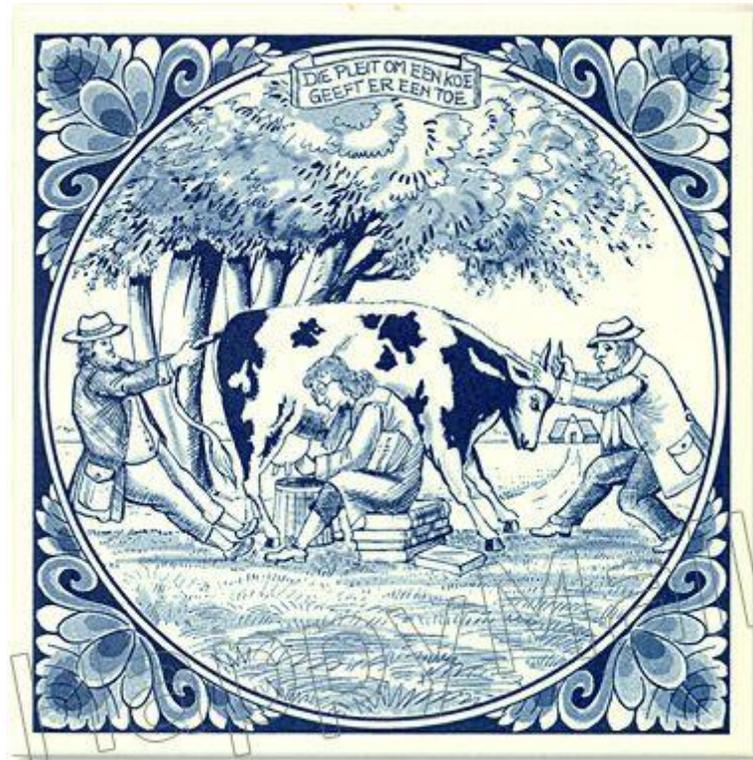


Cross-border Insolvency Litigation



Nortel Allocation and UKPC Claim

Or, how creditors fight over the cow and the lawyers milk it!



How cross-border insolvencies arise

Main proceeding in one country and recognition proceedings in another

1. CCAA filing in Canada
2. Chapter 15 Bankruptcy Code filing in the U.S.
3. Chapter 11 Bankruptcy Code filing in the U.S.
4. Section IV CCAA recognition filing in Canada

Most contentious issues dealt with in the jurisdiction of the main filing.

- Stay of proceedings ordered in the other jurisdiction
- Recognition of other orders in the other jurisdiction
- Some issues can be contentious, e.g. U.S. DIP financing order securing Canadian assets for the benefit of the U.S. Creditors. See *Re Payless Holdings Inc.* (2017), 47 C.B.R. (6th) 117; *Re Zochem Inc.* (2016), 33 C.B.R. (6th) 276.

Rare need for a joint hearing

Two or more main proceedings

Nortel is a good example

The Nortel Group consisted of more than 140 separate corporate entities located in 60 separate sovereign jurisdictions including Canada, the United States and the EMEA region, as well as the Caribbean and Latin America and Asia.

NNC, the Nortel Group's ultimate parent holding company, was publicly listed and traded on both the Toronto Stock Exchange and the New York Stock Exchange.

NNL was the Canadian operating company of the Nortel Group. NNL owned NNI, the main operating company in the U.S.

All of the EMEA and other Nortel companies were owned by NNL.

On January 14, 2009

Nortel Canada filed in Toronto under the CCAA

Nortel U.S. filed in Delaware under chapter 11 of the U.S. Bankruptcy

Nortel was more complex because there were 19 EMEA subsidiaries that filed for administration in the U.K. under the U.K. Insolvency Act

- A different regime with far less court intervention. The Administrator is the most important figure.
- Neither Nortel Canada nor Nortel U.S. sought recognition orders in the U.K.

Joint Hearings in the Canadian and U.S. courts became quite common as the same or similar relief was sought in both courts

Eg. Approval of sales of assets, joint creditor claims

Query- why no recognition orders in the U.K.

Nortel Cross-Border Insolvency Protocol

It is the norm when two or more main filings to have a cross-border insolvency protocol approved by both courts to govern the conduct of all parties in the Insolvency Proceedings

Some provisions:

Purpose and Goals

6. Though full and separate plenary proceedings are pending in the United States ...and in Canada ..., the implementation of administrative procedures and cross-border guidelines is both necessary and desirable to coordinate certain activities in the Insolvency Proceedings, protect the rights of parties thereto, ensure the maintenance of the Courts' respective independent jurisdiction and give effect to the doctrines of comity.

