

Diane Urquhart Notes on Key Points in the HWT Distribution Hearing  
 Ontario Superior Court of Justice, September 29th, 30th and October 1st  
 Presiding Judge: Justice Geoffrey Morawetz

## What is the Main Legal Issue in the HWT Distribution Hearing?

The HWT Distribution Hearing is about the interpretation of the words in the Termination Clause of the Nortel Health and Welfare Trust ("HWT") Trustee Agreement that was signed on January 1, 1980.

### ARTICLE VI - AMENDMENT AND TERMINATION

2. Upon sixty (60) days prior written notice to the Trustee, the Corporation may terminate its obligation to make Employer's contributions in respect of benefits after the date of written notice to the Trustee (hereinafter called the "Notice of Termination"). Upon receipt of the Notice of Termination the Trustee shall within one hundred twenty (120) days determine and satisfy all expenses, claims and obligations arising under the terms of the Trust Agreement and Health and Welfare Plan up to the date of the Notice of Termination. The Trustee shall also

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determine upon a sound actuarial basis, the amount of money necessary to pay and satisfy all future benefits and claims to be made under the Plan in respect to benefits and claims up to the date of the Notice of Termination. The Corporation and the designated affiliated or subsidiary corporations shall be responsible to pay to the Trustee sufficient funds to satisfy all such expenses, claims and obligations, and such future benefits and claims. The final accounts of the Trustee shall be examined and the correctness thereof ascertained and certified by the auditors appointed by the Trustee. Any funds remaining in the Trust Fund after the satisfaction of all expenses, claims and obligations and future benefits and claims, arising under the terms of the Trust Agreement and the Health and Welfare Plan shall revert to the Corporation.

J. Morawetz's decision is between two different interpretations of the sentence in the HWT Trustee Agreement Termination Clause shown in the box on page 1.

The timing of J. Morawetz's decision is as soon as possible bearing in mind the need to have an HWT distribution for December 31, 2010.

### **Who are the Parties at the HWT Distribution Hearing?**

Rochon Genova LLP's interpretation supports the Scenario 3 HWT distribution. The following law firms' and the CAW Canada lawyer have consented to agree with the Goodmans LLP's interpretation that supports Scenario 2 ("Opposing Lawyers").

- Goodmans LLP - for the Ernst & Young Nortel Court Monitor
- Sacks Goldblatt Mitchell LLP - for Sue Kennedy, the CCAA Court Appointed Representative of the Nortel Long Term Disabled Employees (Sue Kennedy has consented to Scenario 2)
- Lerner LLP - for Don Sproule, David Archibald and Michael Campbell, the CCAA Court Appointed Representatives of the Nortel Pensioners and Other Former Employees (Don Sproule, David Archibald and Michael Campbell have consented to Scenario 2)
- CAW Canada Lawyer - for the Long Term Disabled Employees and the Pensioners, who are members of the CAW Canada
- Shibley Righton LLP - for Kent Felske and Doug Sylvain, the CCAA Court Appointed Representatives for the Current Employees (Kent Felske and Doug Sylvain have consented to Scenario 2)
- Ogilvie Renault LLP - for Nortel

Both Scenario 2 and Scenario 3 provide settlement from the HWT for the Long Term Disabled Income Beneficiaries and the Survivors' Income and Transitional Income Beneficiaries ("Survivors Income Beneficiaries".) The difference in Scenario 2 is inclusion of a settlement from the HWT for Pensioners' Life Benefits.

### **What are the Consequences of J. Morawetz's Decision?**

Rochon Genova LLP's Interpretation of the HWT Trustee Agreement Termination Clause supporting Scenario 3, has the result of the Long Term Disabled Employees receiving an estimated settlement from the HWT of \$58 million. This is double the estimated settlement of \$29 million supported by the Opposing Lawyers, which includes the Goodmans LLP, lawyer for the Ernst & Young Nortel Court Monitor and Sacks Goldblatt Mitchell LLP ("SGM"), lawyer for Sue Kennedy.

