

**ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)**

**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**

**APPLICATION UNDER THE *COMPANIES' CREDITORS ARRANGEMENT ACT*,
R.S.C. 1985, c. C-36, AS AMENDED**

AFFIDAVIT OF JOANN WILLIAMS

**I, JOANN WILLIAMS, of the City of Ottawa, in the Province of Ontario,
SOLEMNLY SWEAR AS FOLLOWS:**

1. I submit this affidavit in response to a motion brought by the Monitor¹ for an Order, among other things, approving the proposed methodology for allocation of the corpus of the Applicants' Health and Welfare Trust (the "Nortel HWT") (the "HWT Allocation Motion"). A summary of my qualifications and experience is provided in an earlier affidavit sworn by me on August 9, 2010, which is also being filed in connection with the HWT Allocation Motion. As a result of my education and experience, as well as my review of the publicly available documents regarding the Nortel HWT, including the

¹ All defined terms used in this affidavit that are not otherwise defined herein, have the meanings ascribed in the Fifty-First Report of the Monitor dated August 27, 2010 (the "Fifty-First Report").

Fifty-First Report and the Appendices thereto, I have knowledge of the matters to which I hereinafter depose to, except where stated to be based upon information and belief.

2. For the reasons set out in my affidavit sworn August 9, 2010, I do not believe that Pensioner Life benefits are eligible to participate in the proposed wind-up distribution of the Nortel HWT. This is because upon wind-up of the Nortel HWT, the liabilities should be calculated **only in respect of claims for insured events occurring up to the date of the wind-up**. In the case of LTD income benefits, the “insurable events”, namely the events of disability, have already occurred. Accordingly, the claims for disability income payments will have occurred prior to the Notice of Termination and the ongoing monthly disability income payments constitute ongoing benefits in respect of those claims.

3. On the other hand, future premiums payable to third party insurers for group life insurance after the wind-up date are not incurred expenses; nor are they liabilities of the Nortel HWT on wind-up. As a result, no portion of the Nortel HWT should be allocated on account of premiums related to the cancelled insurance coverage that would have applied to future contingent events given that the available funds are insufficient to satisfy all existing claims for previously “insured events” (such as those for LTD income benefits).

4. My conclusion that only incurred claims should be paid out of the Nortel HWT on termination is consistent with the express wording of termination provisions of the Trustee Agreement which provides, in Article VI:

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 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.

5. It is clear that the termination language of the Nortel HWT provides only for the payment of future benefits and claims “up to the date of the Notice of Termination”. I disagree with the analysis in the legal memorandum prepared by *Goodmans LLP* at paragraphs 52(ii), 52(v), 54 and 64 that the payment of life insurance premiums – whether for pensioners or disabled – is a benefit that is captured by the termination clause in the Nortel HWT Trustee Agreement.

6. The *Goodmans LLP* Memorandum of Law found at Appendix B of the Fifty-First Report states at paragraph 52(ii) that the “pensioners life is permanent (and not term) insurance”. An examination of the Sun Life documents found at Appendices L and M contradict this statement. Further, it is not permissible to hold permanent insurance policies in a Health and Welfare Trust. As set out in my affidavit sworn August 9, 2010, only group term life insurance policies are permissible. While such benefits may give rise to claims against Nortel, I do not consider the payment of premiums for future life insurance coverage to represent an obligation of the Nortel HWT on termination.

7. The Nortel HWT was established as at January 1, 1980 pursuant to an Advance Income Tax Ruling dated December 28, 1979 (Appendix J to the Fifty-First Report). It has consistently been referred to as a “Health and Welfare Trust” throughout the relevant documentation and it was clearly established with a view to optimizing the tax status of the contributions and benefits.

8. Following the issuance of Interpretation Bulletin IT-85R2 *Health and Welfare Trusts for Employees*, as published by the Canada Revenue Agency, dated July 31, 1986, certain changes to the administration of the Nortel HWT were required in order for the tax advantages of a Health and Welfare Trust to be preserved.

