# *Nortel:* The Long and Winding Road

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We have chosen to describe the first seven years of the Nortel Networks proceedings by reference to Beatles song titles, for no reason other than the fact that one of us is a lifelong Beatles fan and the other is too polite to protest.

At the time of writing, the Nortel proceedings are in their seventh year and, with various appeals outstanding, do not appear to be near completion. The allocation trial that was conducted jointly by the Ontario Superior Court of Justice and the United States Bankruptcy Court for the District of Delaware from May to September 2014 was ground-breaking, both in its conduct and its result.[1] But the case has gained notoriety for other, less positive reasons. By the time of the allocation trial, more than US$1.3 billion in professional fees had been incurred[2] and no distributions had been made to creditors in any of the insolvency proceedings in the three main geographic regions: Canada, the United States ("US") or Europe, the Middle East and Africa ("EMEA").[3] There is no

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1 *Re Nortel Networks Corporation*, 2015 ONSC 2987 (Ont SCJ [Commercial List]) at paras 16-17 [*Nortel ONSC*].

2 Canadian press reports have most recently put this figure at $2 billion.

3 At various times, references are made to "the three estates", which means collectively the various individual Nortel estates in each of the three geographic regions in which insolvency proceedings were commenced on 14 January 2009. In fact, there are 5 individual debtor estates in Canada, 17 individual debtor estates in the US and 19 individual debtor estates in EMEA.

immediate prospect of distributions to creditors while the various appeals wind their way through the Canadian and US appeal routes.

However, the impact of the prolonged proceedings is not measured just in dollars. More than 5,000 former employees and pensioners under Nortel's UK pension plan died before the allocation trial began in May 2014. More than 1,800 former employees and pensioners under Nortel's Canadian pension plans died between the filing date and the time of writing.

These facts are nothing to sing about, and the use of Beatles song titles to describe the saga of the proceedings over the past seven years should not be taken as trivializing any aspect of the case or the positions of the parties. But, with a little luck, it will hopefully make the reading a little more bearable. In view of the various appeals pending in respect of the allocation trial and other aspects of the proceeding, this article provides a high level overview only and does not attempt to drill down on the many interesting legal issues that are before the courts in each jurisdiction. As eternal optimists, the authors hope that before another year passes those issues may be ripe for discussion and analysis.

## I. *YESTERDAY*: BEFORE THE FILINGS

Nortel Networks Corporation ("NNC"), the Canadian-based parent of the once iconic telecommunications company, traced its roots back to 1895 when the Bell Telephone Company of Canada founded the Northern Electric and Manufacturing Company as an equipment provider for Canada's then nascent telephone system. From those humble roots, Nortel grew into a global telecommunications giant.[4] Throughout the mid-1980s to 2000, Nortel undertook a rapid global expansion establishing significant operations in the US, EMEA, Asia and Latin America. In 2000, Nortel was spun-off from Bell

4 References to "Nortel" or the "Nortel Group" means the global enterprise as a whole.

Canada (now "BCE") into an independent global company. At its peak in 2000, Nortel had approximately US$30 billion of annual revenue, employed nearly 93,000 people, had a market capitalization of over US$250 billion and represented over 30% of the S&P/TSX composite index.

The Dot Com bust of 2001 was the start of what would become a slow and painful death for Nortel. Between 2001 and 2008, Nortel's global workforce shrank from 93,000 employees to less than 30,000. During this period, Nortel faced a number of accounting scandals, which resulted in four successive restatements of its financial statements for the fiscal years 2000 through 2005. The accounting scandals spawned a number of class action claims, which were collectively settled in 2006 for over half a billion dollars in cash and Nortel shares valued at US$1.6 billion at the time.

The financial crisis of 2008 was the final death knell for Nortel. Its major customers significantly cut back their technology spending and Nortel's well-publicized financial troubles caused customers to lose confidence in the company's long-term viability.

On 14 January 2009, Nortel's Canadian-based global parent, NNC, its main Canadian operating company Nortel Networks Limited ("NNL") together with three other Canadian subsidiaries[5] collectively, the "Canadian debtors" sought and were granted an initial order under the *Companies' Creditors Arrangement Act*[6] *(CCAA)*, whereby Ernst & Young Inc was appointed by the Court as the "monitor". On that same day, certain of Nortel's US subsidiaries,[7] (the "US debtors"), filed

5 Nortel Networks Technology Corporation, Nortel Networks Global Corporation and Nortel Networks International Corporation.

6 *Companies' Creditors Arrangement Act*, RSC 1985, c. C-36 [*CCAA*].

7 The US debtors are Nortel Networks Inc ("NNI") (formerly Northern Telecom International), Nortel Networks Capital Corporation, Nortel Altsystems Inc, Nortel Altsystems International Inc, Xros, Inc, Sonoma Systems, Qtera Corporation, CoreTek, Inc, Nortel Networks Applications Management Solutions Inc, Nortel Networks Optical Components Inc, Nortel Networks HPOCS Inc,

voluntary petitions pursuant to Chapter 11 of the US *Bankruptcy Code*.[8] Finally, on that same day, 19 of Nortel's subsidiaries incorporated in various countries within EMEA, collectively the "EMEA debtors", commenced administration proceedings in the UK pursuant to the *Insolvency Act 1986*.[9] Upon being granted administration orders under the UK *Insolvency Act 1986* by the High Court of Justice of England and Wales, certain individuals from Ernst & Young LLP (UK) were appointed as administrators of each of the EMEA debtors, collectively, the "joint administrators". The joint administrators were appointed to administer the insolvencies of each of the EMEA debtors and represent the interests of each EMEA debtor in Nortel's insolvency proceedings across the globe.

Following the global insolvency filings, two main restructuring options were considered. The first involved a "right-sizing" of Nortel's operations, whereby a significantly slimmed-down Nortel would focus on certain aspects of its legacy wireless business and potential future business based on technology such as 4G LTE, which has become the standard for today's Smartphones. The second option involved the liquidation of all of Nortel's worldwide businesses and intellectual property ("IP"). Approximately six months into its insolvency proceedings, the Nortel Group determined that a liquidation of its business and other assets would produce the best recovery for creditors. The focus of this article is on the period following the decision to liquidate, and the issues that arose after the sale of the global assets.

