Nortel's US Wing, UK Pensioners Vie Over $7.3B in Sale Funds

Share us on: By **Jamie Santo**

Law360, Wilmington (September 23, 2014, 9:58 PM ET) -- The long-running fight over how to divvy up $7.3 billion realized from Nortel Networks Corp.'s liquidation continued Tuesday as U.K. pensioners called for all parties to receive an equal percentage while Nortel's U.S. arm argued it deserved most of the proceeds since it contributed most of the value.

The second day of closing arguments in the cross-border trial, which links courtrooms in Delaware and Ontario via computer video, saw Nortel's U.K. pension fund champion a pro rata allocation of the $7.3 billion in escrowed funds, which include $4.5 billion raised in a **massive patent sale**.

Nortel's U.K. fund, which represents about 36,000 claimants, argued that paying each party about 71 percent of what they are owed is appropriate given the entangled relationship of Nortel's various estates.

Nortel is the “absolute paradigm case for pro rata distribution,” attorney D.J. Miller of Thornton Grout Finnigan LLP told the Toronto court.

Nortel's assets were never “ring-fenced,” Miller said, and multiple entities had a piece of the whole.

A pro rata payout is not barred by any legal principle, attorney Brian E. O’Connor of Willkie Farr & Gallagher LLP said in Delaware.

The fund's proposal is neither substantive consolidation nor a sub rosa plan, O'Connor said.

“Pro rata is an allocation metric, nothing more,” O'Connor said.

Nortel's U.S. arm argued that it should receive the bulk of the sale proceeds, since it was the telecom's largest and most profitable line of business.

More than 97 percent of the patents involved in the IP sale were U.S. patents, and the American debtors are entitled to “fair market value” for their exclusive licenses on those patents, attorney James L. Bromley of Cleary Gottlieb Steen & Hamilton LLP told the Delaware court.

Nortel's Canadian parent owned the American patents only through its equity ownership in the U.S. unit, Bromley said, countering the Canadian arm's **Monday argument** that it owned all the IP under a master research and development agreement that governed the creation and application of new technology.

The Canadian company "seeks to use the value of other estates to pay its own creditors," said Sheila Block of Torys LLP, an attorney representing the U.S. arm.

Whether the U.S. unit owned or held exclusive license to the patents is an unimportant distinction, Block told the Toronto court.

"It's not the label that matters, because these were the valuable rights that were sold," Block said.

Moreover, it should not be overlooked that the Canadian company was financially dependent on the U.S. wing, Bromley said.

Nortel's U.S. units contributed $453 million to the Canadian parent during the first 12 months of the bankruptcy to help fund a sale, Bromley said, and more than 75 percent of claims against the U.S. debtors stem from guarantees of $4 billion in bonds issued by the Canadian entities.

Nortel's U.S. creditors committee backed the proposal of the American debtor and said the allocation theory put forth by the U.K. pension fund should fail for a number of reasons.

The most fundamental flaw of the pro rata plan is that "it does not allocate to any estate the value of what that estate gave up in the sales process," said committee counsel Abid Qureshi of Akin Gump Strauss Hauer & Feld LLP.

The pro rata plan is results-oriented, and there is "no rule of international law that supports distribution on a single pool approach," Qureshi said in Toronto.

Creditors didn't believe there was one Nortel, and evidence demonstrates the corporate separateness between the telecom's units, Qureshi said.

An ad hoc committee of bondholders, representing noteholders owed about $2.2 billion, echoed the committee's support for the U.S. proposal.

The pro rata plan defies creditor expectations by treating Nortel as a single entity, said Andrew M. Leblanc of Milbank Tweed Hadley & McCloy LLP.

Underwriters provided the most important evidence that creditors viewed Nortel as distinct units, since they testified that Nortel Canada could get more money and better terms on its bond issue if the notes were guaranteed by the U.S. wing, Leblanc told the Delaware court.

U.S. Bankruptcy Judge Kevin Gross and Justice Frank Newbould of the Ontario Superior Court are jointly presiding over the trial from their courts in Wilmington and Toronto, respectively. Closing arguments are slated to wind up Wednesday morning.

After seeking court protection in the U.S., Canada and the U.K. in 2009, Nortel sold all of its major assets, raising about $9 billion, including $4.5 billion from a sale of its patent portfolio to a consortium of tech giants including Apple Inc. and Microsoft Corp.

Nortel, its global affiliates and other creditors had expedited the sale by agreeing to split the spoils at a later date, and about $7.3 billion in proceeds ended up in an escrow account in New York.

The parties **failed to resolve their differences** in mediation, however, and the **two courts ruled** in March 2013 that the allocation issue would be settled at a joint trial rather than in arbitration.

The trial got under way four months ago with opening arguments **May 12** and **13**.

In the Delaware court:
The U.K. pension plan is represented by Willkie Farr & Gallagher LLP and Bayard PA.

Nortel's U.S. arm is represented by Cleary Gottlieb Steen & Hamilton LLP and Morris Nichols Arsht & Tunnell LLP.

The U.S. creditors committee is represented by Akin Gump Strauss Hauer & Feld LLP and Richards Layton & Finger PA.

The ad hoc bondholders are represented by Milbank Tweed Hadley & McCloy LLP and Pachulski Stang Ziehl & Jones LLP.

The U.S. bankruptcy is In re: Nortel Networks Inc. et al., case number 1:09-bk-10138, in the U.S. Bankruptcy Court for the District of Delaware.

--Additional reporting by Matt Chiappardi and Lance Duroni. Editing by Brian Baresch.