

**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**

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(HWT Distribution Motion returnable September 29, 2010)

Date: September 27, 2010

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NETWORKS GLOBAL CORPORATION, NORTEL NETWORKS INTERNATIONAL
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**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**

FACTUM OF THE DISSENTING LTD BENEFICIARIES

PART I: OVERVIEW

1. The Monitor¹ seeks an order approving a methodology for the allocation of the corpus of the Nortel Health and Welfare Trust (the "HWT"). The Monitor's recommendation² contemplates a *pro rata* distribution between beneficiaries whose claims are "in pay", namely, those with income claims presently being paid, including LTD income benefits **and** those whose claims are said to be "certain to be payable at some future date" which, according to the Monitor, includes claims for the payment of future premiums for Pensioner Life insurance benefits.

¹ All defined terms 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").

² As set out at Appendix D-1, column 2 ("Scenario 2"), of the Monitor's Motion Record.

2. While the Dissenting LTD Beneficiaries largely agree with the structure of the analysis provided by counsel for the Monitor (“Goodmans”) in its memorandum of law, these LTD Beneficiaries respectfully disagree with the conclusion that future Pensioner Life benefits, which represent the payment of annual premiums **on one year term life insurance policies**, are entitled to participate in a distribution of the HWT.

3. The Dissenting LTD Beneficiaries have assembled a compelling case supported by two of Canada’s highest ranking actuaries, a renowned senior financial analyst and a company insider (the past Treasurer of Nortel and member of the Pension Investment Committee) who have collectively **provided detailed reasoning as to their support of Scenario 3** in addition to analyzing the complex financial productions to assist the court.

4. On the other hand, neither the Monitor, nor the proposed independent counsel, have produced any evidence from an actuary or analyst in response. The expert evidence filed by the Dissenting LTD Beneficiaries cannot be lightly brushed aside. Given the seriousness of the issues before the Court, this is not the time to invoke technical arguments or make unfounded attacks on well-regarded and suitably qualified experts so as to avoid an honest debate of the issues on the merits.

5. The plain reading of the termination provision of the HWT Trust Agreement demonstrates that only the claims of the HWT actually *incurred* prior to the Notice of Termination can participate in the wind-up distribution. Such claims would include the ongoing future income payments which flow from claims incurred up to the date of the Notice of Termination. This interpretation is consistent with tax, actuarial and insurance

rules, principles and practices that apply to HWTs, as well as the publicly available documentation related to the HWT.

6. Conversely, there is no reasonable interpretation of the termination provisions of the HWT Trust Agreement which would allow for a conclusion that future premium payments owing to a third party insurer in respect of coverage beyond the date of termination should be paid from the trust.

7. In recommending the inclusion of extraneous future claims, the Monitor ventures beyond the plain wording of the termination provision of the Trust Agreement and advocates for an overly expansive interpretation of these provisions in order to capture future claims (that may never come to pass) and is off side the tax rules that govern HWTs.

8. The former Treasurer of Nortel and past member of the Nortel Pension Investment Committee stated clearly in his affidavit responding to the implications of Scenario 2 where future life premiums would be paid from the HWT to the detriment of the disabled: **“this was never the intention of the Nortel Pension Investment Committee”**.

9. This motion is of the highest importance to the LTD Beneficiaries. It represents the LTD Beneficiaries' last meaningful opportunity to cushion the fall resulting from the massive funding shortfall in the HWT. As the LTD Beneficiaries' rights to bring action against the trustees and others responsible for the funding shortfall have been

extinguished through the terms of the Settlement Agreement approved on March 31, 2010, there are no other remedies available to the LTD Beneficiaries.

10. The LTD Beneficiaries are also the most profoundly affected by the underfunding in the HWT and have the greatest comparative need among all potential beneficiaries. Therefore, apart from being justified by the plain reading of the termination provisions of the Trust Agreement and plan documents, as well as actuarial and tax principles, a distribution in accordance with Scenario 3 yields the only just result.

11. Many disabled have serious chronic, life threatening conditions with no prospect of ever again being gainfully employed. Most require exorbitantly priced medications to live with dignity. A drastic cut in disability income payments would force the LTD Beneficiaries to rely on social assistance and will push them **below the poverty line**.