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Architel Systems (US) Corporation, Nortel Networks International Inc, Northern Telecom International Inc., Nortel Networks Cable Solutions Inc and Nortel Networks (CALA) Inc.

8 *Bankruptcy Code*, 11 USC §§ 1101-1174.

9 *Insolvency Act 1986* (UK), c 45.

## II. *WE CAN WORK IT OUT*: AGREEMENT GOVERNING LIQUIDATION

At the time of its insolvency filings, Nortel operated through 130 subsidiaries across the globe. What had begun historically as a Canadian company was now an extensive enterprise with a fully integrated global footprint. With certain minor exceptions, all of Nortel's business operations were organized around lines of business or business segments, rather than by geography or legal entity. Those operations cut across jurisdictions and legal entities, and were fully integrated in every major respect. The structure of Nortel's business was described by Justice Newbould in his allocation decision as follows:

> The Nortel Group operated along business lines as a highly integrated multinational enterprise with a matrix structure that transcended geographic boundaries and legal entities organized around the world. Each entity, such as NNL, NNI, NNUK, NN Ireland and NNSA, was integrated into regional and product line management structures to share information and perform research and development ("R&D"), sales and other common functions across geographic boundaries and across legal entities. The matrix structure was designed to enable Nortel to function more efficiently, drawing on employees from different functional disciplines worldwide, allowing them to work together to develop products and attract and provide service to customers, fulfilling their demands globally.
>
> As a result of Nortel's matrix structure, no single Nortel entity, either NNL or any of the other Canadian debtors in Canada, NNI or any of the other US debtors in the United States or NNUK or any of the other EMEA debtors, was able to provide the full line of Nortel products and services, including R&D capabilities, on a stand-alone basis. While Nortel ensured that all corporate entities complied with local laws regarding corporate governance, no corporate entity carried on business on its own.[10]

Around the time that it decided to liquidate its business lines and other assets, Nortel believed that if the allocation of the future proceeds of sale amongst the various Nortel entities had to be determined prior to the closing of any sales, such sales could be delayed and the value of the assets could depreciate, resulting in an erosion of value for all creditors. At the same

10 *Nortel*, *supra* note 1 at paras 16-17.

time, since the commencement of the global insolvency proceedings, Nortel's entities had stopped making certain intercompany and transfer pricing payments to one another. In order to address these two issues, the main operating entity in each of Canada, the US and EMEA and their estate representatives, among other parties, entered into an interim funding and settlement agreement, the ("IFSA") in June 2009.

For asset sales, the IFSA provided that: (a) the execution of sale documentation or the closing of a sale transaction would not be conditional upon reaching agreement either on the allocation of the sale proceeds among the various entities or on a binding procedure for determining allocation; (b) that the sale proceeds from Nortel's asset sales would be deposited into escrow, the "lockbox funds", and there would be no distribution out of escrow without the agreement of all parties or the determination of any dispute relating to allocation by the relevant "dispute resolver"; (c) that the IFSA would not have any impact on the allocation of proceeds to any debtor from any asset sale and would not prejudice a party's rights to seek its entitlement to the proceeds from any sale; and (d) certain Nortel entities would enter into IP license terminations in order to facilitate Nortel's asset sales.

The IFSA represented an extraordinary example of international cooperation by insolvent debtors in separate insolvency proceedings in multiple jurisdictions. At least initially, this cooperation allowed the maximum value to be obtained for the assets. Unfortunately, that laudable cooperation was short lived. As Justice Newbould stated in his allocation reasons:

> In this case, insolvency practitioners, academics, international bodies and others have watched as Nortel's early success in maximizing the value of its global assets through cooperation has disintegrated into value-erosive adversarial and territorial litigation described by many as scorched earth litigation.[11]

11 *Ibid* at para 208.

Between March 2009 and March 2011, Nortel entered into nine separate sales transactions for the business lines worth a combined total of approximately US$3.275 billion. By the time the last business line sale transaction closed in March 2011, Nortel no longer had any operating businesses and had transferred approximately 2,700 patents in connection with the business line sales. What Nortel did have was a treasure trove of approximately 7,000 residual patents and patent applications, the "residual patent portfolio".

In April 2011, after significant negotiations with a number of prospective purchasers, certain Nortel entities entered into a stalking horse asset sale agreement with a wholly owned subsidiary of Google Inc. The stalking horse agreement with Google valued the residual patent portfolio at US$900 million. In June 2009, an auction was held for the residual patent portfolio. After a number of vigorous rounds of bidding, bids for the residual patent portfolio had swelled to the US$4 billion range. Ultimately, the residual patent portfolio was sold to Rockstar Bid Co, a single purpose entity backed by a consortium consisting of Apple, Microsoft, Ericsson, Blackberry, Sony and EMC, for US$4.5 billion.[12] The higher-than-anticipated proceeds apparently also had the effect of creating "five times the incentive" to fight over how the proceeds would be allocated among the various entities comprising the Nortel Group.

12 As certain of the experts testified at trial, a single company like Nortel was less likely to be able to derive defensive benefits equal to the combined and cumulative defensive benefits that could be gained by several large companies with extensive product and service lines that ranged well beyond what Nortel offered. Accordingly, the defensive value of the residual patent portfolio to the members of the Rockstar consortium made it more valuable to them than it was in the hands of Nortel.

## III. *COME TOGETHER*: MEDIATION OR ARBITRATION?

The IFSA provided that if the parties could not agree on an actual allocation of the sale proceeds, they were to develop an interim sales protocol to provide for binding procedures for the allocation of the lockbox funds. However, the parties could not even agree on what the interim sales protocol should cover, or the process for resolving any disputes. The IFSA provided for disputes to be determined by the "relevant dispute resolvers" but did not prescribe whom those "relevant dispute resolvers" would be.

Just prior to the auction for the residual patent portfolio, the Canadian debtors and the US debtors each brought motions to have an allocation protocol approved by the Canadian and US courts. While certain parties supported the allocation protocol, the EMEA debtors took the position that the appropriate method for the resolution of allocation was binding arbitration, rather than judicial determination. The EMEA debtors also argued that the courts did not have jurisdiction to determine the issue of allocation.