9. In the absence of information to the contrary, I have assumed that Nortel continued to deduct all of its contributions made to the Nortel HWT from its operating income as they were made. I also assume that group term life insurance premiums were not taxable benefits to employees / pensioners until they were actually paid them from the Nortel HWT. These considerations, along with the tax returns filed by the Nortel HWT itself (Appendix N to the Fifty-First Report), are consistent with the characterization of the Trust as a *bona fide* Health and Welfare Trust for tax purposes; accordingly, any allocation of the Nortel HWT assets on wind-up should produce a result that is consistent with the applicable funding rules.

10. In this regard, I do not believe that it is possible for the level of reserve assets allocated to Pensioner Life to have arisen from tax-deductible contributions to a Health and Welfare Trust. The current prohibition against deducting prepaid insurance considerations is found in subparagraph 18(9)(a)(iii) of the *Income Tax Act (Canada)*. Since 1994, a Health and Welfare trust may purchase insurance for a term of longer than one year, but it must be under a *bona fide* group term life insurance policy. Since at least 1986, no deductible contributions could have been made for life insurance unless they were in the form of premiums actually paid to an insurer during the year.

11. In accordance with Interpretation Bulletin IT-85R2, paragraphs 11 and 12:

Taxation of Trust

11. A trust which invests some of the contributions received and earns investment income, or has incidental income (other than contributions from employers and employees which are not included in computing income of the trust), is subject to tax under section 104 on the amount of such "trust income" remaining after the deductions discussed in 12 below. Where gross income (i.e., the aggregate of its income from all sources) exceeds \$500 in the taxation year (and in certain other circumstances indicated on the form), the trustee is required to file form T3 (Trust Information Return and Income Tax Return).

12. In computing trust income subject to tax, the trust is allowed to deduct, to the extent of the gross trust income, the following expenses, premiums and benefits it paid, and in the following order:

(a) expenses incurred in earning the investment or other income of the trust,

(b) expenses related to the normal operation of the trust including those incurred in the collection of and accounting for contributions to the trust, in reviewing and acquiring insurance plans and other benefits and for fees paid to a management company to administer the trust, except to the extent that such expenses are expressly not allowed under the Act,

(c) premiums and benefits payable out of trust income of the current year pursuant to paragraph 104(6)(b). Benefits that are paid out of proceeds of an insurance policy do not qualify. Other benefits paid are normally regarded as having been paid first out of trust income of the year. However, premiums and benefits that would not otherwise be taxable in the hands of the employee by virtue of paragraph 6(1)(a) may be treated at the trustee's discretion as having been paid out of prior year's funds or current year's employer's contributions, to the extent that they are available, to avoid the application of subsection 104(13).

The remainder of the income of the trust is subject to income tax under section 122 of the Act. As an inter vivos trust, the taxation year of the trust coincides with the calendar year. (emphasis added)

12. The Nortel HWT tax returns (Appendix N to the Fifty-First Report) demonstrate compliance with this paragraph in that all investment income is declared. Expenses are the first deduction from income. Following that, claims and premiums may be deducted up to the point where the fund has no taxable income.

13. In accordance with the underlined section of excerpted paragraph above, insurance premiums and benefits paid during the year are normally regarded as having

been paid first out of trust income for the year. The amount of investment income earned by the Nortel HWT in a given year appears to always be less than the premiums and benefits paid out. **Therefore any realistic notional accounting for reserves would not include investment earnings.**

14. In my experience with pension plans I note that, on wind-up, any notional accounting that may have been used by the administrator prior to the wind-up is not used in the distribution of assets, regardless of the purpose of such accounting. As the Nortel HWT is also constituted as a single trust, I would expect the same principle to apply.

15. However, to the extent that it may be relevant to the Court, I will briefly summarize the inconsistencies between the notional reserve accounting being used by the Nortel HWT as compared to the historical tax status of the contributions and benefits.

- The Pensioners' Insurance Fund (the "PIF") was shown as \$25,144,897 in the Nortel HWT Financial Statements for the year ended December 31, 1986, the year following the changes to the tax regime.
- As previously mentioned, no investment income would be allocated to this fund, as the premiums for group term life insurance would first be paid using the investment income during the year.
- If the investment income was insufficient to fund the insurance premiums, the additional premium could be paid from the PIF or by a new deductible

contribution. However such a contribution would go directly on to the insurer and would not add to the PIF.

- In my opinion the PIF could not have increased significantly from its 1986 value.
- In later years when Nortel began contributing less than the cost of premiums and benefits each year, any reasonable notional accounting would have had seen the PIF decreasing in order to pay the requisite premiums to the third party insurer.

