The Trustees' perspectives on their recovery efforts: 2009 - 2018

Since Nortel Networks entered insolvency in January 2009, the Trustee has been on a journey to improve the financial position of the Nortel Networks UK Pension Plan ("the Plan").

To help others in a similar situation, we thought it would be helpful to set out some of the key questions that we needed to answer along the way.

1. ***Who was appointed as administrator of the Plan's employer?***
   Ernst & Young LLP ("EY") were appointed as administrators ("JAs") to the Nortel UK entity in January 2009. Their appointment also covered the other entities across the European subsidiaries ("EMEA").

2. ***What was the size of the Plan's section 75 debt (i.e. the claim that it had into the insolvent UK entity)?***
   Under the Pensions Act 1995, the Plan's section 75 deficit ("S75") (i.e. the difference between its existing assets and its liabilities on the statutory prescribed basis) crystallised as a claim against the UK employer when it went into insolvency. Our scheme actuary calculated this as £2.1bn, but it should be noted that this was the number as at January 2009, and the actual deficit has increased since that time.

3. ***What proportion of the UK creditor population was the Plan's deficit?***
   The Plan's deficit was more than 90% of the UK creditor base so we had a significant role in the UK administration. Together with the PPF, we had a strong voice on the UK Creditors' Committee. (The Plan did not have an accepted claim into the European entities.)

4. ***How and when did you engage with the PPF?***
   We engaged with the PPF as soon as we were aware of the insolvency, developing an excellent relationship with both the Head of Insolvency and Restructuring at the time, Richard Favier, and later on his successor, Malcolm Weir.

   Whilst a scheme is in a PPF assessment period, the rights and powers of the trustees in relation to the S75 debt are exercisable by the PPF. However, the ultimate economic beneficiary of any receipts from an insolvent estate will either be the PPF or the scheme itself, depending upon whether the scheme ultimately has enough money not to enter the PPF.

5. ***How well funded was the Plan?***
   At January 2009, on a PPF funding basis (i.e. with liabilities calculated at the level at which members would be paid out if they were to receive PPF-level rather than full benefits), the Plan was funded at about 70% which meant there was a deficit of £650m. It was not clear, at the date of insolvency, whether the Plan would receive enough funds from the insolvent estate to be able to pay benefits above PPF levels (and therefore not enter the PPF).

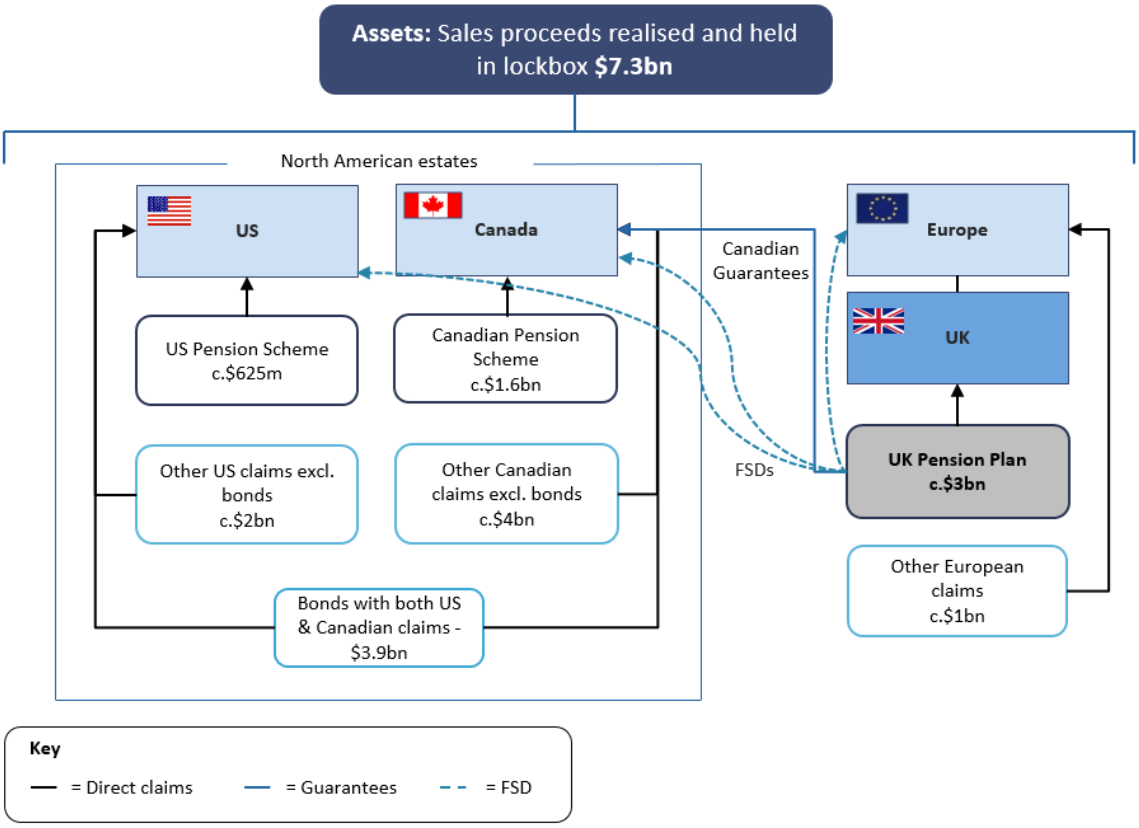
6. ***How and when did you engage with the Pensions Regulator?***
   While the PPF exercises powers over the S75 debt, it is the Pensions Regulator ("tPR") which has powers to help a pension scheme e.g.:
   - S72 - gives the Regulator power to obtain access to information from any entity, including the employer and its group;
   - Contribution Notice ("CN") - helps return money to a pension scheme where other parties have acted inappropriately; and
   - Financial Support Direction ("FSD") - a power designed to require stronger members of a corporate group to provide financial support to an underfunded scheme, where the less strong sponsoring employers cannot fully support it.