12. It must not be forgotten that at least \$30 million was removed from the HWT when Nortel engaged in a moratorium on making contributions in 2005/2006 and paid medical and life insurance benefits to pensioners directly from the assets of the HWT, as confirmed by Nortel's past Treasurer and the analysis of an independent financial analyst. This action had a massive impact on the Nortel disabled population and enured to the benefit of the pensioners.

13. The bottom line from an equitable perspective is that **the average LTD Beneficiary will lose approximately \$72,000 if Scenario 2 is chosen**. Conversely, the selection of Scenario 3 over Scenario 2 would result in the average pensioner foregoing just **\$3,500 in total**. Here, in these unique circumstances, and after considering all of the

facts, it is respectfully submitted that it would lead to an injustice to invoke the maxim “equality is equity” as suggested by the Monitor. It must be recalled that this is a principle of last resort. The allocation methodology ultimately approved by the Court should adequately address the equitable considerations in play in these proceedings.

14. It is respectfully submitted that appropriate methodology for allocation of the HWT assets upon the HWT wind-up is that shown in Appendix D-1, column 3 to the Fifty-First Report (“Scenario 3”).

PART II: FACTS

A. Background

15. Nortel applied for and was granted protection from creditors under the CCAA pursuant to an Initial Order dated January 14, 2009. The Initial Order provided that Nortel was “entitled but not required” to make payments in respect of, among other things, employee benefits, after the CCAA filing.

16. The Nortel HWT has been operated such that certain employee benefits such as disability and survivor income benefits have had employer contributions placed into the trust for the purpose of accumulating trust assets to pay claims, whereas other employee benefits such as medical and dental costs, or life insurance premiums, have been funded

by Nortel employer and employee contributions on a “pay-as-you-go” basis and paid through the Nortel HWT as an administrative matter.³

17. After the Initial Order, Nortel continued to make employer contributions to pay for pensioner and LTD medical and dental benefits, and LTD life insurance benefits after the Initial Order. LTD income benefits and survivor income benefits, as well as retiree life insurance benefits, were paid from the Nortel HWT assets without new employer contributions being made into the HWT.

18. As confirmed by subsequent disclosures, principally through the Monitor’s Thirty-Ninth Report, and the schedules thereto, at the time Nortel filed for CCAA protection, the HWT was significantly underfunded relative to the actuarial liabilities of the various plans by approximately \$100 million.⁴

19. On March 31, 2010, this Court approved the Settlement Agreement that has the effect of bringing to an end disability income and benefits for the LTD Beneficiaries after December 31, 2010. In exchange for the payment of these limited benefits pending the cut-off date, the Settlement Agreement entirely releases those responsible for breaches of trust in relation to the funding shortfall as well as the improper removal of approximately \$32 million in trust assets.

20. The Settlement Agreement further provides that the settlement parties would work towards a court approved distribution of the HWT corpus in 2010.

³ Affidavit of Arlene Borenstein (Plante), sworn August 10, 2010 (the “Borenstein Affidavit”) at para. 38.

⁴ Borenstein Affidavit at para. 7.

B. The Conflict of Interest of Koskie Minsky LLP and the “Independent Legal Counsel”

21. On June 24, 2010, *Koskie Minsky LLP* issued a progress report which highlighted the still ongoing involvement of *Koskie Minsky* on the HWT allocation issues. This progress report stated that pensioners would be entitled to share in the distribution of the HWT in relation to Pensioner Life benefits.⁵

22. As a result of the concern that *Koskie Minsky* or its experts would agree to or recommend a distribution methodology that would allow pensioners to inappropriately share in the HWT distribution, the Dissenting LTD Beneficiaries instructed Rochon Genova LLP to investigate HWT distribution issues for the purpose of bringing a motion for a representation order for LTD Beneficiaries on the basis that *Koskie Minsky* was in a conflict of interest in representing Former Employers and LTD Beneficiaries, both of whom were potential beneficiaries of the underfunded HWT.