<b>Settlement and Actuarial Liabilities \$ Millions</b>	<b>Scenario 2</b>	<b>Scenario 3</b>
LTD Settlement	\$30	\$58
Mercers LTD Actuarial Liabilities 2010	\$87	\$80
LTD Settlement Ratio	34%	72%
LTD Settlement	\$34	\$60
Higher LTD Actuarial Liabilities 2010 (Possible Difference in Determined Claims )	\$111	\$103
LTD Settlement Ratio	31%	59%

On the basis of the Mercers estimate of actuarial liabilities, for which limited disclosure of assumptions has been made to date, the settlement ratio in Scenario 2 is 34% and in Scenario 3 is 72%. Scenario 3 means

the difference of the Long Term Disabled Employees having considerably less poverty relative to Scenario 2. Scenario 2 causes certain poverty for the Long Term Disabled Employees, who do not have other savings to support themselves.

Joann Williams, one of the two senior actuaries retained by Rochon Genova LLP, has raised questions about the Mercers' estimate of actuarial liabilities for both the Long Term Disabled Income Benefits and the Pensioners Life Benefits in her Supplementary Affidavit sworn on September 23, 2010. The settlement ratios for the HWT distribution at December 31, 2010 will be lower for both Scenario 2 and Scenario 3, if the final actuarial liabilities accepted by the court for Long Term Disability Income Benefits are higher than Mercers' current estimate.

### **What is the Interpretation of the Ernst & Young Court Monitor and Goodmans LLP?**

The Ernst & Young Court Monitor and Goodmans LLP has read into the HWT Trustee Agreement Termination Clause that there should be settlement on the amount of money necessary to pay future benefits under the plan up to the date of the Notice of Termination covering both:

- (a) **the present value of future income benefits already in pay**, such as for the LTD and Survivors' Income Benefits; and
- (b) **the present value of claims that have not been made but would certainly have been made in the future**, namely the Pensioners' and LTD life insurance.

Goodmans Arguments of Law  
Appendix A  
Page 19, Point 64

64. With regard to future claims, it may be argued that (i) all claims for all future benefits vested under the Plans should be present valued and participate; or that (ii) only claims made prior to the date of the Notice of Termination, including the present value of future income payments for benefits already in pay, should participate. Given the language of the Trust Agreement as supported by Nortel's funding practices, the better view is that claims that have not been made but would certainly have been made in the future should participate in addition to those in (ii) above. Therefore, the following would participate for the actuarial

value of future benefits: pensioner life insurance, LTD income, SIBs and STBs in pay and, on balance, LTD life insurance.

The reasons given for supporting the read in of **the present value of claims that have not been made but would certainly have been made in the future** are:

- (i) Language of the HWT trustee agreement
  - i. The English of the HWT trustee agreement needs to be read in the context of the circumstances at the time the agreement was written. Pensioners' Insurance Plan is a Group Life Insurance Plan on the list of benefit plans covered by the Nortel "Health and Welfare Plan."

## WHEREAS:

1. The Corporation has established for the benefit of certain of its employees and the employees of such affiliated or subsidiary Corporations as the Corporation may designate, certain Health and Welfare plans, and such other similar plan or plans as the Corporation may from time to time place in effect, as follows:

- a) a Health Care Plan;
  - b) a Management Long Term Disability Plan;
  - c) a Union Long Term Disability Plan;
  - d) a Management Survivor Income Benefit Plan;
  - e) a Management Short Term Disability Plan;
- f) a Group Life Insurance Plan;

all of which are hereinafter collectively referred to as the "Health and Welfare Plan".

2. The term "Benefits" as used herein shall mean payment benefits as determined under the Health and Welfare Plan.

(ii) Nortel's funding practices

The HWT Financial Statements have notes that have the Pensioners' Insurance Plan on the list of reserved plans (plans for which the Fund holds assets) and have reserve assets allocated to the Pensioners' Insurance Plan.

