

Court of Appeal File No. M38748
Court File No. 09-CL-7950

COURT OF APPEAL FOR ONTARIO

**IN THE MATTER OF THE *COMPANIES' CREDITORS*
ARRANGEMENT ACT, R.S.C. 1985, c. C-36, AS AMENDED**

**AND IN THE MATTER OF A PLAN OF
COMPROMISE OR ARRANGEMENT OF
NORTEL NETWORKS CORPORATION, NORTEL NETWORKS LIMITED,
NORTEL NETWORKS GLOBAL CORPORATION, NORTEL NETWORKS
INTERNATIONAL CORPORATION AND NORTEL NETWORKS
TECHNOLOGY CORPORATION**

**REPLY FACTUM OF THE OBJECTING LTD BENEFICIARIES
(Motion for Leave to Appeal)**

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1. This is the reply factum of the Objecting LTD Beneficiaries to the facta of Nortel, the Monitor, Representative Counsel, CAW, the Board of Directors of Nortel, the Official Committee of Unsecured Creditors, and the Informal Nortel Noteholders (collectively, the "Responding Parties").¹

2. In their facta, the Responding Parties collectively herald the certainty that results from approval of the Amended Settlement Agreement. It is, however, entirely inconsistent with the spirit and purpose of the CCAA for such certainty to come at the expense of an equitable result. Certainty is not the driving settlement approval criterion and should not supersede fairness. The overriding objective should be to secure a just result, even if doing so minimally delays the CCAA proceeding.

¹ Capitalized terms herein, unless otherwise indicated, have the same meaning as they do in the Factum of the Objecting LTD Beneficiaries (Motion for Leave to Appeal).

3. The Responding Parties further emphasize the binding effect of the Amended Settlement Agreement. What they neglect to mention, however, is that the agreement only becomes binding upon court approval. The requirement for court sanction serves a critical gate-keeping function to ensure the fairness and reasonableness of a Plan or interim agreement to protect the rights and interests of minority groups directly affected by the proposed compromise. The fact that the court-appointed representatives and Representative Counsel had a mandate to negotiate an agreement on behalf of various employee groups cannot be the basis upon which a motions judge rests his finding that a compromise is fair and reasonable. This would eviscerate the purpose of court sanction.

4. The Responding Parties also tout the purported benefits of the Amended Settlement Agreement to “20,000 affected employees, former employees, pensioners and their survivors.” The LTD Beneficiaries, former employees, and pensioners are different groups with fundamentally different stakes in these proceedings. The Responding Parties have merged these two distinct constituencies together in order to support an argument that the overall agreement is fair when, in fact, it disproportionately prejudices the LTD Beneficiaries.

5. Of all Nortel’s stakeholders, the LTD Beneficiaries are the most directly impacted by the Amended Settlement Agreement. The analysis performed by the Objecting LTD Beneficiaries’ financial expert concludes that, even under favourable assumptions, recoveries for the LTD Beneficiaries will be minimal.² Further, it is not disputed that the

² Affidavit of Diane A. Urquhart (Financial Expert), sworn February 28, 2010, Motion Record of the Objecting LTD Beneficiaries (Motion for Leave to Appeal), Tab 25.

shortfalls suffered by pensioners will be much less on a pro-rata basis than those suffered by the LTD Beneficiaries. The benefits to the LTD Beneficiaries under the Amended Settlement Agreement are worth no more than \$12 million and, in exchange, they must surrender their rights to assert priority as beneficiaries of the HWT and to claim against third parties for the unexplained and significant shortfall and removal of funds from the HWT.

6. In the submissions below, the Objecting LTD Beneficiaries reply to a number of issues raised by the Responding Parties in their facts.

A. The Appointment of Representatives and Representative Counsel Does Not Neutralize the Right to Object

7. Representative Counsel asserts that “the proposed appeal purports to undercut the authority of the court-appointed representatives and representative counsel to exercise their mandate.”³ Likewise, the Monitor accuses the Objecting LTD Beneficiaries of “mounting a collateral attack that throws into doubt” the role of representatives and representative counsel in CCAA proceedings.

8. The Responding Parties misconstrue the purpose of the proposed appeal. The Objecting LTD Beneficiaries are not attempting to challenge the authority of the court-appointed representatives and Representative Counsel. Rather, they seek appellate intervention in order to set aside an agreement that is wholly unfair to the constituency most severely affected by the compromise and to protect the fundamental right of creditors to object to agreements entered into on their behalf. The need to meaningfully

³ Responding Factum of the Former Employees and Disabled Employees at para. 87.

protect this important procedural right requires particular attention and justifies appellate intervention in circumstances where the employee groups were expressly granted a right to object pursuant to the Notice Procedure Order.