   We opened up a dialogue with tPR regarding which powers were appropriate to use on behalf of the Nortel Plan immediately following the January 2009 insolvency date.

7. ***How did you ensure you had the appropriate advisers in place?***
We needed to appoint legal advisers in the key Nortel operating countries of the UK, US and in Canada, as well as financial advisers in the UK. In each case we ran a competitive tender process to choose the best advisers. We needed to match the quality of advice that other competing Nortel creditors, e.g. bondholders, were receiving to ensure that we were properly prepared. We sought Beddoe Court approval for the actions we were taking throughout.

8. ***How did you decide what course of action to take?***
Our first step was to seek comprehensive financial advice. Our financial advisers performed an "Entity Priority Analysis" exercise which told us what both we and other creditors could expect to receive from the insolvent group under a number of scenarios. In performing this exercise, we analysed the other major creditor groups and what they expected to get back in the insolvency. This helped us understand what the Plan was likely to receive, and where the value lay in the group. We needed to pursue a policy of creditor activism which, though not common in the UK, is much more common in Canada and the US.

9. ***Diagram showing the major creditor groups in the Nortel insolvency***
There were four major creditor groups in the Nortel insolvency: the US bondholders ($3.9bn), the UK Plan ($3bn or £2.1bn), the Canadian pension scheme ($1.6bn), and the US pension scheme ($0.6bn). This is explained in the structure diagram below. We needed to understand the complexities of the competing claims across the global Nortel estate. The financial and legal advisers helped clarify this, so we could make the right strategic decisions.



10. ***What were the Nortel group's major assets?***
Value in the Nortel group consisted of cash, debtors and other non-cash business assets. Whilst it was fairly easy to understand the value of the cash and debtor balances, the potential sales value of the other assets was more complicated, in particular intellectual property.

11. Who owned the Lockbox assets?

The insolvency officers of all the legal entities had their own reasons to argue why their estates should receive the sales proceeds. Canada argued that they were the legally registered owners of the intellectual property, the US argued that they had the key customer contracts, and the UK argued that they had historically developed much of the intellectual property so they had a good claim on it. This is explained more fully in the attached legal paper.

12. Where were the sales proceeds held?

The different estates agreed to sell the business and intellectual property assets quickly to maximise sales proceeds, before the technology being sold lost value. The sales proceeds, which ultimately totalled more than $7bn, were held in an account with J P Morgan in New York, referred to as the 'Lockbox', until it could be agreed how they would be split between the different creditors.

13. Was the Plan able to make any claims into the non-UK entities?

Outside the Nortel experience, the issue of tPR's ability to enforce FSDs against overseas entities remains an open and unresolved question. In the case of Nortel, tPR issued FSDs against entities in the US, Canada and Europe. tPR argued that the Plan should be entitled to a return from assets in Group estates (even though the Plan was not a creditor of those estates) because the Group operated as one globalised unit. This was a complex legal question and is covered in more detail in the attached legal document.

There were also a few other claims that are worth mentioning. The Plan had two guarantees from the Canadian parent, which had been negotiated prior to the insolvency: first a guarantee of the UK Company's scheme funding commitments, and second a guarantee to be called upon should the UK Company enter insolvency, which was negotiated following a corporate reorganisation in 2007.