1. DESCRIPTION OF THE FUND

The Health and Welfare Trust Fund (the "Fund") was established by Nortel Networks Limited (the "Administrator") on January 1, 1980 in order to provide a funding vehicle for the employee benefits programs for all eligible employees of Nortel Networks Limited and its Canadian subsidiaries (collectively, the "Company") under the following plans:

Reserved plans (plans for which the Fund holds assets)

- (a) Long-term Disability Plan
- (b) Survivor Income Benefit Plan
- (c) Pensioners' Insurance Plan
- (d) Employee - financed Group Life Plan (Group Life - Part II)

- (iii) Both Pensioners' and LTD future life benefits are vested and the court should not de-couple the Nortel estate and the HWT.

Nortel's obligation to pay the future Pensioners' death benefits and life insurance premiums and the LTD life insurance premiums is fused into the HWT having the same obligation to pay these life benefits.

The court is deciding upon the distribution of the "Health and Welfare Plan" referred to in the HWT Trustee Agreement and not upon the distribution of a "Health and Welfare Trust" as defined by Canada Revenue Agency Guidelines to Income Tax Act provisions governing a "Health and Welfare Trust."

Income tax act provisions and related guidelines for their interpretation by the Canada Revenue Agency on Health and Welfare Trusts have no bearing on the legal distribution of HWT assets on HWT wind-up.

- (iv) Death is certain to occur in the future.
- (v) The court should approve Scenario 2 because it has the consent of the Representatives of the Nortel Pensioners and Other Former Employees, the Representative of the Long Term Disabled Employees, the Representatives of the Current Employees and the CAW Canada upon the recommendation of their legal counsel named above. The Court Monitor recommends Scenario 2 and Nortel supports Scenario 2.

## **What is the Interpretation of Rochon Genova LLP on Behalf of the Dissenting Long Term Disabled Employees?**

Rochon Genova LLP argues that the interpretation of "to pay future benefits under the plan up to the date of the Notice of Termination" must be compliant with current income tax law and generally accepted actuarial principles and practices.

Rochon Genova LLP says the Court Monitor should not read into the HWT Trustee Agreement Termination Clause the words "**the present value of claims that have not been made but would certainly have been made in the future,**" since these words are not compliant with current income tax law and generally accepted actuarial principles and practices. Furthermore, the reading of these words into the HWT Trustee Agreement to support Scenario 2 will cause certain poverty for the Long Term Disabled Employees, who do not have other savings to support themselves.

Goodmans LLP argues that J. Morawetz must not permit Rochon Genova LLP to read into the HWT Trustee Agreement Termination Clause the words "**incurred claims.**" Rochon Genova LLP argues that if any words are to be read into the Termination Clause it is these two key words that have a well accepted implication for an obligation to pay future benefit payments under both current income tax laws and generally accepted actuarial principles and practices.

According to the sworn affidavits of senior actuaries Joann Williams of Welton Parent Inc. and Jeremy Bell of the British Columbia Health Care Trust, current income tax laws and generally accepted actuarial principles and practices rely on the principle of "incurred claims." This fundamental principle of "incurred claims," is that future benefit payments are obligations only if they relate directly to the insured or self-insured events that have already taken place prior to the termination of the contract promising to pay these benefits.



For example the future income payments for the LTD and Survivors' Income Benefits are obligations because the disabilities and deaths have respectively already occurred before the termination of the HWT. On the other hand, the future cash proceeds from death benefits and life insurance for the Pensioners and LTD employees relate to their deaths that have not occurred prior to the termination of the HWT. Plus, the future life insurance premiums are not owed, just like the future insurance proceeds are not owed, on group life insurance policies after they have automatically terminated on Nortel's receivership or bankruptcy.