23. On August 6, 2010, while the motion for a representation order was being finalized, *Koskie Minsky* issued another progress report which disclosed the potential conflict of interest and advised that each of the two groups represented by *Koskie Minsky* “have sought independent legal advice” with respect to the allocation of HWT assets. The names of independent counsel were not then disclosed. The progress report further indicated that the Monitor would be making a proposal for the allocation of

⁵ Borenstein Affidavit, exhibit “V”.

the HWT assets and “that interested beneficiaries will have an opportunity to make submissions to the Court on that proposal and on the distribution of the assets”.⁶

24. Following inquiries, it was confirmed that independent counsel were retained in mid-June. Despite the apparent recognition of conflict at this time (mid-June), *Koskie Minsky* was still apparently in discussions with the Monitor and Nortel at the time of its **June 24, 2010 progress report**. The Fifty-First Report indicates that *Koskie Minsky* was involved in in-person meetings and telephone discussions on HWT allocation issues since June 2010.⁷

25. Based on subsequent confirmation from the Monitor that the Dissenting LTD Beneficiaries would indeed be entitled to make submissions as to the appropriate distribution of the HWT assets, and that the **allocation motion would be based on legal principles – i.e. the Monitor’s recommended scenario would not be offered as an agreement entered into by the Representatives on behalf of the employee constituents** – the motion of the Dissenting LTD Beneficiaries for an order appointing Rochon Genova LLP as representative counsel for LTD Beneficiaries was adjourned *sine die*.

26. The foregoing also suggests that there is no significance in terms of the test to be applied to the entitlement and distribution questions raised by this motion to the fact that the employee representatives have “consented” to the order proposed by the Monitor.

⁶ Borenstein Affidavit, exhibit “G”.

⁷ Fifty-First Report at para. 106.

27. Beyond the problems associated with what appeared to be the continued involvement of Koskie Minsky *subsequent* to the recognition of a potential conflict, it also appears as though *Sack* and *Lerners* have both continued to rely the advice obtained by the same actuary originally retained by *Koskie Minsky*, namely, Segal and Company (“Segal”). In this regard, the proposed new independent counsel have failed to take all necessary steps to remove themselves from the taint of an expert conflicted in the exact same manner as *Koskie Minsky* is conflicted from acting for both sides of a serious dispute.

28. Segal, it would appear through the reports and recently received facts, has remained the primary actuary for *both* the LTD Beneficiaries and the pensioners and has never “stepped aside” in terms of developing, presenting actuarial evidence and participating in negotiations with the Monitor on behalf of *either* the LTD Beneficiaries or pensioners.

29. The result of the apparent continued involvement of a key conflicted expert at the heart of this important process is that the LTD Beneficiaries have been prejudiced by not having an independent actuary.

30. Despite having a budget of \$7,500 to hire an actuary, the proposed independent counsel for the LTD Beneficiaries has not as yet produced an actuarial report or affidavit. Despite this, *Sack* has, without any serious reservation, endorsed the Monitor’s recommendation on allocation without having offered any actuarial evidence in support of its position. Proposed independent counsel for the pensioners has similarly failed to offer the evidence of any independent actuary to support its position.

31. In these circumstances, it is respectfully submitted that the submissions of *Sack* and *Lerners* must carry little or no weight and the Court need not retroactively sanction their appointment as counsel for the constituents they seek to provide independent legal advice to.

C. The Experts Evidence Filed by the Dissenting LTD Beneficiaries

32. On the other hand, the Dissenting LTD Beneficiaries have filed expert affidavits from two of the highest ranking actuaries in Canada, a renowned senior financial analyst and a company insider, namely the past Treasurer of Nortel and member of the Pension Investment Committee, all of whom have **provided detailed reasoning as to their support of Scenario 3** in addition to analyzing the complex financial productions to assist the Court. As noted, proposed independent counsel have filed no evidence in response.

33. One of the actuaries relied on by the Dissenting LTD Beneficiaries, Jeremy Bell ("Bell"), is a Fellow of the Society of Actuaries and a Fellow of the Canadian Institute of Actuaries. These designations represent the highest professional standing as an actuary.⁸

34. Initially, Bell worked as an actuary in the pension consulting field for Mercers. These are the same consultants who are advising Nortel. At Mercers Bell determined

⁸ Affidavit of Jeremy Bell sworn September 3, 2010 ("Bell Affidavit") at para. 4.

reserves and funding requirements for pension plans and provided advice on related matters to clients.⁹