Following a joint hearing, rather than ruling on the allocation protocol, the Ontario and Delaware Courts ordered the parties to attend a mediation before (then) Chief Justice of Ontario, Warren Winkler.[13] This mediation would be the third mediation between the parties, the first having been held in late 2010 and the second having been held in April, 2011, shortly after the last business line sale had closed.

## IV. *GET BACK*: THE FINAL MEDIATION

The third mediation began on 24 April 2012 to much fanfare. In his publicly-available opening remarks delivered at the Metropolitan Hotel in Toronto, Chief Justice Winkler admonished the parties with the following quote, which referenced comments that had previously been made by the

13 *Re Nortel Networks Corporation*, 2011 ONSC 4012.

United States Court of Appeals for the Third Circuit in the *Nortel* proceeding:

> The circumstances cry out for a mediated solution ... I do not see a realistic "litigation option" in this case. What I mean is that the alternative to a mediated outcome is a lengthy litigation process ... Even if judgments are rendered it would be entirely possible that those judgments would have no legal effect beyond the jurisdiction of the courts rendering them. It will take years to get through this process, with an uncertain outcome, and significant amounts of the assets now available will have been depleted as a result.
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> Justice Morawetz and Judge Gross have ordered that this mediation take place to attempt to avert protracted litigation. The United States Court of Appeals for the Third Circuit has also indicated that a mediated solution is the preferred outcome. As Judge Sloviter wrote late last year:
>
> > We are concerned that the attorneys representing the respective sparring parties may be focusing on some of the technical differences governing bankruptcy in the various jurisdictions without considering that there are real live individuals who will ultimately be affected by the decisions being made in the courtrooms. It appears that the largest claimants are pension funds in the U.K. and the United States, representing pensioners who are undoubtedly dependent, or who will become dependent, on their pensions. They are the Pawns in the moves being made by the Knights and the Rooks.[14]

Despite Chief Justice Winkler's warning, by January 2013, it was clear that no mediated resolution to allocation would be reached and Chief Justice Winkler ultimately declared that the mediation talks had failed.

## V. *ALL TOGETHER NOW*: THE ALLOCATION PROTOCOL

After the failure of the third mediation, the Canadian and US debtors once again brought motions before the Ontario and Delaware courts to approve an allocation protocol that would govern the cross-border litigation to determine allocation. The

14 Publicly available *Opening Remarks of Chief Justice Warren Winkler* at the Nortel Mediation on 24 April 2012, citing *In re Nortel Networks, Inc*, 669 F 3d 128 (3rd Cir 2011).

EMEA debtors once again raised the argument that the courts did not have jurisdiction to hear or determine the allocation dispute and that, under the IFSA, the allocation dispute should be referred to binding arbitration for determination. After a joint hearing of the Ontario and Delaware courts, the EMEA debtors' arguments were rejected and a revised allocation protocol was approved, holding that allocation would be determined pursuant to a joint trial of the Ontario and Delaware courts, the "allocation protocol".[15]

In rejecting the EMEA debtors' argument and approving the allocation protocol, Justice Morawetz referred specifically to the jurisdiction granted to the courts pursuant to Section 16(b) of the IFSA and further held as follows:

> I am satisfied that this court has discretionary authority under the CCAA to approve the Allocation protocol. Considering, and potentially approving, the Allocation protocol is consistent with the CCAA objectives of promoting efficiency and fairness by avoiding a multiplicity of inconsistent proceedings: *Re Muscletech Research and Development Inc*. (2006), 19 C.B.R. (5th) 54 (Ont. S.C.J.). This court's authority extends to the subject matter and the persons at issue here and this court has the authority to make the order sought approving the Allocation protocol.
>
> It is my view that all parties have irrevocably and unconditionally submitted to the jurisdiction of the Canadian Court and the U.S. Court. This is established as a result of the jurisdiction clause in each of the Escrow Agreements, the filing of claims by the EMEA Debtors and section 16 of the IFSA.[16]

A motion for leave to appeal the order approving the allocation protocol brought by the EMEA debtors, including, specifically, on the issue of jurisdiction, was dismissed by the

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15 *Re Nortel Networks Corporation*, 2013 ONSC 1757 (Ont SCJ [Commercial List]) [*Nortel (Canada)*]; See also *In Re Nortel Networks, Inc*, 2013 WL 1385271 (Bankr D Del 2013), affirmed 737 F 3d 265 (3rd Cir 2013) [*Nortel (US)*].

16 *Nortel (Canada)*, *supra* note 14 at paras 34-35; See also *Nortel (US)*, *supra* note 14 at para. 3: "This Court's jurisdiction rests on the IFSA itself, and Debtors' submission to the Court's jurisdiction by submitting claims against the US Debtors."

Court of Appeal for Ontario on 20 June 2013.[17] An order approving the allocation protocol was similarly issued by the US Court, and affirmed following an appeal brought by the EMEA debtors in the US.

There was now a final order of both courts confirming the jurisdiction of those courts to determine the issue of allocation of the lockbox funds among the various Nortel entities. The allocation protocol established the framework by which the allocation dispute would be determined by the courts, and all aspects of the litigation.

The allocation protocol provided an opportunity for each of the core parties to advance its theory of how the lockbox funds should be allocated by the delivery of an extensive allocation pleading, and then to respond to the allocation positions advanced by the other parties by way of written reply. The allocation protocol did not provide for any specific metric by which allocation would be determined by the courts and, consistent with the IFSA, specifically stated that there was no "restriction on the ability of any [party] to advance or oppose any theory of allocation".[18]

## VI. *ACROSS THE UNIVERSE*: THE ALLOCATION POSITIONS

The allocation protocol had identified certain parties who were granted standing to participate in the litigation trial to determine allocation of the lockbox funds, referred to as "core parties". Pursuant to the allocation protocol, all core parties were required to file pleadings with the Canadian and US courts setting out their proposed theory of allocation of the lockbox funds, with responding allocation pleadings served by all core parties two weeks later. The main core parties and the allocation positions they advanced, in summary, are as follows.

