender into Holdings' Offer, pursuant to the Support Agreements the shareholders party thereto have agreed *to vote* their Target Shares in connection with the Expropriation Transaction pursuant to which Holdings will acquire the Target Shares held by such shareholders. The Support Agreements do not require that these shareholders *tender* their Target Shares into the Offer and there can be no dispute that the acquisition of such Target Shares in the Expropriation Transaction occurs outside of the take-over bid.

There is no supportable interpretation of section 185(1) of the Regulation that would exempt the Support Agreements. To so interpret section 185(1) of the Regulation would require that the Commission disregard the plain language of section 185(1) of the Regulation, which mandates that the securities subject to any such agreements must be tendered into a take-over bid. Such an interpretation would also require that the Commission ignore the important public policy purpose underlying section 94(2) of the

Act. By exempting only those agreements which require shareholders to tender to a formal bid, section 94(2) ensures that all of the other protections of the Act, such as the prohibition on collateral benefits, are brought to bear. If agreements enabling an offeror to acquire shares outside the bid were permitted under section 94(2), the other protections of the Act would be excluded. To take a simple example, were Holdings' Support Agreements allowed to stand, a future offeror could, in the course of a take-over bid, agree to pay a shareholder of a target significant additional consideration for entering into a support agreement to vote on a second step transaction without engaging the protections of Part XX. Provided that the subject shareholder was not a joint actor with the offeror, pursuant to section 8.1 of Rule 61-501 that shareholder could then vote in the minority on the second step going private transaction notwithstanding the additional consideration he or she received and notwithstanding that had such shareholder received the collateral benefit in connection with tendering into the bid, his or her shares could not have been counted in the minority by virtue of section 8.2(b)(ii) of Rule 61-501.

3. The Scotia Parties are Joint Actors and Should Not Count in Minority Shareholder Approval

(a) Overview

The fundamental purpose of the take-over bid provisions of Part XX of the Act is to protect the integrity of the capital markets and the interests of shareholders of an offeree company and to ensure that such shareholders are treated fairly and equally. These protections have evolved through Rule 61-501 and its predecessor instruments to enshrine majority of the minority approval as the key protection of shareholders against the conflicts of interest inherent in a going private transaction. Minority approval is required on the theory that minority shareholders' interests are being expropriated by a party with different interests and an information advantage and that this should not occur unless a majority of the disinterested shareholders agree.

In the Commission's decision *In the Matter of Certain Directors, Officers and Insiders of Hollinger Inc.* (2005), 28 OSCB 3309, the Commission declined to allow a going private transaction to proceed to a vote because the Rule 61-501 protections had failed to work properly. The valuation process was flawed, disclosure in the proxy circular was inadequate and the independent committee of directors had been unable to make a recommendation to the shareholders as to how they should vote in the going private transaction. In refusing to let the going private transaction proceed, the Commission stated that "the minority shareholders are entitled to be certain that the safeguards which are so central to Rule 61-501 are permitted to work effectively." Where shareholders' confidence in the integrity of the safeguards is undermined by the conduct of the parties, confidence in the fairness and integrity of the capital markets overall will be undermined. These comments apply with equal force here.

The right outcome with respect to the Pending Transaction is to preserve the sanctity of the Rule 61-501 protections by ensuring a majority of the minority vote that excludes Target Shares held by joint actors or related parties of Holdings.

(b) Joint Actors

The application of the minority approval protections of Rule 61-501 relies on the correct identification of persons who are "joint actors" with the offeror such that they are excluded from the minority. In this regard, the definition of "joint actor" in Rule 61-501 refers to the definition of "acting jointly or in concert" in section 91 of the Act. It is a question of fact as to whether a person is acting jointly or in concert with an offeror. Section 91 establishes certain presumptions but is not exhaustive. Section 91(2) states that a registered dealer, acting solely in an agency capacity, not executing principal transactions for its own account and not performing services beyond customary dealers' functions, shall not be presumed solely by reason of such to be acting jointly or in concert with the offeror. However, section 91(2) also indicates, as the Commission stated in *In the Matter of Seel Mortgage Investment Corporation and Dominion Trustco Capital Inc.* (1992), 15 OSCB 4287, that although "acting in an advisory or administrative role alone for customary remuneration should not be construed as acting jointly or in concert...relationships that go beyond an advisory or administrative role may, nonetheless, result in an advisor being construed to be acting jointly or in concert with its client".