35. Subsequently, Bell has become the Chief Actuary and Chief Investment Officer of the Healthcare Benefit Trust, one of the largest health and welfare trusts in Canada covering over **80,000 active** members and over **6,000 disabled members** with current assets of approximately \$750,000,000.¹⁰

36. Joann Williams (“Williams”) is also a Fellow of the Society of Actuaries and of the Canadian Institute of Actuaries. Williams was also the Acting Superintendent of Pensions for the Province of Nova Scotia from 1996-1997, where she acted as the provincial regulator ultimately responsible for the administration of the *Pension Benefits Act* and the regulation of all private pension plans in the province.¹¹

37. Since 1997, Williams has provided actuarial consulting services for Welton Parent Inc., an Ottawa firm of actuaries, and is frequently engaged to prepare actuarial valuations and provides advice on funding contributions for self-insured Health and Welfare Trusts established to comply with the requirements of the Canada Revenue Agency (“CRA”).¹²

38. Further, Diane Urquhart’s (“Urquhart”) qualifications as an expert are also unassailable. Urquhart’s experience includes being on the Executive Committee of

⁹ Bell Affidavit at para. 5.

¹⁰ Bell Affidavit at para. 8; Affidavit of Jeremy Bell sworn September 23, 2010 (“Supplementary Bell Affidavit”) at para. 2.

¹¹ Affidavit of Joann Williams, sworn August 9, 2010 (the “Williams Affidavit”) at paras. 4, 6.

¹² Williams Affidavit at para. 7.

Scotia McLeod and Director of Investment Strategy and the Managing Director of Research and Institutional Equities at Burns Fry (the predecessor to BMO Nesbit Burns). Urquhart has served as the Court Appointed financial analyst expert under the Representative Counsel Order of Justice Colin Campbell dated April 15, 2008 for retail owners of non-bank asset backed commercial paper in the *ABCP CCAA* proceeding. She has thus been accepted as an expert by this Court. Urquhart's exhaustive review and analysis of the voluminous recent disclosures made by the Monitor is for the purpose of assisting this Court in making a fair determination as to the appropriate allocation of HWT assets.

D. Tax, Actuarial, and Insurance Principles Apply to the HWT

39. Non-pension employee benefits are frequently structured as Health and Welfare Trusts ("HWTs") in order to secure the favourable tax treatment afforded to such trust arrangements under Interpretation Bulletin IT-85R2, dated July 31, 1986, titled Health and Welfare Trusts for Employees, as published by the CRA.¹³

40. In accordance with CRA Interpretation Bulletin IT-85R2, the types of benefits that may be administered by an employer under an HWT arrangement are restricted to:

- a) group sickness or accident insurance plans;
- b) private health services plans;
- c) group term life insurance policies; or
- d) any combination of a) to c).¹⁴

¹³ Williams Affidavit at para. 9.

¹⁴ Williams Affidavit at para. 10.

41. While the benefits, other than life insurance, provided through an HWT may be self-insured, in order to qualify as a “private health services plan”, the self-insurance of extended health care benefits must comply with CRA Information Bulletin IT339R2 - Meaning of Private Health Services Plan. Similarly, in order to comply as a “group sickness or accident insurance plan” with reference to paragraph 10 of this affidavit, self-insurance of the long-term disability (“LTD”) benefits must comply with Information Bulletin IT-428 titled Wage Loss Replacement Plans, dated April 30, 1979.¹⁵

42. The income replacement provisions of the Nortel HWT for employees on long-term disability (“LTD Beneficiaries”) constitute a Wage Loss Replacement Plan under CRA Interpretation Bulletin IT-428. 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 IT-428:

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 contingency reserve on the part of the employer, it would not be an insurance plan.