9. The Responding Parties import great significance to the fact that the Objecting LTD Beneficiaries did not opt out of representation by Representative Counsel. The Monitor states that, in approving the Amended Settlement Agreement, the motions judge did not extinguish any rights of the parties and that “all of the parties who are bound by the [agreement] agreed to it.”⁴ Representative Counsel asserts that there was no unfairness because “the supervising judge implemented an extensive representation process and, through their representatives, [the employees] were armed with all relevant information and professional advice.”

10. However, the right to opt-out of representation by Representative Counsel months prior to the Amended Settlement Agreement being entered into is entirely irrelevant to the substantive fairness of the Amended Settlement Agreement and the procedural fairness of the notice process, including the right to object expressly provided by the Notice Procedure Order.

11. The Monitor and Nortel also attempt to distinguish *ABCP* on the basis that the Objecting LTD Beneficiaries “are bound by the agreement of their representatives and, therefore, the guiding principles for court approval of third-party releases do not apply.”⁵

⁴ Responding Factum of the Monitor at para. 49.

⁵ Responding Factum of the Monitor at para. 49; Responding Factum of the Applicants at para. 48.

This is incorrect and ignores the fact that the agreement was not binding on anyone until approved by the court. As noted, court sanction serves a critical gate-keeping function. An interim agreement is not “fair and reasonable” simply because the representatives have authority to negotiate on behalf of their constituency.

B. Evidentiary Disclosure and Content of Notice Was Not Meaningful

12. In their facts, the Responding Parties seek to diminish the significance of the inadequate disclosure by making bald statements that Representative Counsel had “all relevant information” to assess the claims being released before entering into the Settlements cannot be relied upon to overcome the inadequate notice. However, in order to validly exercise their right to object, the constituency of persons affected by an agreement must be adequately informed of the rights being compromised.

13. Here, the LTD Beneficiaries received notice that was devoid of meaningful content (having no mention of the over \$100 funding shortfall in the HWT) which, coupled with the aggressive timelines, deprived them of a sufficient opportunity to properly investigate and gather important information in order to validly object. Indeed, despite not having this critical information, the LTD Beneficiaries had an unreasonably short period of time to consider the Amended Settlement, which was executed on March 30th only one day prior to the March 31st approval hearing. This amounts to an egregious violation of fundamental procedural fairness, particularly considering the physical and mental challenges faced by this vulnerable group.

14. At paragraph 52 of its factum, Representative Counsel states that notice was effective because no prejudice resulted to the 39 Objecting LTD Beneficiaries who were represented by counsel at the March 31st hearing. However, this ignores the fact that the notice to the LTD Beneficiaries, as a constituency, was inadequate, as well as the fact that the Objecting LTD Beneficiaries' requests for an adjournment and additional disclosure were denied. As a result, it cannot be said that the Objecting LTD Beneficiaries had a meaningful opportunity to object.

C. No Basis for Inferring Majority Endorsement of the Amended Agreement

15. Representative Counsel and the other Responding Parties rely on the motion judge's statement that "the objections of 10% minority" should not "override the views of 90% of the LTD Beneficiaries who support the settlement through their court-appointed representative."⁶ In the circumstances of this case, there is no basis for the Responding Parties to infer that the remaining 90% of LTD Beneficiaries supported the Amended Settlement Agreement given that the notice disseminated to the LTD Beneficiaries was inadequate and, therefore, this constituency had no opportunity to meaningfully exercise their right to object. In fact, putting aside issues related to the lack of disclosure, the evidence demonstrates that feedback was only received from one third of the approximately 100 members of CNETED for whom Ms Kennedy had an email address. Of the people who responded, the majority of them supported the execution of the Amended Settlement Agreement. As a result, it can be reasonably extrapolated from the evidence that a small number of the total constituency endorsed the amended agreement.

⁶ Responding Factum of the Monitor at para. 41.