In the context of the Offer, Scotia Capital is the financial advisor to and dealer manager of Holdings. Were Scotia Capital only performing customary advisory and administrative functions for Holdings, it would not be presumed to be acting jointly or in concert with Holdings. However, in relationships that go beyond this, such as in this circumstance where it appears Scotia Capital (together with its affiliate BNS) have gone well beyond the traditional role of advisor and taken a hand as principal to deliver, through the mechanism of the Support Agreements, a transaction that has been rejected by the independent directors of the target and found to be inadequate by an independent valuator, the advisor and its affiliates must be construed to be acting jointly or in concert with its client. No distinction can or should be drawn between Scotia Capital and BNS in this regard. Not only are their interests completely aligned in this matter, but as discussed in more detail below, in negotiating and entering into identical Support Agreements on the same day, Scotia Capital and BNS demonstrated such a degree of coordination that one must draw the inference that they were acting in concert or, at a minimum, in a consciously parallel manner.

Although the definition of "joint actor" in Rule 61-501 states that "a security holder is not considered to be joint actor with an offeror...solely because there is an agreement, commitment or understanding that the security holder will...vote in favour of the transaction," this presumption cannot protect a shareholder who is not being treated identically with the minority. The public interest requires that parties as intimately linked to an offeror as Scotia Capital and BNS are to Holdings (through the Support Agreements,

financial advisor and dealer management engagements and lending relationship) should not be permitted to determine the outcome of a vote that, as a matter of both law and policy, is required to be determined by the true minority shareholders of the target. The public interest compels a finding that, at a minimum, Scotia Capital and BNS are joint actors with Holdings and that Holdings should not be entitled to count the Scotia Parties' Target Shares in the minority on any Expropriation Transaction.

Hand in hand with the fundamental requirement of actual substantive and procedural fairness is that take-over bids and going private transactions must be perceived to be substantively and procedurally fair. The appearance of an offeror and a party intimately linked with it, such as its financial advisor, engaging in transactions which are perceived to be delivering collateral benefits and accommodating the particular needs of certain shareholders to the detriment of the minority shareholders, while failing to disclose critical information about the relationship, can only have a deleterious effect on the investing public's confidence in the Canadian capital markets. This too compels a finding that, at a minimum, Holdings should not be entitled to count in the minority votes by the Scotia Parties on any Expropriation Transaction.

These conclusions are only made more compelling if it is correct that Scotia Capital acquired Target Shares that are the subject of the Support Agreement for its own account during the period in which it was acting as financial advisor to Holdings or anticipating its engagement as such. The exclusion of BNS from the minority is also made more compelling if it is true that BNS is in a synthetic net short position with respect to Sears Canada by virtue of being a counterparty to the BNS Swaps in respect of the economic equivalent of 5,300,000 Target Shares while owning an offsetting hedge of only 4,000,000 Target Shares. In addition to the significant collateral benefit to which BNS appears to be receiving pursuant to the Support Agreements, being in a synthetically net short position in respect of the economic equivalent of 1,300,000 Target Shares puts BNS' interests in the Expropriation Transaction in direct conflict with the interest of the minority shareholders of Sears Canada. Security holders with disparate economic interests should not vote in the same class to determine the outcome of a critically important expropriation transaction. Certainly a matter as fundamental as the majority of minority vote on a going private transaction cannot be allowed to turn on the votes of a party with an interest diametrically opposed to the minority in the transaction.

Scotia Capital's and BNS' interests may also differ from those of the minority shareholders in two other important respects. First, with respect to Scotia Capital, as financial advisor to Holdings, Scotia Capital is entitled to a success fee payable at the discretion of Holdings. (That engagement agreement respecting the financial advisory services in connection with the Pending Transaction is neither filed nor disclosed in Holdings' take-over bid circular.) Second, as discussed above, unlike other shareholders, BNS' synthetic net short position means its interest in the Pending Transaction is in minimizing the per share price. Even without a net short position, BNS is largely indifferent to the Offer price

due to the swap transactions discussed above. Its principal economic interest in the Offer and Expropriation Transaction is a valuable tax loss which, based on the limited facts available, is estimated to be significantly in excess of $50 million. The tax loss is locked-in, unaffected by the Offer price, and ensured by virtue of the restructuring of the Offer and Expropriation Transaction pursuant to the Support Agreements. These additional benefits to the Scotia Parties also militate against treating their Target Shares as part of the minority.