More details on the Rochon Genova LLP legal arguments in support of Scenario 3 are as follows:

- (i) Where there are two possible interpretations of the HWT Trustee Agreement Termination Clause, one of which does not comply with the law, and the other which complies with the law, then the court should adopt the interpretation that complies with the law.

In this case, the Scenario 2 interpretation of the 1980 HWT Trustee Agreement does not comply with current income tax law. While the 1980 HWT Trustee Agreement complied with income tax law when it was written in 1980, the income tax law was changed in 1986 through Canada Revenue Agency Interpretation Bulletin 85R2 ("IT85R2"), which says:

"The purpose of this bulletin is to describe the tax treatment accorded to an employee health and welfare benefit program that is administered by an employer through a trust arrangement and that is restricted to

- (a) a group sickness or accident insurance plan (see 2 below),
- (b) a private health services plan,
- (c) a group term life insurance policy, or
- (d) any combination of (a) to (c)."

Interpretation of the current income tax laws do not permit the Pensioners' Insurance Plan to be fused into the HWT because HWT's are restricted to group term life insurance policies. The Pensioners' Insurance Plan, comprising Nortel's promise to pay life benefits from retirement age to death, is not on the HWT list of eligible benefit plans. So the tax efficient vehicle, the HWT that Nortel chose to execute its promise to pay life benefits from retirement age to death is itself restricted from delivering upon the promise that Nortel made.

- (ii) Nortel's past funding practices as it relates to its book-keeping within the HWT Financial statements are to be ignored in the decision.
  - the HWT Financial Statements are not audited in recent years.
  - Nortel has had a history of accounting irregularities that have been the subject of securities law violation settlements, class

action lawsuit settlements and pending Canadian criminal prosecutions against three top Nortel executives.

- The Advanced Tax Ruling in 1979 that permitted a transfer into the HWT of \$11 million from a former Mutual Life pensioners' life insurance arrangement was compliant with income tax law at the time, but became non-compliant after the 1986 income tax change in IT85R2. The 1986 reserve assets allocated to the Pensioners' Insurance Plan was not placed into a single trust at the time, but left commingled in the HWT with the LTD and Survivors' Income Benefit Plans. The 1986 grandfathered reserve assets of \$25 million notionally allocated to the Pensioners' Insurance Plan was depleted by Pensioners Life Insurance Premiums paid out of the HWT assets between 2000 and 2010.
- Nortel changed to a "No Funding Policy" for Pensioners' Life Insurance coverage in 1999 when it stopped making employer contributions into the HWT for pensioners' life insurance and officially so in 2002 when Mercers' acknowledged this new "No Funding Policy" in its last actuarial report for funding on the Pensioners' Insurance Plan.

(iii) Rochon Genova LLP asks that the court's decision be on the legal arguments of who qualifies as beneficiaries to receive settlement from the HWT wind-up. The HWT is a distinct bona fide trust, the kind of trust described in IT85R2, not an operating division of Nortel and the single trust vehicle Nortel chose to execute its Health and Welfare Plan described in the HWT Trustee Agreement.

Rochon Genova LLP's disagrees with the Goodmans LLP's legal argument that the court is deciding upon a distribution of the "Health and Welfare Plan" referred to in the HWT Trustee Agreement. It says the court is deciding upon the distribution of the "Health and Welfare Trust," which is a specific type of trust defined

by Canada Revenue Agency Guidelines to the Income Tax Act provisions governing a "Health and Welfare Trust."

Rochon Genova LLP argues that legally only the Long Term Disabled and the Survivor Income Beneficiaries are the beneficiaries of the HWT. The Pensioners are only legally entitled to receive one year of life insurance premiums for the period ending December 31, 2010 out of the HWT assets based on the March 31st Settlement Agreement and the HWT's group term life insurance policies for the Pensioners being terminated at that time.