Moreover, as set out below, the approvals from this small subset of the LTD Beneficiaries were admittedly provided under a cloud of duress.⁷

16. For example, according to the submissions of CAW, CAW members were “angry, frustrated, [and] live in fear of what will come of them as a result of Nortel’s insolvency...”⁸ In addition, evidence of the LTD Representative also emphasizes the prevailing sentiment among LTD Beneficiaries was of “hopelessness and despair” and she indicated that members were “quite anxious and distressed” and “terrified” about getting their medical benefits cut off on March 31, 2010.⁹ These emotions do not evidence a true, fully informed endorsement of the Amended Settlement Agreement and are more reflective of coercion and duress than consensus.

17. The Responding Parties also rely heavily on the motion judge’s finding that “significant creditors in the CCAA proceeding” were “emphatic in stating that either the [Amended Settlement Agreement] be approved or benefits should cease.”¹⁰ However, while the views of other creditors may be relevant, the ultimate decision regarding the continuation of benefits is that of the motion judge based on the overarching principles of fairness and reasonableness. The position of other creditors should not carry the day. Here, the fact is that the motions judge has retained the ability to extend benefits for an

⁷ Affidavit of Susan Kennedy, sworn March 31, 2010 at paras. 13 and 15, Joint Responding Motion Record, Tab 4, page 22; Affidavit of Diane Urquhart, sworn March 30, 2010 at paras. 14, Motion Record, Tab 29 and 29G, pages 959-960, 1005.

⁸ Responding Factum of CAW at para. 41.

⁹ Affidavit of Susan Kennedy, sworn March 31, 2010, paras. 7, 10, 14, and 19, Joint Responding Motion Record, Tab 4, pages 20-23.

¹⁰ Responding Factum of the Monitor at para. 54.

interim period so that the LTD Beneficiaries could make a reasonably informed decision about whether to object to the Amended Settlement Agreement.

D. Representative Counsel's Analysis of Trust Claims

18. At paragraphs 73 through 81 of its factum, Representative Counsel addresses the breach of trust claims, including an analysis of the trust agreement for the HWT.

19. Representative Counsel did not provide this level of analysis at the March 3rd hearing where it merely relied on a bald assertion that any litigation in respect of the HWT was “risky, lengthy, uncertain, and costly.”¹¹ It has belatedly provided this analysis in an effort to demonstrate that there was sufficient evidence before the motions judge to permit him to exercise an objective, impartial and independent assessment of the fairness and reasonableness of the settlement, including, in particular, the broad third party releases relating to breach of trust claims. Regardless, the analysis now provided still falls well short of demonstrating that the breach of trust claims have no merit.

20. Representative Counsel's analysis focuses solely on select terms of the longstanding trust agreement. The Objecting LTD Beneficiaries disagree with Representative Counsel's analysis and submit that based on a reading of the entire contract, and consideration of the factual matrix underlying it, Nortel and the Trustee were obligated to ensure the HWT was properly funded. In any event, there is an overarching obligation upon a trustee to protect the interest of the beneficiaries beyond its

¹¹ Affidavit of Susan Kennedy, sworn February 23, 2010 at para. 41(d), Motion Record of the Objecting LTD Beneficiaries (Motion for Leave to Appeal) at Tab 25, page 696; see also Factum of the Former and Disabled Employees on the Motion to Expedite, p. 7, para. 24, as filed in Court File No. M38773.

contractual duties provided in the trust agreement.¹² Moreover, one cannot look at trust agreements in isolation. Justice Cory, for the majority of the Supreme Court of Canada in *Schmidt v. Air Products*, stated:

138 Documents not normally considered to have legal effect may nonetheless form part of the legal matrix within which the rights of employers and employees participating in a pension plan must be determined. **Whether they do so will depend upon the wording of the documents, the circumstances in which they were produced, and the effect which they had on the parties, particularly the employees.**

139 Foisy J. explained why courts will in specified circumstances bind an employer to the terms of a pension brochure in *Harris v. Robert Simpson Co.*, [1985] 1 W.W.R. 319 at 327 [34 Alta. L.R. (2d) 64] (Q.B.):

If it were otherwise then an employer could provide the employee with a brochure claiming to represent the significant and material terms in the company's pension plan. Yet the "true" plan could vary significantly from this representation without the employee's knowledge. In such a case it cannot be said that the "true" agreement prevails, as to do so would leave the door open to mischief.¹³ (emphasis added)

21. Representative Counsel attempts to distinguish *Froese v. Montreal Trust Co.* which decision has direct application to the Objecting LTD Beneficiaries' breach of trust claims. Representative Counsel asserts that *Froese* does not apply because Nortel had no obligation to fund the HWT and, therefore, the Trustee had no such obligation.¹⁴ The Objecting LTD Beneficiaries respectfully disagree with this analysis for the following reasons:

a) First, while Nortel may not have had a *statutory* obligation to fund the HWT, the question of whether it had a contractual obligation under the trust

¹² *Froese v. Montreal Trust Co. of Canada*, [1996] B.C.J. No. 1091 (B.C.C.A.) at para. 39, Brief of Authorities, Tab 7.