(c) The Chinese Wall Was Not Effective

The public learned for the first time in Holdings' May 1, 2006 press release that the Scotia Parties are party to the Support Agreements, Scotia Capital with respect to 511,000 shares and BNS with respect to 4,000,000 Target Shares. Through counsel Scotia Capital and BNS have suggested that Scotia Capital is not responsible for the conduct of BNS on the basis that a "Chinese wall" existed between them. Similarly, Scotia Capital has suggested that there is a Chinese wall between its M&A operations and its equity trading operations.

The mere existence of a Chinese wall, should one exist, is not an answer to allegations that Scotia Capital, BNS and Holdings are joint actors or that the conduct of the Pending Transaction is otherwise not in the public interest. This is the case for two reasons. First, the publicly known facts do not permit one to conclude, in this case, that there was an effective barrier to information passing from one of the Scotia Parties' operations to the other. Second, and more importantly, for the reasons discussed below, even the most impermeable Chinese wall does not answer the question of who is entitled to vote in an expropriation transaction.

The actions of the Scotia Parties and Holdings raise serious questions about whether the Chinese wall, if it existed, was respected.

The concern arises from the fortuitous timing of the execution of the Support Agreements entered into by Holdings and the then unnamed shareholders party thereto which, as it turned out, included Scotia Capital and BNS. Shortly after Vornado entered into its deposit agreement with Holdings, the Scotia Parties were able to deliver to Holdings sufficient votes to purportedly lock up the majority of minority approval of a transaction that may otherwise have failed due to independent director and shareholder opposition. The fact that the Scotia Parties did so when they did, and that Holdings restructured the Pending Transaction to accommodate the tax interests of the Scotia Parties, suggests a high degree of coordination. This degree of coordination invites the conclusion that BNS and Scotia Capital worked together or, at a minimum, in a consciously parallel manner. It is noteworthy that both BNS and Scotia Capital entered into concurrent identical support agreements with Holdings to secure for Holdings all at once the acquisition of Sears Canada.

If the decision of BNS to enter into a Support Agreement was made independently from the activities of Scotia Capital, then why were the identities of the parties to the Support Agreements kept secret? Why did Holdings not announce publicly on April 6, 2006 that BNS was party to a Support Agreement and that the agreement had been entered into by BNS independently of Scotia Capital which was on the other side of a Chinese wall? It is submitted that Holdings knew, given the circumstances, that minority shareholders would question the effectiveness of any Chinese wall and would perceive that Holdings and the Scotia Parties were joint actors. Holdings therefore decided to avoid giving minority shareholders (and, we understand, the independent directors of Sears Canada) the information necessary to properly assess the Proposed Transaction by refusing to disclose the identities of any of the parties to the Support Agreements until they had no option but to do so with respect to the Scotia Parties on May 1, 2006. It should be noted that to this date Holdings has not publicly disclosed the identity of Royal Bank as the other party to a Support Agreement.

The decision to keep the identity of the "unnamed shareholders" confidential is in striking contrast to the decision by Holdings to immediately notify the market of the details surrounding its lock-up agreement with Natcan on December 5, 2005 and its deposit agreement with Vornado on April 1, 2006. It is submitted that the insistence on secrecy with respect to these important facts betrays a "consciousness of guilt" or an awareness on the part of Holdings that if the facts concerning the Support Agreements were made known to the market there would be a basis to assert, as the Complainants have, that the facts disclose breaches of the letter and the spirit of Ontario securities laws.

(d) Determining "Minority" under Rule 61-501 is Question of Fact

Whether a shareholder is properly included in the minority under Rule 61-501 is a question of fact. This is so because section 8.1 of Rule 61-501 excludes from the minority persons who are "joint actors", which is itself a question of fact.

In determining who should be regarded as a "joint actor", it is instructive to start from the central policy issue, namely: who gets to vote on an expropriation transaction?

The Commission has traditionally been scrupulous to ensure that expropriation transactions are approved by shareholders who are independent – and who are perceived to be independent – of the bidder. The majority of the minority rules under Rule 61-501 and its predecessors going back to Policy 3-37 are designed to define a group of shareholders with as much community of interest as possible and who are adverse in interest to the bidder, and to let a majority of those shareholders decide whether all shareholders must accept the expropriation of their shares. If the voting pool includes shareholders whose interests may be aligned with the bidder, the justifications for the expropriation are vitiated.