The Protocol contained a number of goals, including:

b. promote the orderly and efficient administration of the Insolvency Proceedings to, among other things, maximize the efficiency of the Insolvency Proceedings, reduce the costs associated therewith and avoid duplication of effort;

c. honor the independence and integrity of the Courts and other courts and tribunals of the United States and Canada, respectively;

C. Comity and Independence of the Courts

6. The U.S. Court shall have sole and exclusive jurisdiction and power over the conduct of the U.S. Proceedings and the hearing and determination of matters arising in the U.S. Proceedings. The Canadian Court shall have sole and exclusive jurisdiction and power over the conduct of the Canadian Proceedings and the hearing and determination of matters arising in the Canadian Proceedings.

Cooperation

12. To harmonize and coordinate the administration of the Insolvency Proceedings, the U.S. Court and the Canadian Court each may coordinate activities and consider whether it is appropriate to defer to the judgment of the other Court. In furtherance of the foregoing:

a. The U.S. Court and the Canadian Court may communicate with one another, with or without counsel present, with respect to any procedural matter relating to the Insolvency Proceedings.

d. The U.S. Court and the Canadian Court may conduct joint hearings (each a "Joint Hearing") with respect to any cross-border matter...With respect to any Joint Hearing, unless otherwise ordered, the following procedures will be followed:

(i) A telephone or video link shall be established so that both the U.S. Court and the Canadian Court shall be able to simultaneously hear and/or view the proceedings in the other Court.

(vi) The Judge of the U.S. Court and the Justice of the Canadian Court, shall be entitled to communicate with each other during or after any joint hearing, with or without counsel present, for the purposes of (1) determining whether consistent rulings can be made by both Courts; ...

The Protocol also provided that substantive rights of the parties were preserved.

Sale of Assets

In June, 2009 Nortel decided to sell its assets

The lines of business were sold for \$3.285 billion by March 2011. \$2.85 billion remained for allocation.

The residual IP was sold in an auction in June 2011 for \$4.5 billion to an IP consortium named Rockstar after a stalking horse bid from Google of \$900 million.

\$7.3 billion was set aside and had to be allocated to the various Nortel debtor estates.

Before the sale of assets an Interim Funding and Settlement Agreement (IFSA) was made in June 2009, signed by U.S. debtors, Canadian debtors, EMEA debtors and others. Terms included:

- The assets would be sold and later the allocation of the sales proceeds would be determined by an arbitration process to be agreed or by the U.S. and Canadian courts
- The EMEA debtors agreed to attorn to the U.S. and Canadian courts

Allocation Protocol

Its purpose was to set binding procedures for determining the allocation of the sales proceeds among the selling debtors (essentially all Nortel debtors)

The U.S. and Canadian courts were to determine the procedures to govern allocation protocol hearings and related discovery.

- It directed pleadings
- It directed the courts to set deadlines for production of documents and expert reports and dates for compelling deposition of fact and expert witnesses
- It provided for the courts to determine the rules governing the joint hearings on the merits
- It provided for the courts to determine the format of opening submissions, affidavits (which were to be the direct testimony at the hearing) and deadlines for filing
- It provided for the trial date (not met!)

Query- why not a three way protocol with EMEA?