17 *Re Nortel Networks Corporation*, 2013 ONCA 427.
18 Allocation protocol order, Schedule "A" at para 4(a).

The monitor, acting with "super monitor" powers[19] and on behalf of the Canadian debtors, took the position that the Canadian parent was entitled to 83% of the lockbox funds, with 14% going to the US debtors and 3% to the EMEA debtors, principally on the basis that title to the patents comprising the IP developed by all members of the Nortel Group was registered in the name of NNL. This position was referred to in the allocation trial as "the legal ownership theory". The Canadian creditors committee ("CCC"), which was also a core party representing the interests of the former Nortel Canada employees and pensioners, supported the monitor in advancing the legal ownership theory.[20]

The US debtors, supported by the *ad hoc* group of bondholders[21] and the unsecured creditors committee of the US debtors, each of which was a core party, but for ease of

19 Ernst & Young Inc ("E&Y Canada") was appointed as monitor of the Canadian Debtors on 14 January 2009. Two orders were issued in the proceedings that expanded the monitor's powers to become what is referred to as a "super monitor". The first, by motion brought by the Applicants, resulted in an order dated 14 August 2009, which provided the monitor with certain additional powers to assist the applicants in undertaking various aspects of the proceeding. The second, by motion brought by the monitor itself, resulted in an order dated 3 October 2012 whereby the monitor was authorized to exercise any powers which may be exercised by a board of directors of any of the Canadian debtors. Thereafter, all steps in the proceeding including in respect of the allocation trial (and the separate claims trial involving the UK pension claimants and EMEA debtors) were taken by the monitor rather than the applicants. It resulted in the monitor becoming a direct adverse party to almost all other stakeholders in the Nortel Group's insolvency proceedings, including the joint administrators of the EMEA debtors represented by Ernst & Young's UK firm, the US estate, which had a $2 billion claim against the Canadian debtors, the bondholders having US$4 billion claims against the Canadian debtors and the UK pension claimants with claims against the Canadian debtors.

20 In the alternative, if the ownership theory was not accepted by the courts, the CCC advocated for a *pro rata* allocation of the lockbox funds among the various Nortel entities.

21 The *ad hoc* group of bondholders represents the holders of approximately $2.5 billion of the $4 billion bonds issued by Nortel.

reference are referred to collectively as the "US Interests", supported an allocation theory referred to as the "license or revenue theory", which sought to measure and value the respective IP license rights of each of the Nortel entities for the sale and distribution of products within their geographic region. The measure by which the US interests sought to advance their allocation position was revenues generated within each geographic jurisdiction, with the US being the largest global market of the Nortel Group's products. The revenue theory advanced by the US debtors sought to allocate 73% of the lockbox funds to the US debtors, with 11% being allocated to the Canadian debtors and 17% being allocated to the EMEA debtors.

The joint administrators for the EMEA debtors advanced an allocation position that became known as the "contribution theory", whereby the relative contribution to the creation of the IP was sought to be measured and allocated based on the location of particular inventors whose R&D contributed to the creation of the IP. Under the EMEA allocation theory, contributions to the creation of IP could best be identified by the amount of money spent by each entity on R&D activities over a lengthy period of time. The EMEA contribution approach did not produce as wildly divergent a result as did the Canadian and US allocation theories, and attributed to the EMEA debtors only 18% of the lockbox funds, while proposing that 50% be allocated to the US debtors and 32% be allocated to the Canadian debtors.

The UK pension claimants, which were designated by the courts as a core party, advocated for a *pro rata* allocation of the lockbox funds by reference to the quantum of claims existing against each of the various entities. The *pro rata* allocation theory advanced by the UK pension claimants was based on the highly integrated nature of the jointly-developed assets that gave rise to the lockbox funds and the manner in which the entire Nortel Group operated as "one Nortel" prior to the insolvency filings. The allocation position contained various

"toggles" that were left in the courts' discretion for purposes of determining the appropriate allocation, including the treatment of guarantees, intercompany claims and cash in each estate outside of the lockbox funds. The UK pension claimants did not seek substantive consolidation of the Nortel Group, but that is how their allocation position was characterized by opposing parties.[22]

The territorial tug of war among the debtor estates and their supporters and opponents in each of Canada, the US and EMEA became obvious upon the delivery of the allocation pleadings in May 2013. The approaches to allocation were subsequently described by Judge Gross of the Delaware Court in his allocation reasons, as follows:

> The [Canadian and US] Courts also agree that the self-serving allocation positions of the Canadian interests, the US interests and the EMEA Debtors are not determinative or helpful. [23]
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> . . . . .
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> The US Debtors, Canadian Debtors and EMEA Debtors advanced allocation positions which suffer from fatal, substantive flaws. EMEA fails to recognize that spending does not necessarily create value. The Canadian Debtors are nothing short of narcissistic in allocating the bulk of the sale proceeds to themselves and in their failure to recognize the contributions of the other Nortel companies and the realities of the manner in which the Nortel enterprise operated on a day-to-day basis. And the US Debtors equate revenue to value without any regard to where

22 The US allocation decision mistakenly refers to the UK pension claimants as "advocating for substantive consolidation" (see *In re Nortel Networks, Inc*, 532 BR 494 at 555, 2015 WL 2374351 (Bnkr D Del 2015). Parties opposed to the UK pension claimants' *pro rata* allocation position (which included as one "toggle" available to the courts, no recognition for guarantees or inter-company claims) referred to it as "impermissible substantive consolidation" which occupied a great deal of space in their opposition to it. In fact, the UK pension claimants' opening submissions and closing brief contained entire sections entitled "Pro Rata Allocation is Not Substantive Consolidation" and arguing that what was requested as *pro rata* allocation was not substantive consolidation. As both courts ultimately made clear, *pro rata* allocation was not substantive consolidation.

23 *Ibid* at 532.

the value generating assets were developed or recognition of the fact that the $2.02 billion intercompany claim already accounts for their contributions as the primary breadwinner of Nortel.[24]

. . . . .