As early as 1978, the Commission said *In the Matter of the Securities Act and M. Loeb Limited and Leobex Limited*: (1978) O.S.C.B. 333.

> "When the company that now wishes to go private sold its securities to the public, it accepted certain obligations of so doing; one of the those obligations is to deal fairly with those members of the public who have invested in the corporation. It is fairness that Policy 3-37 is directed to, and it is not for the majority to tell the minority what is fair or what is in its best interest. It is for the minority to make that decision by a majority vote. That is what Policy 3-37 requires and it is that Policy that we insist on being adhered to in this transaction and in issuing a cease trading order to prevent the amalgamation squeeze-out proposed."

Given the longstanding importance of majority of the minority approval under Ontario securities law, any doubt as to whether a shareholder is entitled to vote must be resolved in favour of the minority in an expropriation case.

In the circumstances of this case, notwithstanding any Chinese wall, BNS and Scotia Capital both stand to benefit if the Pending Transaction succeeds, including by virtue of the collateral tax benefits and the success fee. These benefits are different from those enjoyed by the minority and, as such, the votes of BNS and Scotia Capital should not be counted as part of the minority. If, as the Complainant's allege, BNS is in a synthetic short position in Sears Canada so that BNS' economic interest is opposed to that of Sears Canada's other shareholders, the difference in benefits and the need to exclude BNS and Scotia Capital from the minority is even more compelling.

In re *Pure Resources, Inc.*, 808 A.2d 421 (Del. Ch. 2002), the Delaware court considered who should be excluded from the minority for purposes of establishing "majority of the minority" tender to an offer from a controlling shareholder. The court stated that "an offer by a controlling stockholder [should be considered] non-coercive only when: 1) it is subject to a non-waivable majority of the minority tender condition; 2) the controlling shareholder promises to consummate a prompt §253 merger at the same price if it obtains more than 90% of the shares; and 3) the controlling stockholder has made no retributive threats." Under this standard, the court found that "[t]he Offer, in its present form, is coercive because it includes within the definition of the 'minority' those stockholders who are affiliated with Unocal [the offeror] as directors and officers. It also includes the management of Pure [the target], whose incentives are skewed by their employment, their severance agreements, and their Put agreements." The court found,

> "Requiring the minority to be defined exclusive of stockholders whose independence from the controlling stockholder is compromised is the better legal rule (and

> result). Too often, it will be the case that officers and directors of controlled subsidiaries have voting incentives that are not perfectly aligned with their economic interest in the stock and who are more than acceptably susceptible to influence from controlling stockholders."

The court ultimately granted the plaintiffs' request for a preliminary injunction based in part on the need "to put in place a genuine majority of the *unaffiliated* minority condition." (emphasis original). (The plaintiffs' motion for certification of an interlocutory appeal (on other grounds) was ultimately denied by the Supreme Court of Delaware.)

Applying the principles of *Pure Resources* to the facts before the Commission, it is evident that the voting independence of the Scotia Parties, like that of the affiliated stockholders in *Pure Resources*, is compromised by reason of the Scotia Parties' affiliation with Holdings as financial advisor and dealer-manager, lender to Sears Canada and party to Support Agreements which provide a substantial collateral benefit. Excluding the Scotia Parties from the minority would thwart the coercion that the court in *Pure Resources* sought to prevent.

(e) The Policy of the Commission Articulated in section 2.1(5) of 61-501CP Necessitates Commission Intervention

As quoted above, Holdings has publicly claimed on several occasions that, by virtue of the voting commitments obtained by it under the Support Agreements, it has sufficient votes to assure completion of the Expropriation Transaction – that it has sufficient votes to carry the majority of the minority required under Rule 61-501.

While the Support Agreements and the position taken by Holdings with respect to the minority voting entitlements of the shareholders party thereto are contrary to Rule 61-501 and Part XX of the Act, such a finding is unnecessary for the Commission to intervene to, at a minimum, exclude from the minority for purposes of determining the majority of the minority under Rule 61-501 (i) the votes obtained by Holdings under the Support Agreements and (ii) the votes of all shares deposited into the offer following Holdings' April 6 press release announcing the Support Agreements and asserting that Holdings had the necessary votes to complete the second step transaction. As noted below, the Commission has the authority to act against a transaction, even where the transaction strictly complies with all legal requirements, if it has been designed to avoid the animating principles of the securities laws or is abusive to shareholders or otherwise undermines the integrity of the Canadian capital markets.