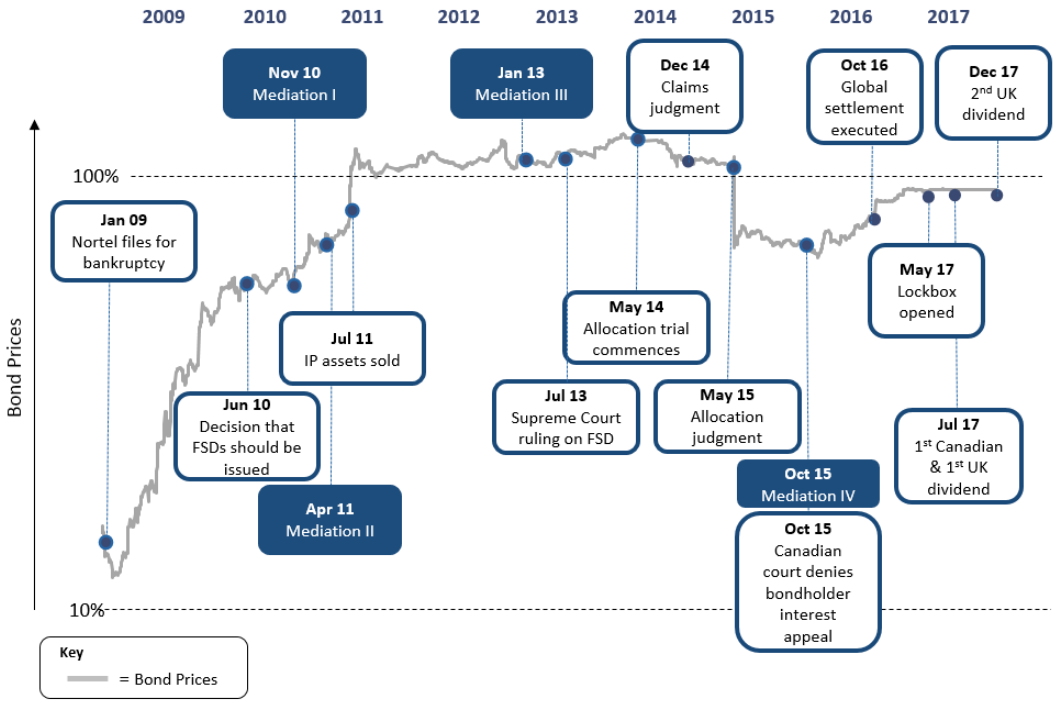
14. What were the other creditor groups expected to recover?

This evolved over time, as the expectations of different creditor groups changed in line with asset realisations. In addition, key developments in the case had an impact on the creditors' likely returns. This was illustrated by the changes in the bond prices below.

15. Chart illustrating key developments in the case with corresponding Nortel bond prices

This diagram provides a guide as to how the bondholders' expectations changed over time as major events in the case took place.

The bond price moved as the expected returns from the different estates around the world increased. The initial expectation post-bankruptcy was a very low return, as can been seen by the bond price at nearly 10% of face value. However, this rose sharply during 2009 as assets around the world were sold.



16. ***Was there an attempt to mediate a deal?***
    There were several attempts to reach a mediated solution, the first and second being in November 2010 and April 2011 respectively. It was apparent that there were not enough assets in the Lockbox to satisfy the needs of all parties and both mediations failed. There was also uncertainty over the value of the intellectual property that had not yet been sold. There was at this stage never a viable or acceptable settlement to be had.

17. ***Did the sale of the intellectual property assets help?***
    The sale of the intellectual property assets went better than expected (indeed, one of the North American parties described the sale "as if an enormous great safe had landed on our heads") and raised $4.5bn, increasing the total assets held in the Lockbox to some $7.3bn. We had hoped that this increased cash would make it easier to reach a mediated settlement. However, it did not help as the ultimate prize was now much larger and creditors' expectations increased. The bonds, not surprisingly, raised their expected return levels or traded out, and the new parties buying in were looking for a return themselves.

    A third mediation took place in Canada in January 2013 with a new mediator, but again it proved impossible to reach a deal. The US and Canada continued to maintain very polarised theories of how the Lockbox should be split.

18. ***How did you feel when the third mediation failed?***
    We were all very disappointed, and felt that there was no end in sight given the polarised positions of US and Canada. We were aware of the dangers of the case turning into "scorched earth litigation", with a disproportionate amount of the remaining cash being spent on legal and other fees rather than being returned to creditors.