The evidence presented to the US court and the Canadian court only serves to magnify the differing and irreconcilable approaches taken by the US Debtors, the Canadian Debtors and the EMEA Debtors. All of their approaches yield an unsatisfactory result and the evidence upon which they rely does not comport with the manner in which Nortel operated.

The extreme allocation proposals of the various Debtors is best conveyed by reference to the following comparison chart contained in the UK Pension post-trial brief which the Court copies here:

[*chart appears as Appendix A to this article*]

. . . . .

. . . The chart reveals that the Debtors have lost sight of the irrationality of their respective positions. The variance of the positions are of such magnitude that highly capable and responsible attorneys were unable, or in the heat of the fight were unwilling, to find a middle ground despite three extensive and costly mediations.[25]

. . . . .

The US, Canadian and EMEA Debtors allocation methods . . . wrongly assert that the individual geographic regions functioned autonomously and can thus claim credit for, and retain proceeds from the sale of Nortel's assets. Their proposals lead to wildly divergent allocation outcomes. Each proponent seeks to obtain a disproportionate share of the proceeds.

. . . . .

One only has to read the parties' briefs (as the Court has done numerous times) and to have presided over the trial to understand that no estate — US, Canadian or EMEA — was able to raise its position above the others. The court compares the allocation dispute to three people trying to reach the top of a mountain by pulling the others down. In other words, no one gets to the top.[26]

24 *Ibid* at 533.
25 *Ibid* at 550-553.
26 *Ibid* at 556.

## VII. *EIGHT DAYS A WEEK*: LITIGATION TSUNAMI

The delivery of the allocation pleadings by each of the core parties in May 2013 pursuant to the allocation protocol was the start of what would become one of the most expensive and contentious trials in Canadian history. The trial was originally scheduled to commence on 6 January 2014 and was adjourned to 12 May 2014. Between June 2013 and May 2014, the start of the allocation trial:

(a) the parties to the allocation litigation produced to the other core parties over 3 million relevant documents in aggregate;

(b) over 140 fact and expert witnesses were "deposed" on three different continents;[27]

(c) over 40 expert reports and rebuttal expert reports were submitted; and

(d) numerous procedural motions and hearings were brought, including motions to strike various expert reports.

The timeframe for completing this process was so compressed that documents were still being produced by parties while witnesses were being examined. Counsel were preparing for and conducting examinations in some cases before relevant documents had been received, catalogued electronically in vast document management systems or reviewed in preparation for witness examination. This complexity was felt most acutely by the "non-estate" core parties, who did not have access to Nortel's internal documents over the course of several years, as was the case with the estate administrators and debtor companies themselves. Several

27 The litigation process took on a decidedly US flavour, including phrases in Canadian court orders describing the examinations as "depositions", providing for the deposition of experts before trial, and other aspects.

deposition-type examinations were conducted on the same day by different counsel for a core party, in different jurisdictions. The task of moving a case of this magnitude through pleadings, production, discovery and trial in 12 months was gruelling and horrendously expensive.

In another case, these extremely difficult circumstances might have led the parties to a settlement. Not so with *Nortel*. With no active business or commercial relationships to preserve, most of the core parties having their professional fees funded from an estate[28] and US$7.3 billion to fight over, it was in every respect the "perfect storm".

From the commencement of the *CCAA* proceedings in January 2009 until February 2014, Justice Geoffrey Morawetz was seized of all Nortel matters before the Ontario Court. In February 2014, it was announced that due to a scheduling conflict that arose as a result of Justice Morawetz's promotion to Regional Senior Justice, Justice Frank Newbould would be seized of the allocation litigation and the determination of certain creditor claims against Canadian debtors. Within three months of inheriting the *Nortel* proceeding, which at that time had been ongoing for over five years, Justice Newbould would be presiding over this complex litigation in Canada by way of a joint trial with the Delaware Bankruptcy Court.

## VIII. *A DAY IN THE LIFE*: THE ALLOCATION TRIAL

On 12 May 2014, the "trial of the century", as it sometimes became referred to, commenced. Lasting 24 trial days between May and September, the joint proceeding was conducted by video link between the Ontario and Delaware Courts, with live video streaming available for those outside the courtroom. A separate courtroom was made available in Toronto with large screen TV's, so that "Nortel TV" could be available to members

28 The authors' clients (UK pension claimants) are an exception, having paid their own professional fees throughout from assets in the UK pension plan, in respect of which there was an approximately US$3.1 billion deficit as at the filing date.

of the public, pensioners who often appeared and other interested parties including the press. Canadian counsel was permitted to appear and make submissions in both courts; wearing their gowns in Ontario, but not in Delaware. US counsel was similarly permitted to appear in both courts. Submissions would ping-pong between the two courtrooms by counsel for the core parties in each jurisdiction. Various objections would be raised by counsel in one courtroom, submissions would be made in one or both courtrooms, and one of the two judges would address the objection, which was in each case supported by the other presiding judge. Live streaming of the trial meant that all counsel for all core parties, and clients who were connected remotely, were able to follow both the live video feed, as well as the rolling transcript of the proceedings on a separate individual screen. Nortel TV was only turned off when the joint trial came to a close on 24 September 2014.

While this proceeding was not the first Canadian trial or insolvency proceeding to use video link technology, the allocation trial was the first cross-border proceeding to use secure multi-camera video link technology between insolvency courts in two different countries. The use of this technology was a first for the Commercial List Court in Toronto and made the joint trial between the Ontario and Delaware Courts possible. To the authors' knowledge, this trial was the first cross-border trial in Canadian, and perhaps US, history.

## IX. *MAXWELL'S SILVER HAMMER*: THE ALLOCATION DECISIONS

On 12 May 2015, exactly one year to the day after the allocation trial had commenced, the Ontario and Delaware Courts simultaneously released their separate rulings at 4:30 pm. In aggregate, the Canadian allocation decision and the US allocation decision were hundreds of pages in length plus

Appendices.[29] Each judgment was detailed and contained numerous findings of fact.[30]

Both courts agreed that the lockbox funds should be allocated among the individual debtor companies on a *pro rata* basis by reference to the aggregate amount of proven claims against each Nortel entity. There was a clear recognition of the distinction between claims against a Nortel entity to be taken into account for the purpose of allocation of the lockbox funds, a matter in which both courts had jurisdiction, and the broader category of allowed claims against a Nortel entity that could be entitled to a distribution as a creditor of that estate, which was within the sole purview of the presiding court in each jurisdiction. For allocation purposes, a claim that could be made against more than one Nortel entity would not be counted more than once, notwithstanding that a creditor may have more than one Nortel entity to assert its claim against in various jurisdictions for the purpose of receiving a distribution with other creditors.