¹³ *Schmidt v. Air Products of Canada Ltd.*, [1994] 2 S.C.R. 611 at paras. 138-139, Supplementary Brief of Authorities, Tab 1.

¹⁴ Responding Factum of the Former Employees and Disabled Employees at para. 78.

documents or an obligation at common law or equity to fund the benefits, in circumstances where it undertook to self-insure such benefits, is an open issue requiring judicial determination. There was insufficient information before the motions judge to allow him to discount the viability of the trust claims being released.

b) Second, one cannot assess a trustee's obligations by exclusively considering a contractual arrangement between the employer and the trustee. Representative Counsel's analysis does not factor the reasonable expectations of Nortel's employees, including the LTD Beneficiaries, who, in light of Nortel's creation of a formal trust to protect assets from Nortel's creditors, would have been unaware of any risk created by Nortel's insolvency and could not have become aware of the risk absent a warning from the defendant.¹⁵

c) Third, contrary to the assertion by the Monitor at paragraph 46 of its factum that "much of the unfairness" to the LTD Beneficiaries is the result of Nortel's insolvency, the fact is the unfairness is the result of choices made about the HWT by Nortel, its directors, members of Nortel's pension committees, and the Trustee well before Nortel's insolvency.

22. In reply to paragraph 79 of Representative Counsel's factum, the assertion that all benefits were paid on a "pay-as-you-go" basis is incorrect. While medical and dental

¹⁵ See *Recchia v. Co-Operators Life Insurance Co.*, 2002 BCSC 712 at para. 12, Joint Brief of Authorities, Tab 28 and *Atco Lumber Ltd. V. Leech*, [2006] B.C.J. No. 707 at paras. 56-57, Joint Brief of Authorities, Tab 5.

benefits were paid on a “pay-as-you-go” basis, disability income, among other benefits, were funded by the HWT, which was established by Nortel to pre-fund and secure the funding of those benefits.¹⁶

23. In its factum, Representative Counsel has not provided any analysis of whether the LTD Beneficiaries’ breach of trust claims would succeed against the directors or members of Nortel’s pension committees who also received releases under the Amended Settlement Agreement. Its submissions also confirm that, in considering the likelihood of Nortel having improperly removed \$37 million from the HWT, Representative Counsel chose to simply rely on unaudited financial statements prepared as at December 31, 2008 which flagged those funds as “**due from Sponsoring Company.**”¹⁷ There is no indication that Representative Counsel obtained any further disclosure from Nortel or the Monitor relating to this “loan” in order to properly assess whether such funds would be impressed with a trust in the LTD Beneficiaries’ favour.

E. The Appeal Will Not Unduly Hinder the CCAA Proceeding.

24. In reply to paragraphs 54 and 55 of the Monitor’s Responding Factum, the Monitor incorrectly states that the granting of leave will hinder the CCAA proceeding. However, the granting of leave will in no way affect the position of the parties and simply enables this Court to address the issues on appeal.

¹⁶ Thirty-Ninth Report of the Monitor, paragraphs 56-68, Motion Record of the Objecting LTD Beneficiaries (Motion for Leave to Appeal), Tab 15, pages 472-474.

¹⁷ Responding Factum of the Former Employees and Disabled Employees at para. 47.

25. Further and in any event, the Montior incorrectly states the test for leave. The test is not whether the granting of leave to appeal will impede the CCAA proceeding; the test is whether the *appeal itself* will hinder the proceeding.

26. This Court has approved an expedited hearing of the appeal, if leave is granted, and this will minimize any undue hindrance to the CCAA proceeding caused by delay.

27. The Responding Parties state that allowing a full appeal will introduce uncertainty into the proceeding because it will throw into doubt payments that have been made under the Amended Settlement Agreement since March 31, 2010. Their concern is exaggerated. The reality is that, if this Court overturns the approval of the Amended Settlement Agreement, all parties will return to the bargaining table and recommence their good-faith negotiations with a view to treating the LTD Beneficiaries equitably. To do otherwise would amount to bad faith. Any suggestion that “there is no other deal to be had” should not be given **elevated significance**. Payments that have been made under the Amended Settlement Agreement can be addressed in the context of any subsequent settlement or, in the unlikely event that another deal cannot be struck, can be dealt with in the context of a final Plan through, for example, applying a credit for the payments. There is nothing inherently complicated about this.