Trial Procedure

Unique trial

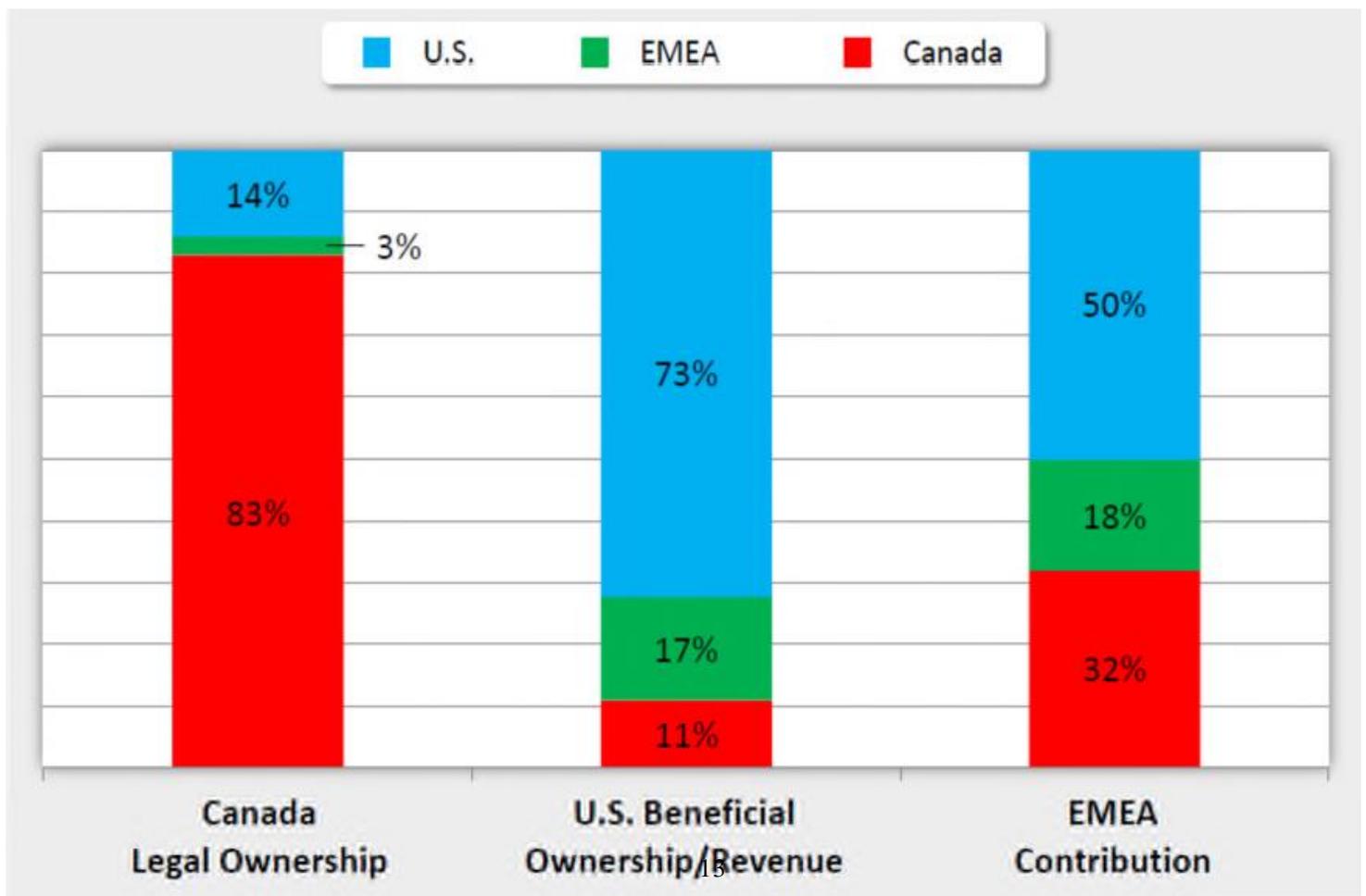
- Video hook-up of both courts
- Lawyers in both court rooms
- Witnesses in one or the other court rooms
- Daily transcripts
- Electronic record
- Streaming into law firms

Position of the parties

The Canadian Debtors contended for an allocation of \$6.034 billion to the Canadian Debtors, \$1.001 billion to the U.S. Debtors and \$300.7 million to the EMEA Debtors.

The U.S. Debtors contended for an allocation of \$0.77 billion to the Canadian Debtors, \$5.3 billion to the U.S. Debtors and \$1.23 billion to the EMEA Debtors.

The EMEA Debtors contended for an allocation of \$2.32 billion to the Canadian Debtors, \$3.636 billion to the U.S. Debtors and \$1.325 billion to the EMEA Debtors.



Allocation Decision

To understand it, a knowledge of how Nortel operated assists. (See Paras. 16 to 21 of the Canadian decision)

- 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.
- 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.
- R&D was the primary driver of Nortel's value and profit. NNL, NNI, NNUK, NNSA and NN Ireland were the principal companies that performed R&D.