One example was the claims of the bondholders, whose claims would be counted for allocation purposes in respect of the Canadian entity that had issued the bonds, notwithstanding that the bondholders would be entitled to assert a claim against more than one Nortel entity by virtue of guarantees held for the bond debt. Another example was the right of the UK pension claimants to assert separate statutory claims for "financial support directions" against multiple Nortel entities in the EMEA region seeking financial contributions in respect of the deficit in the UK pension plan, pursuant to the UK *Pensions Act 2004*.[31] Those claims were considered sufficiently connected with the UK pension claimant's direct claim for the statutorily-determined deficit against the named employer of the UK pension plan (NNUK), such that the claim against

29 The Canadian Allocation Decision itself was over 350 paragraphs in length. *Nortel*, *supra* note 1.

30 *Nortel*, *supra* note 1 at note 6; and *In re Nortel Networks Inc, Allocation Trial Opinion, supra* note 22.

31 *Pensions Act 2004* (UK), c 35.

NNUK but not any "financial support direction" claims against other EMEA debtors would be counted for allocation purposes.[32]

In issuing the allocation decisions, both judges had regard to the highly integrated nature of Nortel's business and IP assets and the manner in which the Nortel Group operated prior to its collapse. Justice Newbould observed that the creation of Nortel's valuable IP was a joint effort, contributed to by all of the now defunct Nortel entities:

> This was not one corporation and one set of employees inventing IP that led to patents. Nortel was a highly integrated multi-national enterprise with [various subsidiaries] doing R&D that led to patents being granted. . . .[33]
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> . . . . .
>
> This is an unprecedented case involving insolvencies of many corporations and bankrupt estates in different jurisdictions. The intangible assets that were sold, being by far the largest type of asset sold, were not separately located in any one jurisdiction or owned separately in different jurisdictions. They were created by all of the RPEs [intellectual property producing entities] located in different jurisdictions. Nortel was organized along global product lines and global R&D projects pursuant to a horizontally integrated matrix structure and no one entity or region was able to provide the full line of Nortel products and services. R&D took place in various labs around the world in a collaborative fashion. R&D was organized around a particular project, not particular geographical locations or legal entities, and was managed on a global basis. The fact that Nortel ensured that legal entities were properly created and advised in the various countries in which it operated in order to meet local legal requirements does not mean that Nortel operated a separate business in each country. It did not.[34]

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32 The contractual claim of the UK pension claimants against NNL in the amount of GBP£339.75 million pursuant to a guarantee for certain ongoing funding obligations was confirmed by Justice Newbould to be distinct from the UK pension claimant's statutory claim against NNUK for the deficit as at the filing date, in the amount determined by statute. Accordingly, both are counted for allocation purposes. Justice Newbould had presided over a separate claims trial in respect of these claims. See *Re Nortel Networks Corporation et al*, 2014 ONSC 6973 (Ont SCJ [Commercial List]).

33 *Nortel*, *supra* note 1 at para 197.

34 *Ibid* at para 202.

In short, the assets giving rise to the lockbox funds could not be separately attributed to any particular Nortel entity, either in part or in whole, due to the nature of the assets IP, the integrated manner in which the inter-related Nortel entities jointly created the assets, and the manner in which the assets were used and generated proceeds comprising the lockbox funds. This was a critical aspect of the allocation decisions. Both judges rejected the various allocation theories advanced by the debtor estates and their supporters, which were all based on determining and then seeking to value individual interests of separate Nortel entities, as being unworkable, unfair and in no way reflecting the evidence or the manner in which the Nortel Group operated. As Judge Gross observed in his judgment:

> The Courts also agree that the self-serving allocation positions of the Canadian Interests, the US Interests and the EMEA Debtors are not determinative or helpful.[35]

Both courts found that they had the jurisdiction to order a *pro rata* allocation in light of the unique circumstances of the case. Justice Newbould found that after six years of legal wrangling and the expenditure of enormous costs, a global solution was required that comported with the fundamental tenets of insolvency law.

In ordering a *pro rata* allocation of the lockbox funds, the courts confirmed that they were not ordering substantive consolidation of the various Nortel entities, notwithstanding that that was how the opponents of a *pro rata* allocation had characterized it at trial. In cases where substantive consolidation is ordered, the assets and liabilities of two of more members of a corporate group are combined, inter-company debt is extinguished and a single fund is created from which all claims against the consolidated debtors are satisfied and claims of creditors against separate debtors instantly become claims against a single entity.[36] By contrast, the allocation decisions maintained the separateness of the Nortel

35 *Nortel*, *supra* note 22 at 532.
36 *Nortel, supra* note 1 at para 213.

entities that were subject to separate insolvency proceedings in each of the various jurisdictions, and claims would continue to be adjudicated by the administrators of each of the insolvency estates within their domestic jurisdiction for the purposes of being entitled to receive a distribution on allowed claims. However, the amount that would be allocated to each entity from the lockbox funds would be determined based on the aggregate allowed claims against each entity, without duplication.

The courts made extensive findings of fact in support of the *pro rata* allocation result, which included the following by Justice Newbould:

a. The Nortel Group operated along business lines as a highly integrated multinational enterprise with a structure that transcended geographic boundaries and legal entities organized around the world.[37]

b. As a result of Nortel's matrix structure, no single Nortel entity, whether one of the Canadian debtors, the US debtors or the EMEA debtors,[38] was able to provide the full line of Nortel products and services, including R&D capabilities, on a stand-alone basis. No corporate entity carried on business on its own and Nortel did not operate a separate business in each country.[39]

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37 *Nortel*, *supra* note 1 at paras 16, 202.