43. Under an income-replacement benefit plan, Disabled Life Reserves (DLR) reflect the obligation of the insurance company for benefit continuation beyond policy termination. Once a claim is admitted and payments commence, the insurance company becomes liable for future benefit payments, usually through age 65, provided the individual continues to qualify under the terms of the benefit plan. The reserve reflects

¹⁵ Williams Affidavit at paras. 22-25.

the present value of future benefit payments and claim-related expenses, adjusted for mortality and recovery assumptions, and discounted for projected interest earnings.¹⁶

44. **Employers may deduct contributions to HWTs in the year the legal obligation to make the payment to the trust arises. An employer's contributions must not exceed the amount required to provide the health and welfare benefits and payments cannot be made on a voluntary or gratuitous basis.** The nature of the employer's legal obligation to make contributions is governed by the terms of the trust agreement. The contribution requirements must be enforceable by the trustee(s) should the employer decide not to make the payments required.¹⁷

45. In order to constitute a legitimate deduction, an employer contribution must not be made in respect of benefits that are "contingent" in nature.¹⁸ A lump sum contribution to an HWT is fully and immediately deductible **to the extent that it represents the expected value of a future obligation at the time of the *insurable event*.**¹⁹ Therefore, the entire value of the income benefits expected to be paid to a LTD Beneficiary is an expense ***incurred at the time of the insurable event*** (i.e. the disability claim) and the present value of future disability income payments may be deducted in the year of disability.²⁰

46. In contrast, **future premiums paid to third party insurers for group term life insurance are *not* incurred expenses** and, if group term life insurance is funded through

¹⁶ Williams Affidavit at para. 25.

¹⁷ Williams Affidavit at para. 11.

¹⁸ *Canadian Pacific Limited v. Ontario (Minister of Revenue)*, 1998 CarswellOnt 3537 (Ont. C.A.)

¹⁹ *Ibid.* at para. 43.

²⁰ Williams Affidavit at para. 12.

an HWT as an administrative matter (as was the case with the Nortel HWT), the premiums paid to the insurance company are only deductible at the time they are paid. The payment of premiums for future coverage periods would not be a deductible expense for an employer and there would be no accumulation of assets in an HWT to fund life insurance coverage into the future.²¹

47. This tax treatment is consistent with accepted actuarial practice where the objectives of funding a HWT are the systematic accumulation over time of dedicated assets to secure the plan's benefits in respect of members' service already rendered and the orderly and rational allocation of contributions among time periods. The focus is on valuing liabilities where the expected value of liabilities assumed in a given a period will define the minimum level of premiums required to fund these benefits. It would be difficult for insurance companies to continue to operate in absence of contributions generally exceeding liabilities already incurred.²²

48. For example, the Healthcare Benefit Trust, an HWT comparable to the Nortel HWT, is funded in accordance with accepted actuarial practice. Contributions provide for the accumulation of assets for current coverage: disabled life reserves for new entrants, **reserves for incurred** but not reported **claims** and payments made to these new claimants during the year.²³

49. While there may be flexibility in interpreting accepted actuarial practice, there are practices that fall outside accepted actuarial practice for funding. **A disability income**

²¹ Williams Affidavit at para. 15.

²² Bell Affidavit at para. 24.

²³ Bell Affidavit at para. 44.

plan funded on a pay-as-you-go basis – in other words, claims payments are paid as they arise – could not claim to be funded in accordance with accepted actuarial practice. A funding practice that does not systematically accumulate assets and discharge deficits would very likely fall outside funding based on accepted actuarial practice.²⁴

50. The Healthcare Benefit Trust also periodically experiences terminations where employers exit the trust and cease contributing pending settlement of outstanding obligations. In these circumstances, coverage for any future claims also ceases. In these instances, the Healthcare Benefit Trust continues to pay for the following in respect of employees covered by the employer:

- a) **income for existing disabled members at the date of termination.** This income is paid until the point that the member is no longer eligible to receive it due to recovery, reaching the maximum age or death; and
- b) reimbursements for life, accidental death and dismemberment, extended health and dental claims that occurred **prior to** the date of termination.

In cases where an employer exits the trust, the Healthcare Benefit Trust **ceases** paying for any claims related to any event occurring after the date of termination. Once the employer terminates from the Healthcare Benefit Trust, non-incurred claims and future coverage for benefits revert to the employer.²⁵

²⁴ Bell Affidavit at para. 46.

²⁵ Bell Affidavit at paras 50-52.

E. The Nortel HWT

51. Nortel has continuously offered various non-pension employee benefits through the HWT since January 1, 1980. The parties acknowledge that the HWT is a tax driven vehicle. Nortel's funding obligations are described in the original trust agreement (1980) as follows:

ARTICLE IV – EMPLOYER'S CONTRIBUTIONS

1. The Corporation and its designed affiliated or subsidiary corporations agree to make Employer's contributions to the Trust Fund in amounts sufficient to pay any claims which may be asserted against the Trust Fund as a result of the administration of the Health and Welfare Plan, and as may otherwise be required from time to time by the Trust for the purposes of the Health and Welfare Plan, as determined by the Trustee on a sound actuarial basis.