28. The Responding Parties also state that overturning the Amended Settlement Agreement will result in potentially complex and lengthy litigation involving Nortel via claims for contribution and indemnity brought by the third parties that are released under the agreement. They do not acknowledge, however, that the prospect of potentially

lengthy and complex litigation exists regardless of whether approval of the Amended Settlement Agreement stands.

29. As the Responding Parties indicate in their facts, the Amended Settlement Agreement does **not** extinguish the LTD Beneficiaries' claims against Nortel arising from the HWT funding shortfall and improper removal of trust monies. Nortel has, however, never admitted liability for the funding shortfall or breaches of trust and, insofar as the LTD Beneficiaries will be filing such claims through Nortel's claims process, the prospect of potentially complex litigation involving Nortel remains. In effect, by approving the broad third party releases, the motions judge was more concerned with protecting Nortel from claims-over litigation from various third parties for contribution and indemnity than in allowing the LTD Beneficiaries to seek civil redress against those strangers to this CCAA proceeding for serious alleged breaches of trust.

30. Further, in terms of the extinguishment of the LTD Beneficiaries' priority rights as trust beneficiaries of the HWT, if this Court sets aside the decision approving the Amended Settlement Agreement, a motion for declaratory relief in respect of these rights could be heard on an interim basis in relatively short order. In this way, there would be a formal adjudication addressing the merits of the LTD Beneficiaries priority claims through an open and transparent process prior to such claims being formally extinguished in the absence of an appropriate evidentiary basis or a fulsome legal analysis. Such a hearing would not be complex and would not unduly hinder Nortel's liquidation.

F. CAW Members Have a Right to Object

31. In its responding factum, CAW raises as an additional issue the ability of Rochon Genova LLP to represent CAW members. Specifically, CAW argues that the Objecting LTD Beneficiaries cannot include CAW members.

32. First, it should be noted that only 2 of the 39 Objecting LTD Beneficiaries are CAW members. Second, and in any event, it is submitted that Rochon Genova LLP can properly represent these CAW members for the limited purpose of opposing the Settlements. In this regard, it should be noted that a CAW settlement notice sent to CAW members signed by CAW counsel's Barry Wadsworth dated February 8, 2010 expressly gave members the ability to seek representation for the purpose of opposing the agreement. The settlement notice titled "Important Update" stated (at page 3):

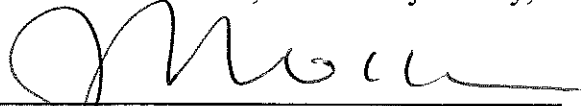
It must be noted that the Union, as a signatory to the agreement, cannot take a position opposing the agreement on your behalf and **you will have to represent yourself or seek other counsel for that purpose.**¹⁸ (emphasis added)

33. Further, the court approved notice letter issued by the Monitor also advises the current and former employee groups generally of the right to oppose the settlement and to attend at the approval hearing in person "or through legal counsel".¹⁹

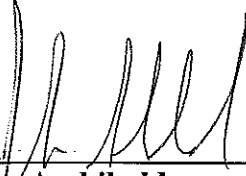
¹⁸ Exhibit "A" to the Affidavit of Laura Johnson, sworn February 25, 2010, Supplementary Motion Record of the Objecting LTD Beneficiaries, Tab 1A, p. 13.

¹⁹ Exhibit "B" to the Affidavit of Laura Johnson, sworn February 25, 2010, Supplementary Motion Record of the Objecting LTD Beneficiaries, Tab 1B, p. 16.

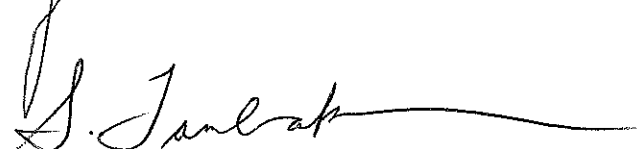
ALL OF WHICH IS RESPECTFULLY SUBMITTED, this 26th day of May, 2010.



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Schedule "A" – Authorities

1. *Schmidt v. Air Products of Canada Ltd.*, [1994] 2 S.C.R. 611.

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