19. ***How did you prepare for litigation?***
    After the third mediation, a cross-border insolvency trial was ordered between the US and Canadian bankruptcy courts, in order to determine how to allocate the Lockbox sales proceeds. Preparation for this litigation was very intense and involved a review of millions of documents and more than a hundred depositions in various parts of the world.

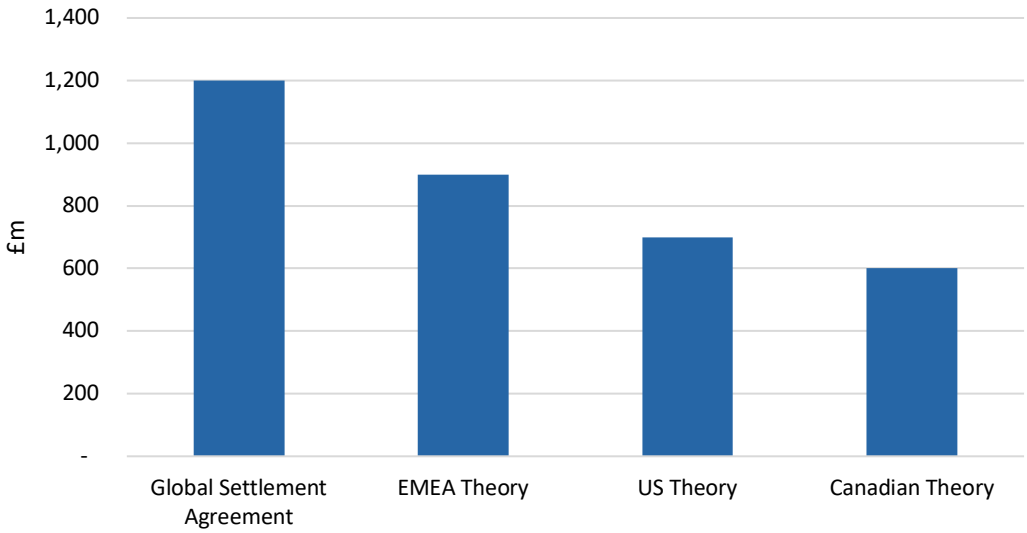
20. ***What was the biggest challenge?***
    The very polarised claims of the other parties. Canada laid claim to some 83% of the residual assets, and the US to 76%. Even without our claims, there was not enough to satisfy these ambitions.

21. ***What was the Trustee's litigation strategy?***
    We took the view that, given the global integrated nature of the Nortel Group, we should argue that it was most appropriate to allocate the assets in proportion to the Group's liabilities, whilst making some allowance for the bondholders' claim into the Canadian estate.

    The advantage of this theory was that it was, and would be seen by others to be, fair. The disadvantage was that the insolvency Courts had never sanctioned this kind of creditor distribution before, so there was no precedent to rely upon. The allocation theories put forward by the different estates are outlined overleaf. It shows clearly just how far apart the US and Canada were on going into Court.

22. Chart showing positions adopted at trial by the various parties and the resultant recoveries by the Plan

This chart shows the recovery to the UK Plan proposed by the different estates, compared to what the Plan ultimately expects to receive.



The figures above are based on a combination of different sources: public information, submissions from different parties during the trial, and informed assumptions.

23. What was the outcome of the trial?

It took the Judges a year to decide the outcome of the trial, and we were delighted when their ruling effectively adopted our proposed solution and allocated the proceeds according to creditor claims globally. This in fact proved to be the basis for the subsequent global settlement agreement.

24. Was the judgment the end of the story?

Unfortunately not, as those parties which saw themselves as having lost out as a result of the judgment immediately began appeal proceedings. There was a danger that, as the appeals had to be heard in two countries' Courts, it would still take several years to litigate and/or settle.

A fourth round of mediation was scheduled, and was lengthy; it took more than a year ultimately to execute a global settlement agreement.

25. Were you pleased with the outcome?

We were very pleased with the outcome. The UK share of the Lockbox was significantly higher than other parties had been prepared to give in their positions at trial.

26. What does this mean for Plan members?

At the start (9 long years ago), we feared that the recoveries may not be sufficient for the Plan to be able to pay benefits above PPF level. This deal means that the Plan is now very likely to have sufficient funds to achieve this, with a clear direct financial benefit to Plan members. The challenge for us throughout the case was to operate on an equivalent footing to other stakeholders. We succeeded in this and in getting a “seat at the table”. A continuing commitment to fight our ground has resulted in a very material improvement to members' benefits.