2. The Trustee shall determine or cause to be determined, on a sound actuarial basis from time to time, and in any event, once every calendar year, the level of contributions to the Trust Fund necessary to fund adequately the Health and Welfare Plan.

3. Subject to paragraphs (1) and (2) hereof, the Corporation and its designated affiliated or subsidiary corporations shall be responsible for the adequacy of the Trust Fund to meet and discharge any and all payments and liabilities under the Health and Welfare Plan.

52. The HWT Trust Agreement provides that the adequacy of the fund is to be evaluated on an actuarial basis at least annually. Sound actuarial practice requires that HWTs maintain sufficient funds to pay the present value of future benefits in respect of all incurred long-term disability claims. With regard to the group term life insurance

component of the HWT, the funding requirement would simply be the premiums that are payable to the insurance company for the year.²⁶

53. Despite the obligation to fund the HWT in accordance with actuarial practice, as recognized by Nortel, the HWT is underfunded relative to the obligations to pay for the reserved income plans.²⁷ In addition, over \$30 million was removed from the assets of HWT trust in 2005-2006 to pay for pay-as-you claims that Nortel was obligated to pay for from its operations.²⁸

54. According to the Fifty-First Report, most of Nortel's non-pension employee benefits, including life insurance, long term disability, medical, dental and survivor income benefits, are funded by Nortel on a pay-as-you-go basis but as an administrative matter are paid using the HWT as a payment mechanism. In respect of certain other benefit plans, the benefits have been funded by the HWT using trust assets. While assets were notionally allocated in the HWT financial statements for book-keeping reasons with respect to reserved plans, assets were not segregated in the HWT by benefit plan and no separate bank accounts were established. As a result, all the HWT assets are commingled.²⁹

55. The Fifty-First Report lists Pensioner Life benefits as one of the benefits that have historically been paid by the HWT from trust assets. Further, the HWT financial statements show that a notional book-keeping reserve has been set aside for the

²⁶ Williams Affidavit at para. 21.

²⁷ Affidavit of Michael McCorkle sworn September 27, 2010 ("McCorkle Affidavit") at paras. 5-8.

²⁸ Fifty-First Report at para. 81; McCorkle Affidavit at para. 8; Urquhart Affidavit at paras. 26-31.

²⁹ Fifty-First Report at para. 34.

Pensioners' Insurance Plan, with \$30.7 million in stated assets as of December 31, 2009.³⁰ As discussed in the legal argument section below, the Monitor's reliance on the significance of these practices as informing entitlement to distribution on termination of the HWT is misplaced.

56. At the time the HWT was established, there was an \$11 million rollover of funds into the HWT from a prior retirement life insurance arrangement.³¹ But for this initial contribution, the nature of the Pensioner Life benefit, namely, the payment of premiums for one year term life policies, suggests that Pensioner Life benefits would be treated as pay-as-you-go claims. The following evidence support this conclusion:

- a) **Mercer's Actuarial Report** on Non Pension Post-Retirement Benefits for the year ended December 31, 2008 describes the funding policy of Pensioner Life benefits as being funded on a **"pay-as-you-go"** basis, i.e. Nortel funds on a cash basis as benefits are paid;³²
- b) The medical costs and life insurance premiums of the pensioners, and of the active and long term disabled employees were paid on a pay-as-you-go basis. Nortel made employer contributions into the HWT annually to reimburse the HWT for the employees' and pensioners' medical claims and the life insurance premiums paid to Sun Life. **Pensioners' life insurance premiums stopped being paid for by employer contributions on a pay-as-you-go basis and began to be paid out of the HWT assets as Nortel had determined earlier in the decade that it was not obliged to pre-fund pensioners' future life insurance premiums;**³³
- c) **Nortel's 1998 Annual Report** indicates that post-employment health care and life insurance benefits are expensed as incurred,³⁴ and

³⁰ Fifty-First Report at paras. 42, 46.