The Commission has specifically recognized in section 2.1(5) of 61-501CP that, as a matter of public policy, the inclusion of the votes obtained by Holdings under the Support Agreements in the minority, where the shareholders party thereto are receiving differential treatment that is not for the benefit of the general body of security holders, would be

abusive and undermine the integrity of the Canadian capital markets. Section 2.1(5) of 61-501CP acknowledges that, in a business combination, unlike a take-over bid, there is no statutory prohibition against unequal treatment of shareholders, and that related parties are excluded from the minority under Rule 61-501 as a consequence of unequal treatment. However, section 2.1(5) goes on to indicate that despite the absence of a statutory prohibition on unequal treatment and despite the protection normally afforded by the minority approval requirement, the policy of the Commission is that shareholders should be treated equally in a business combination unless the differential treatment is justified in that the benefits to the general body of security holders arising from the unequal treatment outweigh the principle of equal treatment. The onus is on the proponent of the transaction to justify unequal treatment in a business combination and, if it cannot be justified (for example, if preferential treatment is offered to a security holder in order to obtain such security holder's support of a transaction), section 2.1(5) is a signal that the Commission will intervene on a public interest basis to achieve fairness for all security holders and to prevent abuse. This is consistent with the treatment of collateral benefits under sections 97(2) and 104(2) of the Act.

The Support Agreements appear to have been negotiated, and the Pending Transactions restructured pursuant thereto, to accommodate the specific transaction structuring desires and for the specific benefit of the shareholders that are party to the Support Agreements. This violation of the principle of equal treatment does not provide any benefit to the general body of security holders of Sears Canada but rather was done to secure votes on the Expropriation Transaction to the detriment of Sears Canada's minority shareholders.

The inclusion of the votes obtained by Holdings under the Support Agreements in the minority for purposes of determining the majority of the minority under Rule 61-501 would be contrary to the Commission's policy position as articulated in section 2.1(5) of 61-501CP, would permit Holdings to successfully avoid the animating principles of the securities laws and would be abusive to Sears Canada's minority shareholders.

4. Holdings' Disclosure is Inadequate

Consistent with the policy of requiring that shareholders be provided with the necessary information to permit them to make a reasoned and informed decision where an offer has been made to acquire their shares under a take-over bid, a take-over bid circular (and any amendments or variations thereto) cannot contain an untrue statement of a material fact, omit to state a material fact that is required to be stated or that is necessary to make a statement not misleading in the light of the circumstances in which it was made or otherwise contain a misrepresentation likely to affect the value or market price of the securities subject to the offer.

In the context of the Offer, Holdings resisted disclosure (and has still not properly disclosed) the identities of the parties to the Support Agreements or the complete terms thereof. Accordingly, it has not been possible for minority shareholders of Sears Canada

to judge whether, in fact, Holdings' claims as to its success in obtaining majority of minority approval are correct. The disclosure made in Holdings' April 7, 2006 Notice of Variation and Change of Information appears, at a minimum, to omit facts that that the minority shareholders, and investors in capital markets generally, consider to be material. This is readily evidenced by the media coverage and speculation surrounding the Support Agreements and the parties thereto. Such lack of disclosure creates an uneven playing field tilted heavily in favour of Holdings and requires remedial action.

In addition to the disclosure surrounding the Support Agreements themselves, given Scotia Capital's role in the transaction, if the Scotia Parties owned, or acquired at any time after Scotia Capital was engaged by Holdings, a sufficient number of Target Shares to affect materially the outcome of the vote on the Expropriation Transaction, that fact ought to have been disclosed by Holdings in its take-over bid circular or in an amendment to the circular. The failure to disclose that fact, if proven, constitutes a misrepresentation by Holdings and requires remedial action.

5. Holdings Offer is Coercive, Abuse and Contrary to the Public Interest

(a) Overview

As described above, Holdings is forcing on the minority shareholders of Sears Canada an insider bid that has been rejected by the Special Committee and deemed inadequate by the independent valuator. Holdings is doing so through the highly unusual device of purporting to lock up sufficient votes to force through the majority of the minority vote on the second step going private transaction through undisclosed Support Agreements that appear to convey benefits to certain shareholders, including Scotia Capital which has a very different interest in the outcome of the transaction than other shareholders by virtue of its role as financial advisor and dealer manager and for the other reasons described herein. This is done in the context of Holdings previously announcing that (i) the Offer would be without a minimum tender condition, and therefore could in effect constitute a partial bid which would result in illiquidity to minority shareholders not tendering into the Offer, (ii) Holdings would be assuming majority representation on the board of directors and cutting to a bare minimum the number of independent directors, and (iii) Holdings would endeavour to eliminate all dividends on the Target Shares.