- Because R&D was the primary driver of Nortel's value and profit, the residual profits of Nortel were paid to these five companies under a Master Research and Development Agreement ("MRDA") based on each company's expenditure on R&D relative to the R&D expenditure of all five.
- Under the MRDA, NNL was the legal owner of the Nortel IP and each of the other five companies was granted an exclusive license by NNL to make and sell Nortel products in its territory using or embodying Nortel intellectual property developed by Nortel companies anywhere in the world and a non-exclusive license to do so in territories that were not exclusive to any of the five.

Position of the Parties on MDRA

The Canadian debtors

- Under the MRDA, NNL owned the IP and the others were granted licenses to use IP only to make Nortel products created or marketed for Nortel.
- No buyer such as Rockstar bought the IP to make Nortel products. The proceeds of IP belonged to NNL.

The U.S. Debtors

- NNI and the other licensees held all of the rights and all of the economic value in the IP in their respective exclusive territories as defined in the MRDA.
- The U.S. was the largest market for Nortel products and entitled to the lion's share of the IP proceeds.

EMEA debtors

- Each party to the MRDA jointly owned all of the IP under common law and statutory principles in proportion to their percentage contributions to R& D. Joint ownership was recognized in the MRDA

Decision on the MRDA

Meaning of the MRDA

Judge Gross and I differed on the meaning of the MRDA, I essentially agreeing with the Canadian debtors' position and he agreeing with the U.S. debtors' position.

I held that under the MRDA, NNL had all ownership interests in the Nortel IP subject to the non-exclusive licenses to the other parties to make and sell Nortel products, which no buyer of the IP would pay for.

Judge Gross held that NNL had no rights to exploit Nortel IP in the U.S. Rather, the U.S. debtors had the exclusive economic and beneficial ownership of Nortel IP in the U.S. and it was theirs to sell to a buyer of the IP.

Effect of the MRDA on the allocation decision

Judge Gross and I agreed that the MRDA was not intended to govern the sale of all of Nortel's assets once in insolvency. It was only an agreement for transfer pricing purposes and to be operative only while Nortel operated its businesses as a going concern.

Power to make the award

Section 11(1) of the CCAA-

Section 11(1) –a court may make any order that it considers appropriate in the circumstances (para. 205)

The Ontario Superior Court has broad jurisdiction to make orders as required to fill in gaps or lacunae not covered by specific provisions in the CCAA and to make orders to do justice between parties (para 206)

Century Services Inc. v. Canada (Attorney General), 2010 SCC 60 at paras. 57-61 recognized that the CCAA was skeletal in nature and does not contain a comprehensive code that lays out all that is permitted, that an incremental exercise of judicial discretion with respect to the CCAA has been adapted and has evolved to meet contemporary business and social needs and that when large companies encounter difficulty and reorganizations become increasingly complex, CCAA courts have been called upon to innovate accordingly. (para. 207)

Modified Pro Rata approach adopted

This solution was based on the fundamental tenet of insolvency law that all debts shall be paid *pari passu* and all unsecured creditors are to receive equal treatment. (para. 209)

Para 211-

Directing a pro rata allocation will constitute an allocation as required. Once the lockbox funds have been allocated, it will be up to each Nortel Estate acting under the supervision of its presiding court to administer claims in accordance with its applicable law. A pro rata allocation can be achieved by directing an allocation of the lockbox funds to each Debtor Estate based on the percentage that the claims against that Estate bear to the total claims against all of the Debtor Estates.

Cash in each debtor estate was not included in the allocation. Thus a “modified pro rate allocation”.

Not substantive consolidation

Big objection raised by the U.S. debtors and bondholders based on *Owens Corning*, 419 F. 3d 195 (3d Cir. 2005)

Substantive consolidation allows for the combination of the assets and liabilities of two or more members of the group, extinguishes inter-company debt and creates a single fund from which all claims against the consolidated debtors are satisfied.

- some creditors may win and some may lose

However, the lockbox funds were largely due to the sale of IP and no one Debtor Estate had any right to those funds.

- It could not be said that these 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 (para. 214)

Appeals

In Ontario leave to appeal to the C of A was required under the CCAA

- Leave to appeal was denied - 2016 ONCA 332

In the US, an appeal taken to the District Court

- Mediation ordered
- Once the Ont C of A refused leave, the District Court judge on his own referred the case to the 3rd Circuit C of A
- Shortly thereafter the case settled

Allocation result

Can—	57.10%	--\$ US 4.1 B	(had claimed \$6.03 billion)
US—	24.35%	--\$ US 1.8 B	(had claimed \$5.3 billion)
EMEA—	18.55%	--\$US 1.3 B	(had claimed \$1.325 billion)

UKPC v. Nortel

2014 ONSC 6973; 20 C.B.R. (6th) 171

UK Pension Claimants made a massive claim against NNC and NNL (Nortel Canada) under two guarantee documents, under a UK long-arm provision in its Pension Act, and under oppression and unjust enrichment principles.