38 Defined in the Master Research & Development Agreement ("MRDA") as the Residual Profit Entities, or "RPEs". While there were 38 parties to the IFSA, the 5 RPEs were the main operating parties in each jurisdiction where Nortel had significant operations. The MRDA was a transfer pricing document pursuant to which the residual profits of the Nortel Group, after payment of fixed rates of return to all Nortel companies for sales and distribution functions, were paid to the RPEs. Payments were made in accordance with a residual profit split method based on each RPE's expenditure on research and development relative to the research and development expenditure of all RPEs.

39 *Nortel*, *supra* note 1 at paras 17, 202.

c. Nortel had fully integrated and interdependent operations, had intercompany guarantees for its primary indebtedness, operated a consolidated treasury system in which cash was used throughout the Nortel Group as required, and created IP through integrated R&D activities that were global in scope.[40]

d. Nortel's R&D, which was the main driver for the value of the company, was performed at labs around the world. R&D was shared throughout the Nortel Group as needed by the business lines and their customers in the various regions and countries;[41]

e. The intangible assets that were sold, being by far the largest type of asset sold, were not separately located in any one jurisdiction or owned separately in different jurisdictions. They were created by all of the RPEs located in different jurisdictions.[42]

f. Nortel has had significant difficulty in determining the ownership of its principal assets, namely the $7.3 billion representing the proceeds of the sale of the business lines and the residual IP, and it is clear that these assets were "so intertwined that it is difficult to separate them for purposes of dealing with different entities".[43]

g. Nortel was a highly integrated multi-national enterprise with all RPEs doing R&D that led to patents being granted. It was R&D that drove Nortel's business, and R&D and the IP created from it was the primary driver of Nortel's value and profits.[44]

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40 *Ibid* at para 223. This evidence is referred to by the court as "clear and uncontested".
41 *Ibid* at para 19.
42 *Ibid* at para 202.
43 *Ibid* at para 222.
44 *Ibid* at para 197.

Based on these findings, the Courts concluded:

a. The lockbox funds were largely due to the sale of IP and no one debtor estate had any right to these funds, nor can it be said that the funds in whole or in part belonged to any one estate or that they constituted separate assets of two or more estates that would be combined;[45]

b. the lockbox funds were not the property of any one of the Canadian debtors, the US debtors or the EMEA debtors;[46]

c. the MRDA was an operating agreement that was not intended to and did not deal with a situation in which no revenue was being earned and no profits and losses were occurring;[47]

d. the MRDA was only intended to apply to the Nortel Group while it operated, and did not contain provisions that were to apply in the event of a world-wide insolvency of all the Nortel Group;[48] and

e. there was no recognized measurable right in any one of the selling debtor estates to all, or a fixed portion of the proceeds of sale.[49]

## X. *LET IT BE*: RECONSIDERATION HEARING

Shortly after the allocation decisions were released, the US debtors, the bondholders, the US unsecured creditors' committee, certain indenture trustees and others sought to have the US and Canadian courts "reconsider or clarify" their

45 *Ibid* at para 214.
46 *Ibid* at para 227.
47 *Ibid* at para 172.
48 *Ibid* at paras 183-185.
49 *Ibid* at paras 193, 224.

rulings. The US debtors asserted that the US Court had the authority to reconsider or clarify its allocation ruling pursuant to § 105(a) of Chapter 11 of title 11 of the US *Bankruptcy Code* and Rules 59(e) and 60 of the US Federal Rules of Civil Procedure.[50] In companion motions brought before the Ontario Court, the US debtors and other parties aligned in interest asserted that the Ontario Court had the authority to reconsider or clarify its allocation ruling at common law, as no formal order had been issued by the court.

Among other things, the parties seeking reconsideration or clarification raised the following issues with the courts: (i) whether additional sales proceeds from the lockbox should be allocated to the US debtors in connection with guarantee claims made by Nortel's bondholders against one of the US debtors which claims would be entitled to receive a distribution; (ii) whether the sales proceeds from the sale of certain Nortel US subsidiaries should only be allocated to the US debtors; (iii) whether intercompany claims by and among Nortel entities within the same region (*ie*, Canada, the US and EMEA) would be recognized for the purposes of allocating the lockbox funds; (iv) whether previously-approved settlements of certain pre-filing claims between the debtor estates and creditors would be counted in determining aggregate claims against an estate for allocation purposes; (v) whether the lockbox funds would be distributed to individual Nortel debtor entities or by region (Canada, the US and EMEA); (vi) whether it was necessary to establish procedures to review potentially inflated claims made or accepted by other debtor estates, on the theory that this could potentially skew the result; and (vii) whether a reserve from the lockbox funds should be established to deal with unresolved claims.

After a joint hearing by both courts, substantially all of the relief sought by the parties seeking reconsideration or clarification was denied.[51] The Courts confirmed, *inter alia*,

50 US Fed R Civ P.

51 *Re Nortel Networks Corporation et al*, 2015 ONSC 4170 (Ont SCJ [Commercial List]).

that inter-company claims by and among individual Nortel entities within a region would be counted for allocation purposes based on the same principles as claims across jurisdictions, that the allocation of lockbox funds would be on an individual debtor basis, that the bondholders' claims would not be counted more than once for *allocation* purposes from the lockbox funds, notwithstanding that they might have multiple claims that could be asserted for *distribution* purposes.

## XI. *WAIT*: APPEALS

### 1. Ontario

Shortly after the relief sought in the motions for reconsideration or clarification was substantially denied, a number of parties initiated appeal proceedings in Ontario and Delaware in respect of the allocation decisions. Pursuant to section 13 of the *CCAA*, leave to appeal must be obtained from the Court of Appeal for Ontario before an appeal of Justice Newbould's allocation decision can be heard. In August 2015, a number of parties sought leave to appeal Justice Newbould's allocation decision. At the time of writing, the appellants' leave application was still before the Court of Appeal awaiting a decision as to whether leave would be granted.