By extending the Offer to August 31, 2006, proposing an Expropriation Transaction to close in December 2006 and purporting to lock up sufficient votes to cram down the Expropriation Transaction while denying full information to the market, minority shareholders of Sears Canada are being coerced into tendering in order to receive $18 per share now rather than wait eight months to receive $18 per share or commence the dissent and appraisal process. Such conduct demands the intervention of the Commission to preserve the integrity of the capital markets and prevent the abuse of minority shareholders.

Among Holdings' coercive tactics, the Complainants submit that Holdings sought to coerce minority shareholders of Sears Canada into tendering by, among other things, threatening to eliminate all dividends on the Target Shares. In addition, the Complainants believe that Holdings attempted to induce management of Sears Canada and its directors to either not oppose or to support the Offer and it interfered with Genuity's independent valuation of Sears Canada.

Whether the threat to terminate Sears Canada's long standing policy of paying regular dividends to its shareholders is coercive is tested both (i) objectively (would a shareholder reasonably be expected perceive it as a retributive threat?) and (ii) subjectively (what was the purpose of the termination of dividends?). It is a question of fact as to whether the termination of the dividends was made for a legitimate business purpose (*i.e.*, to reinvest the funds in the growth of the business) or for an improper purpose (*i.e.*, to punish minority shareholders for refusing to tender into Holdings' inadequate offer).

It is respectfully submitted that, in the context of Holdings' other actions in connection with the Offer, Holdings' efforts to eliminate all dividends on the Target Shares is not being made for a proper purpose.

6. The Commission's Should Exercise its Public Interest Jurisdiction in the Pending Transaction

The Commission recently analysed its public interest jurisdiction in its decision *In The Matter of Financial Models Company Inc.* (2005), 28 OSCB 2184. In *Financial Models*, the Commission was asked to consider whether, in the context of competing offers for a closely held company, shares acquired by a bidder pursuant to rights of first offer and first refusal under a shareholders agreement could be counted in the minority under Rule 61-501 for purposes of approving a second step transaction. It was common ground in that case that there was no violation of Rule 61-501. Accordingly, the case turned on whether the Commission should exercise its public interest jurisdiction under section 127(1) of the Act.

In its reasons, the Commission states that intervention under section 127(1) of the Act may be appropriate where there is abuse and that "in the take over bid context, this could occur where a transaction is artificial and defeats the reasonable expectation of investors." Alternatively, the Commission will intervene under its public interest jurisdiction "where intervention would further the policy aims of the Commission."

<u>Holdings conduct is distinguishable from the conduct in Financial Models</u>

On the facts in *Financial Models*, the Commission found no basis to intervene under section 127(1) of the Act. *Financial Models* is a very different case than the case advanced by the Complainants.

Unlike in *Financial Models*, in this case there has been a breach of Rule 61-501. Holdings proposes to include in the minority for purposes of Rule 61-501 shares held by Scotia Capital and BNS. Section 8.1(2) of Rule 61-501 prohibits the inclusion in the minority of shares held by joint actors of an "interested party", in this case being Holdings. For the reasons set out above, the Complainants assert that the Scotia Parties are joint actors of Holdings.

In addition, as addressed above, the Commission should find that Holdings has violated section 94(2) of the Act by entering into the Support Agreements. Further, the Complainants assert that Holdings has violated section 97(2) of the Act by entering into collateral agreements with holders of Sears Canada shares that, on the facts and for the reasons described above, have the effect of providing to such holders a consideration of greater value than that offered to the other holders of the same class.