³¹ Fifty-First Report at para. 37(d).

³² Borenstein Affidavit at para. 50, exhibit "W".

³³ McCorkle Affidavit at paras. 3, 4.

³⁴ Borenstein Affidavit at para. 51, exhibit "X".

- d) the Clarica Insurance Agreement with Nortel for Administrative Services Only in relation to the HWT, dated January 1, 1999 (the "ASO"), states that Clarica's base fees include the following services: "annual estimate of **disability and survivor reserves**". The use of the term reserves for disability and survivors implies recognition by both Nortel and Clarica, the parties to the ASO, that there is a need for funding of the disability and survivors benefits (but not Retiree Life Benefits) in a manner comparable to how insurance companies treat these types of benefits on an insured basis.³⁵

PART III: ISSUES

57. Having regard to the analysis provided by the Monitor and the positions taken by the other potential beneficiary groups, the following two issues present themselves for consideration in this motion:

- a) Can future Pensioner Life benefits participate in the termination of the HWT?
- b) If Pensioner Life benefits can participate in the termination of the HWT, how should this Court distribute the assets of the HWT among the participating beneficiaries?

PART IV: ARGUMENT

A. Introduction and General Trust Principles

58. The proper distribution of the assets of the Nortel HWT upon wind-up depends on the termination provision of the Trust Agreement for the Nortel HWT (the "Termination Provision"), read in the context of the Trust Agreement as a whole, and with a view to the intention of Nortel as the settlor at the time it entered into the trust agreement. Evidence of such intention may be gleaned from various sources, including the factual matrix at the

³⁵ Borenstein Affidavit at para. 53, exhibit "Y".

time and other documents relating to the HWT, employee benefits and employee communications.³⁶

59. A trust document should be construed using rules of contractual interpretation and rules of statutory interpretation.³⁷ The goal of contractual interpretation is to discover, objectively, the parties' intention at the time the contract was made.³⁸ Second, the agreement must be construed as a whole with meaning given to **all** its provisions.³⁹ Third, the Court should interpret the agreement having regard to the business context in which the agreement was concluded.⁴⁰

60. As noted, there is substantial agreement with the analysis provided by the Monitor and Goodmans as to the proposed allocation methodology. As such, a detailed review of the trust and legal principles provided in the memorandum of law prepared by Goodmans found at Appendix B to the Fifty-First Report (the Memorandum) is not necessary. For the reasons provided in the Memorandum, there is no dispute that LTD Income, SIBs and STBs are benefits that should participate in the HWT distribution. However, the Dissenting LTD Beneficiaries disagree with the conclusion that future Pensioner Life benefits should also be participating benefits. A review of the Termination Provision bears out the unreasonableness of the interpretation advocated by the Monitor and supported by proposed "independent" counsel.

³⁶ *Schmidt v. Air Products of Canada Ltd.*, [1994] 2 S.C.R. 611 at paras. 138-139.

³⁷ *Electrical Industry of Ottawa Pension Plan v. Cybulski*, [2001] O.J. No. 4593 (Ont. S.C.J.) at para. 18.

³⁸ *Gilchrist v. Western Star Trucks Inc.*, [2000] B.C.J. No. 164 (B.C. C.A.) at para. 17.

³⁹ *Pass Creek Enterprises Ltd. v. Kootenay Custom Log Sort Ltd.*, [2003] B.C.J. No. 2508 (B.C. C.A.) at para. 17.

⁴⁰ *Ventas Inc. v. Sunrise Senior Living Real Estate Investment Trust*, [2007] O.J. No. 1083 (Ont. C.A.) at para. 24.

B. The Termination Provision Is Limited to Incurred Claims

61. The Termination Provision reads as follows:

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. (emphasis added)

62. The Monitor and the Dissenting LTD Beneficiaries' actuarial experts, Williams and Bell have concluded that it is clear that any claims actually made and obligations actually incurred up to the date of the Notice of Termination should participate on termination. Such claims would include future income payments due to LTD Beneficiaries. The fact that incurred claims should be paid out of the HWT on termination is consistent with the express wording of the Termination Provision.