16. In summary, the wind up liabilities should be calculated in accordance with a funding basis consistent with the tax considerations that have applied since the inception of the Nortel HWT. The Nortel HWT is first and foremost a vehicle for the tax effective funding of employee benefits; the current regime does not provide for the tax-deductible funding of future insurance premiums.

17. As a result, based on the actuarial, tax and insurance principles discussed in my earlier affidavit, I do not believe that the Monitor's recommended scenario appropriately reflects the wind-up obligations of the Nortel HWT. I have reviewed the Monitor's allocation scenarios and believe that the scenario in Appendix D-1, column 3 is most consistent with my opinion as to how the Nortel HWT assets should be distributed.

18. Beyond determining whether Pensioner Life benefits would qualify for participation in the Nortel HWT wind-up, I have concerns relating to the actuarial liabilities of the various potential benefits/plans. As confirmed by the Monitor at paragraph 90 of the Fifty-First Report, "the Mercer 2010 HWT Preliminary Valuation

was prepared solely for the purpose of providing a preliminary valuation of the non-pension post retirement benefit plans and post employment benefit plans to assist with the analysis of the Proposed Allocation Methodology and is the basis for distribution of the HWT corpus.”

19. Given the significance of the Nortel HWT distribution and the amounts in issue, I believe proceeding with the distribution based on a preliminary actuarial report would be unfair. The significance and potential impact of proceeding with the distribution based on the preliminary actuarial liability estimates would be elevated if the Court determines that pensioners should be participating beneficiaries of the Nortel HWT on account of Pensioner Life benefits.

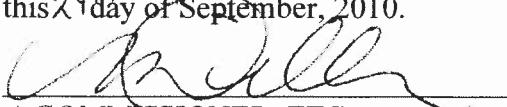
20. It also bears mention that the actuarial liabilities for LTD income is disclosed to be \$79.9 million, down from the \$103 million estimate in the Mercer 2009 actuarial report previously filed. While I recognize that the assumptions used in the 2010 report for wind-up purposes differ from assumptions appropriate for accounting, the important assumptions are the same for all benefits considered. As a result, one would expect that the relative value of the resulting liabilities would remain unchanged. However, where the 2010 report shows a significant decrease for the LTD income liabilities, the Pensioner Life liabilities appears to have increased from the estimates in the 2009 report.

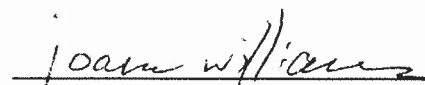
21. In this regard, I note that page 21 of the report for 2009 (Appendix FFF to the Fifty-First Report), shows the accrued benefit liability for life insurance is \$134,559 as at December 31, 2008 and \$128,402 as at December 31, 2009. These are the figures that have been transferred to page 6 of the Nortel HWT Financial Statements for December

31, 2009 (Appendix PP to the Fifty-First Report). **However, these accounting figures do not represent the actuarial liability for life insurance.** The actuarial liability is referred to as the “accrued benefit obligation” or “ABO” for accounting purposes. That item is shown at the top of page 21 of the accounting report. Thus, the actuarial liability at December 31, 2008 should have been shown in the Nortel HWT Financial Statements as \$105,840 (not \$134,559). It is also worth noting that the part of the total \$105,840 relating to Pensioner Life is \$97,244. While a similar breakdown has not been shown as at December 31, 2009, I can say that the liability for Pensioner Life at December 31, 2009 is less than \$121,464.

22. I believe it would be helpful to the Court for these discrepancies to be explained prior to the hearing of the HWT Motion. Alternatively, while the allocation method could be decided now, I believe it would be appropriate for a final determination of the amounts to be decided based on a final actuarial report.

23. I swear this affidavit in response to the HWT Allocation Motion, and for no other purpose.

AFFIRMED BEFORE ME at the)
City of Ottawa, Province of Ontario)
this 24th day of September, 2010.)
)
A COMMISSIONER, ETC.)



JOANN WILLIAMS

MOIRA SARA DILLON
Barrister & Solicitor
Notary Public & Commissioner of Oaths
in and for the Province of Ontario.
My commission is of unlimited duration.
No Legal advice given.



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