Holdings conduct is abusive under the standards established in the Canadian Tire decisions

Apart from non-compliance with the Act and Rule 61-501, this transaction clearly meets the standard of abuse established in the *Canadian Tire* decisions referred to in *Financial Models*:

- *Artificiality:* Holdings sought to present the transactions with the parties to the Support Agreements as ordinary course. This artifice was achieved by Holdings failing to identify in its bid circular or any amendments thereto that its financial advisor and bank affiliate were parties to Support Agreements and by failing to disclose that its financial advisor and bank affiliate controlled sufficient shares of the target to deliver the majority of the minority vote.
- *Reasonable expectation of investors defeated*: The reasonable expectation of investors in the Canadian capital markets is that expropriation transactions can only be approved by shareholders who are independent – and who are perceived to be independent – of the bidder. The Complainants believe that the Support Agreements were engineered to thwart this expectation and this expectation will be defeated if the shares held by parties to the Support Agreements, such as Scotia Capital and its bank affiliate, are permitted to be included in the minority.
- *Policy aims of the Commission*: Scotia Capital is a registrant under the Act. It should be a policy aim of the Commission to demand from registrants the highest standard of conduct in order to avoid bringing the Canadian capital markets into disrepute.

The *Financial Models* case was largely concerned with rights under a contract entered into by shareholders in a closely held corporation and did not raise the significant public policy issues identified herein. That the Commission regarded *Financial Models* as nothing more than this is evident from the Commission's conclusion that "A desire to be free of a contractual commitment is not a basis to invoke the jurisdiction of the Commission."

The Pending Transaction is as abusive a transaction as the capital markets have seen:

- It has been rejected by the independent directors of Sears Canada, each of whom has resigned in protest.
- It is at a price below the bottom end of a conservative valuation range established by an independent valuator.
- It is at a price that even one of the locked-up shareholders, Vornado, has publicly characterized as inadequate.
- Material information has been withheld from shareholders including: (i) a description of the collateral tax benefits and the fact that tendering into the offer could result in a shareholder being unable to take advantage of such collateral tax benefits; (ii) the fact that the Scotia Parties hold a sufficient number of shares to materially affect the outcome of the majority of the minority vote on the Expropriation Transaction; and (iii) the identity of the parties to the Support Agreements.
- Minority shareholders have been threatened with a *fait accompli* Expropriation Transaction engineered through Support Agreements with, among others, Holdings' own financial advisor and its bank affiliate, that deliver financial benefits to the shareholders party thereto, and critical votes to Holdings on the second step, in contravention of fundamental principles of securities laws.
- If, as the Complainants have asserted, BNS is in a synthetic net short position in Sears Canada such that its economic interest is diametrically opposed to that of Sears Canada's other shareholders, Holdings is purporting to count in the critically important minority vote on the expropriation of the minority's shares the votes of security holders with an economic interest that is diametrically opposed to that of Sears Canada's other shareholders, which is an affront to the public policy rationale underlying the requirement for such a minority vote.
- Holdings has attempted to coerce the shareholders to tender by, among other things, threatening to eliminate dividends on their shares and by emphasizing to shareholders the futility of exercising their dissent and appraisal remedy.
- Not only the Complainants, but also the independent directors of Sears Canada, believe the facts (which are better known to them than to the Complainants) call out for Commission intervention.

For these and other policy reasons described herein, the Commission should exercise its public interest jurisdiction to provide a remedy for the conduct of Holdings.

Relief Requested

It is requested that the Commission make orders under sections 104(1) and 127(i) of the Act:

(a) requiring the Offer circular to be amended to:

(i) disclose that Holdings will not count in the minority for purposes of Rule 61-501 any Target Shares committed under the Support Agreements or any Target Shares deposited or taken up under the Offer in the period from April 6, 2006 to the date that is 5 business days after Holdings has complied with the requested order.

(ii) disclose the identity and interests of parties to the Support Agreements and to describe the tax benefits to them and to disclose the banking relationship and any other material relationships between Holdings, Sears Canada and the parties to the Support Agreement;

(iii) provide an opportunity for all shareholders who tendered to withdraw their Target Shares from the Offer notwithstanding that such shares may have been taken up; and

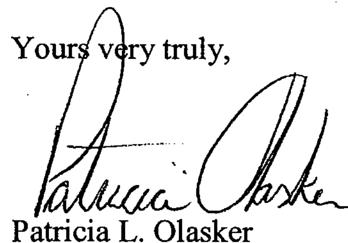
(iv) disclose the success fee contemplated by the terms of Scotia Capital's engagement;

(b) declaring that Holdings has breached sections 94(2) and 97(2) of the Act and ordering that the Offer be cease traded until such non-compliance is remedied; and

(c) such other orders as counsel may request and the Commission thinks fit.

Our cheque in respect of the application fee is enclosed.

Yours very truly,



Patricia L. Olasker

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