- (iv) Rochon Genova LLP argues that "death being certain" is not the issue to be decided. The certainty is that the HWT and its qualifying group life insurance policies are being terminated at December 31, 2010 and the future deaths of the Pensioners and LTD employees are not occurring prior to these terminations.
- (v) Rochon Genova LLP repeated its understanding that J. Morawetz had made his assurance at the September 19, 2010 case conference with the parties' lawyers that his decision on the HWT distribution would be made strictly on legal principles and that the Monitor's recommended Scenario 2 would not be offered as an agreement entered into by the Representatives on behalf of the constituent employee groups.

What happened at the September 29th hearing is that the Court Monitor's lawyer and the legal counsel for the Representatives of the three employee groups all urged J. Morawetz to give weight to the consent agreement amongst the Representatives for the three employee groups supporting Scenario 2.

Rochon Genova LLP argued that Lerner's LLP, Sacks Goldblatt Mitchell LLP and Shibley Righton LLP did not have court status as Representative Counsel for the three employee groups since this was an HWT Distribution hearing, where the HWT is not an entity

under CCAA. Koskie Minsky LLP is the Representative Counsel for the pensioners, former employees and long term disabled continuing employees in the Nortel CCAA proceeding. Shibley Righton LLP is the Representative Counsel for continuing employees in the Nortel CCAA proceeding.

- (vi) The Long Term Disabled Employees Income Benefit constitutes a Wage Loss Replacement Plan under CRA Interpretation Bulletin IT428. Accordingly, even if the benefits are not insured with a licensed insurer, the principles of insurance must be respected. From paragraph 7 of Interpretation Bulletin IT428:

"If, however, insurance is not provided by an insurance company, the plan must be one that is based on insurance principles, i.e., funds must be accumulated, normally in the hands of trustees or in a trust account, that are calculated to be sufficient to meet anticipated claims. If the arrangement merely consists of an unfunded contingent reserve on the part of the employer, it would not be an insurance plan."

### **What Will Not Be in the J. Morawetz HWT Distribution Decision?**

This HWT Distribution is a settlement only of the estimated \$80 million in the HWT for December 31, 2010.

J. Morawetz is not making a decision on whether the Nortel Canada estate needs to restore alleged misappropriated HWT assets, which was an alleged wrongdoing in the affidavit of financial expert Diane Urquhart.

- \$32 million HWT assets withdrawn in 2005 and 2006 to pay for pensioners' medical claims and the actives' and LTD employees' medical claims and life insurance premiums, during a 12 month moratorium when Nortel did not make employer contributions into

the HWT to fund these pay-as-you-go employee benefits on a flow through basis.

- \$27 million loan granted to Nortel for past employer contributions to fund the LTD and Survivors' Income Benefits by way of IOU rather than in cash.

The J. Morawetz decision does not cover settlement for post December 31, 2010 claims for:

- medical benefits to age 65, death or recovery
- medical benefits post retirement
- pension accruals from now to retirement
- defined benefit plan options for cash commuted value or deferred annuities upon the Long Term Disabled Employees' termination on December 31, 2010 and the wind-up of the Nortel pension plans
- defined contribution pension plan employer contributions
- core and optional life insurance to age 65, death or recovery, if Scenario 3 is approved
- core life insurance post retirement, if Scenario 3 is approved.

### **Can Justice Morawetz's Decide Between Scenario 2 and Scenario 3?**

The Opposing Lawyers say that J. Morawetz must accept or reject Scenario 2 in his decision for this September 29th hearing. If he rejects Scenario 2, the Opposing Lawyers say that the next step is to send the dispute on the HWT Distribution to litigation, which involves all the

beneficiary parties' legal and expert fees being paid from the HWT assets as agreed to in the March 31st Settlement Agreement.

Rochon Genova LLP says J. Morawetz has the jurisdiction to approve Scenario 3 now and that the court need only consider Scenario 2 or Scenario 3. However, since the Opposing Lawyers are seeking more time to have the opportunity to prepare further legal arguments pertaining to Scenario 3, Rochon Genova LLP has expressed its support for reconvening a continuation of this hearing in the near future to enable the Opposing Lawyers to present their additional arguments relating to Scenario 3.