### 2. Delaware

The appeal process from Judge Gross' allocation decision in Delaware is less straightforward than appeals in Ontario. From decisions of the Delaware Bankruptcy Court, there are two potential appeal routes. First, an appeal of the Bankruptcy Court's ruling can be taken to the United States Court for the District of Delaware. If the US allocation decision is a final order, an appeal to the District Court exists as of right. If the US allocation decision is an interlocutory order, leave to appeal must be sought from the District Court. Alternatively, proposed appellants can seek to have an appeal of the

Bankruptcy Court's ruling certified for direct appeal to the United States Court of Appeals for the Third Circuit. In order to proceed down this appeal route, certification must be received from the Bankruptcy Court and a request for appeal, which is functionally equivalent to a leave to appeal, must be granted by the Third Circuit.

After the motions for reconsideration were denied, certain parties took the position that the US allocation decision was a final order and an appeal to the District Court existed as of right. Other parties took the position that the US allocation decision was an interlocutory order and sought leave to cross-appeal from the District Court. Simultaneously, a number of other parties sought direct certification of an appeal to the Third Circuit, which, if granted would have required a further ruling on leave from the Third Circuit. In August 2015, Judge Gross denied certification of the appeal directly to the Third Circuit.

At the time of writing, a number of motions in respect of appeal are still pending before the District Court. As part of the appeal process before the District Court, the core parties to the allocation proceedings were required to attend mandatory mediation in Delaware, which occurred in October and November 2015. No settlement was reached.

## 3. The Consequences

Appeals of the allocation decisions, which followed a joint trial of courts in two separate jurisdictions, will be fraught with complexity. First, unlike the proceedings before Justice Newbould and Judge Gross, there is no cross-border protocol or agreement of the parties to govern or coordinate *appellate* proceedings between the Canadian and US courts. Second, there are no statutory or jurisdictional mechanisms that allow for the Canadian and US appellate courts to sit together jointly on any appeal. Thirdly, the appeal routes in Ontario and Delaware are not symmetric, meaning that there is only one level of appeal in

Ontario before a matter reaches the Supreme Court of Canada. In Delaware, there are two potential levels of appeal before a matter reaches the US Supreme Court. Even if coordination was possible between the appellate courts of two jurisdictions, it is not a case where there are parallel appellate courts in each jurisdiction. Finally, if the appellate courts in either jurisdiction were inclined to consider or alter the allocation decisions, it is difficult to imagine an alternate outcome that would be identical in both jurisdications, in view of the extensive findings of fact that are generally afforded considerable deference by an appellate court.[52]

If leave to appeal is granted and appeals of the allocation decisions proceed in two jurisdictions, it is trite to state that the risk of inconsistent final decisions in the two jurisdictions increases. That would result in a deadlock in respect of the lockbox funds, since consistent decisions of the two courts is required in order to release the funds from escrow and permit a distribution to creditors. Neither jurisdiction has unilateral authority to issue a decision to resolve the dispute.[53]

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52 That would be particularly difficult in a case such as this one, where the evidence considered by the two trial courts was based on the production of over 3 million documents by the core parties, thousands of exhibits, transcripts from over 100 depositions and live testimony of 36 witnesses over the course of a six week trial.

53 (Then) Chief Justice Warren Winkler, the court-appointed mediator presiding over the third and final mediation warned of the possibility of conflicting decisions from the courts in his published Opening Remarks on 24 April 2012:

> [T]he complexity of this case would make even a conflicts of laws professor cringe! As if it were not enough to attempt to work through to bring about a timely resolution to the Nortel Insolvency, the fact that there may be more than one avenue of appeal available to the parties through the courts of numerous countries adds yet another layer of complexity. It, of course, raises the prospect of additional delays and the potential for conflicting decisions. There is a point here worth repeating. There is no single jurisdiction with the ultimate, final authority in the matter; no final court of appeal or supreme court with the power to issue a decision that conclusively determines the outcome of litigation.
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> See the publicly available *Opening Remarks of Chief Justice Warren Winkler* at the Nortel Mediation on 24 April 2012.

The allocation decisions were driven by the unique facts that existed with Nortel. As Justice Newbould stated:

> *This is an unprecedented case* involving insolvencies of many corporations and bankrupt estates in different jurisdictions. *The intangible assets that were sold, being by far the largest type of asset sold, were not separately located in any one jurisdiction or owned separately in different jurisdictions*. They were created by all of the RPEs located in different jurisdictions. Nortel was organized along global product lines and global R&D projects pursuant to a horizontally integrated matrix structure and no one entity or region was able to provide the full line of Nortel products and services. R&D took place in various labs around the world in a collaborative fashion. R&D was organized around a particular project, not particular geographical locations or legal entities, and was managed on a global basis. *The fact that Nortel ensured that legal entities were properly created and advised in the various countries in which it operated in order to meet local legal requirements does not mean that Nortel operated a separate business in each country. It did not*.[54] [Emphases added.]

The extent to which the allocation decisions in *Nortel* will stand as a precedent for future insolvencies therefore remains to be seen, in view of its unique facts.

## XII. *THE END*: THE CHAPTER NOT YET WRITTEN

It is not clear when this chapter will be able to be written. In January 2016, the *Nortel* proceedings will be in their seventh year, and various appeals in Canada and the US are outstanding at the time of writing this article.

Upon the allocation decisions becoming final in each jurisdiction, the lockbox funds can be released, and creditors will finally receive a distribution on their claims. At that time all parties involved in the proceeding can consider the early successes achieved in creating the lockbox funds through co-operative global efforts, and the lessons learned for future proceedings from the territorial wrangling that followed. The ability of the courts in Canada and the US to have coordinated and undertaken a joint trial of this magnitude with the assistance of state-of-the-art technology is remarkable, and

54 *Nortel*, *supra* note 1 at para 202.

sets the standard for future cross-border cases. The fact that two trial courts in separate jurisdictions presided over a six-week trial and reached the same decision on allocation is a testament to the strength of the evidentiary record that they each independently considered, as well as the similarities in the legal principles underlying bankruptcy and insolvency proceedings in Canada and the US that have provided the basis for decades of cooperation and recognition. The long and winding road will undoubtedly have many more twists and turns before the end is reached.

## APPENDIX A