All claims except part of one on a guarantee were dismissed.

The Financial Support Direction (FSD) claim

Under the UK Pension Act, if a company has a pension deficit, i.e. less money in its pension fund than required to pay out future expected pension benefits, steps must be taken to restore the plan over time to have no deficit.

The FSD regime permits the regulator in the UK to issue a FSD to a related company requiring it to provide financial support to the underfunded company.

An elaborate regulatory system is set up for this purpose.

If the related target company fails to provide financial support in an amount satisfactory to the regulator, a Contribution Notice can be issued imposing a legal obligation on the target company to pay a specified amount to the trustee of the pension plan.

The NNUK pension plan was underfunded by U.S.\$3 billion when it filed for insolvency protection in the UK in January 2009.

The claim of the UKPC for in respect of this deficit was a contingent claim in the CCAA proceedings.

The claim was that had Nortel Canada not been protected by the stay of proceedings in the CCAA proceedings in Canada, a FSD and then a Contribution Notice would have been issued and enforceable against Nortel Canada.

- What were the chances that such a result would have been obtained in the UK?

Defences raised to the FSD claim

1. An exercise of foreign authority not to be permitted

Nortel Canada argued that Canadian courts will not enforce claims emanating from the sovereign authority of a foreign state. Eg. Penal, revenue or other public law claims

- Not dealt with

Nortel Canada argued that an FSD claim is a long arm statute authorizing the UK to claim in other countries in global insolvencies, and if such a claim were recognized, every country involved in international insolvencies would have no choice but to do the same thing by creating a similar regime. Thus on public policy grounds a Canadian court should not entertain the claim.

- I held that the issue was one for Parliament rather than the courts.

2. Was the contingent claim a provable claim

In Canada, a contingent claim at the time of the insolvency may be made if based on past actions or inactions. It must however not be too remote or speculative.

In *AbitibiBowater Inc., Re*, [2012] 3 S.C.R. 443 Justice Deschamps stated at para. 36-

“The criterion used by courts to determine whether a contingent claim will be included in the insolvency process is whether the event that has not yet occurred is too remote or speculative.”

The claim made was that after the filing date an FSD and a Contribution Notice would have been made but for the CCAA stay of proceedings. I held it was too speculative to be recognized.

Steps to a Contribution Notice under the UK legislation-

- (i) Whether the Regulator would seek leave of the CCAA Court to issue a Warning Notice that it is considering asking the Determinations Panel to issue an FSD, and whether the Court would grant leave permitting the Regulator to proceed to a hearing of the Determinations Panel.
- (ii) What date the Regulator would choose to determine the IR test.
- (iii) Whether the Determinations Panel would find that the IR test has been met such that it would be open to the Determinations Panel to issue an FSD.
- (iv) Whether the Determinations Panel would determine that it was reasonable to issue an FSD.
- (v) Whether if the Determinations Panel decided that it was reasonable to issue an FSD what the Upper Tribunal on an appeal would decide with respect to steps (iii) and (iv).

(ix) What amount the Determinations Panel would determine should be required in the Contribution Notice to be paid;

(x) Whether the Upper Tribunal would uphold a decision of the Determinations Panel to issue a Contribution Notice and, if so, in what amount.

The Determinations Panel was not particularly expert. The Upper Tribunal consists of legally qualified persons.

Only four FSD cases so far in the Determinations Panel, none being relevant. No cases in the Upper Tribunal so no judicial guidance at all.

Test of reasonableness was very broad, including benefits to Nortel and to NNUK.

Wide discrepancy of competing experts.

In the end, Canadian court being asked to speculate as to what would happen in the U.K.

3. Insufficiently Resourced test

If the value of the NNUK's resources was less than 50% of the cost to buy an annuity to pay the pension plan's pension liabilities, it would be insufficiently resourced.

If Nortel Canada's resources were sufficient to fund the shortfall, the IR test would be met and an FSD and a later Contribution Notice could be issued,

This involved a battle of competing valuation and legal experts. I accepted the Nortel experts.