### **What were the Incremental Legal Arguments of SGM on Behalf of Sue Kennedy?**

Sacks Goldblatt Mitchell LLP agreed with the Court Monitor's recommendation to adopt Scenario 2 for all the reasons given by Goodmans LLP. Its reasons include that Sue Kennedy has consented to Scenario 2 in agreement with the consent for Scenario 2 from the other Representatives named in CCAA Representative Court Orders and the CAW Canada.

SGM argued that it supported Scenario 2 since Sue Kennedy had considered his law firm's advice that there was considerable risk if Scenario 2 is not adopted and the HWT distribution went to litigation. The risk is that the court could decide amongst many other Scenarios that provided a worse settlement for the Long Term Disabled Income Beneficiaries than Scenario 2.

SGM argued it was not necessary for it to bring a sworn affidavit from its independent actuary, John Christie, since Sue Kennedy had consented to Scenario 2 after consulting with independent actuary John Christie, as well as with the Nortel actuary, Mercers, and the Koskie Minsky LLP actuary, Segal, who is working with both the Pensioners and Former

Employees and the Long Term Employees in the Nortel CCAA proceeding.

Also, SGM argued that if Scenario 2 was not adopted by J. Morawetz that the matter would need to go to litigation which would cause delay in the HWT's distribution beyond December 31, 2010 causing a problem for the Long Term Disabled Employees whose income payments would stop at that time.

SGM presented to the court its position that it had the requisite Representative Counsel status for the HWT Hearing since Sue Kennedy was a powerful woman, with the responsibility as Representative for the Long Term Disabled Employees under the Representative Counsel Order for the Nortel CCAA proceedings, to retain and instruct independent legal counsel.

In reply, the CAW Canada legal counsel seemed to concur with Rochon Genova LLP that he and Joel Rochon were the only legal counsel in the courtroom officially representing a constituency group of employees.

### **Were There Any Other Issues Raised by Goodmans LLP on Behalf of the Court Monitor?**

Goodmans LLP has requested that J. Morawetz disqualify the sworn affidavits of both senior actuaries, Joann Williams and Jeremy Bell, of financial expert, Diane Urquhart, and of Nortel Disabled Employee, Arlene Borenstein. The Goodmans LLP reason for disqualifying the expert affidavits was that actuarial and financial expert opinions were not necessary for the court to establish a fair and reasonable decision on the HWT distribution based on law arguments. Goodmans LLP rejected Arlene Borenstein's affidavit because it was focussed on the Motion put forward by Rochon Genova LLP on the alleged conflicts of interest of Koskie Minsky LLP in representing both the Pensioners and Former Employees and the Long Term Disabled Employees.



Rochon Genova LLP argued that all the expert evidence must be taken into account in the HWT Distribution decision. The firm conceded in this HWT distribution hearing the Arlene Borenstein affidavit portions describing the alleged conflict of interest by Koskie Minsky LLP providing legal counsel for both the Pensioners and Former Employees and Long Term Disabled Employees.

Rochon Genova LLP counter-argued that actuarial and financial experts are acceptable and necessary to give substance to law arguments. It said the experts were not opining on the legal interpretation of the HWT Trustee Agreement, but providing context for defining a proper legal interpretation taking into account tax, actuarial and financial considerations.

Goodmans LLP pointed out a description error in Point 31 of the Diane Urquhart affidavit, which was corrected in the court record.

Pt. 32 - The distribution of the \$32 million of benefits paid from the HWT are as follows:

- i) **pensioners' medical benefits --\$16 million;** [Corrected from pensioners' life insurance premiums. Description was correct in Pt. 30 and Table 5 and hence the error is acknowledged as a description typing error and not an analytical error.]
- ii) actives' medical benefits and life insurance premiums-- \$11 million; and,
- iii) LTD medical benefits and life insurance premiums--\$5 million.