63. However, the Monitor urges the Court to step beyond the plain meaning of the Termination Provision by contending that "future claims" should include "claims that have not been made but would certainly have been made in the future". Such an interpretation fails to give any meaning to the "up to the Notice of Termination" cut-off date noted in the Termination Provision and runs afoul of the basic tenet of contractual

interpretation that meaning should be given to provisions in their entirety. Giving meaning to the expression “future benefits” and to the stipulated cut-off date, necessarily leads to the conclusion that only “future benefits and claims” that can be considered to have been made or incurred prior to the Notice of Termination are payable on a wind-up of the HWT.

64. A pivotal premise upon which the Monitor supports its recommendation that Pensioner Life benefits should participate in the termination of the HWT is that such benefits relate to permanent (and not term) insurance. Remarkably, however, the evidence disclosed in the Fifty-First Report demonstrates that the opposite is true: Pensioner Life benefits relate to one year renewable term life insurance policies that are paid monthly by Nortel to Sun Life.⁴¹ It is telling that no evidence has been filed by the Monitor or the other employee creditor groups to challenge this. There is no basis, therefore, to justify a finding that the future value of Pensioner Life benefits in accordance with the full estimated actuarial liability of such benefits is an obligation of the HWT. The only thing that might be argued to be certain was the payment of one year's worth of premiums for Pensioner Life insurance ending December 31, 2010.

65. Another reason why the payment of all future years of premiums for Pensioner Life insurance is not justified can be found in the the termination provisions of the Sun Life Group Term Life Insurance Policies. These policies indicate that coverage is automatically terminated upon the receivership or bankruptcy of the policyholder, Nortel Networks Limited and that: **“the insurance of all members stops on the termination**

⁴¹ Urquhart Affidavit at paras. 5-7; Fifty-First Report, Appendix L.

date of this policy and claims incurred after that date are not eligible for payment”.⁴² As Nortel has confirmed that it is in the middle of a wholesale liquidation, and will not re-emerge as a going concern, it is clear that the company is effectively bankrupt and will eventually become formally bankrupt with the effect that the Pensioner Life and other life insurance coverage provided will terminate. As such, it cannot be said that Pensioner Life benefits would “certainly be made in the future”.

66. Moreover, the reading in of an obligation to pay “claims that have not been made but would certainly have been made in the future” is problematic as the certainty of the claim being relied upon relates to the certainty of death. However, **the payment of the death claim is an obligation of Sun Life, a third party insurer, not Nortel or the HWT.** As discussed, the benefit provided by Nortel is that of the payment of premiums only. **The nature of the benefit is such that it cannot give rise to a claim in the future that would be captured by the Termination Provision.**

67. In addition, beyond having no support in actuarial or insurance practice, the standard introduced by the Monitor is unworkable as it adds unnecessary ambiguity to the Termination Provision. For example, for many LTD Beneficiaries medical treatment or drugs known to be required into the future can be said to constitute “claims that have not been made but would certainly have been made in the future”.

⁴² Fifty-First Report, Appendix L.

68. Further and in any event, tax rules make it impermissible to hold permanent insurance policies in an HWT – only group term life insurance policies are permissible.⁴³ As such, an interpretation that Pensioners Life benefits should participate on termination would thus offend the tax rules governing health and welfare trusts and would potentially throw into question the tax treatment of the HWT. In the Memorandum, interpretations of the Trust Agreement that conflict with tax rules of the HWT are described as “untenable”.⁴⁴

69. Indeed, it is an accepted principle of contractual interpretation that when faced with two plausible interpretations, one of which will lead to a construction of a contract that is unlawful, courts will prefer the interpretation that is consistent with the law.⁴⁵ Thus, the proper interpretation of the Termination Provision is the one that is compliant with tax law and applicable actuarial and insurance standards and principles.

70. In this regard, it must be recalled that Nortel established the HWT in order to secure the tax benefits of such trust arrangements. The tax purpose and motivation of the HWT, and Nortel’s subsequent actions in relation to the Nortel HWT, should strongly inform the interpretation of the Termination Provision and the proposed allocation methodology. Nortel was taking tax deductions equal to its contributions and, as such, one should infer that its contributions were in respect of claims that had occurred or were currently occurring such as disability income payments (consistent with applicable tax

⁴³ Williams Affidavit at para. 10; Affidavit of Joann Williams sworn September 24, 2010 (“Supplementary Williams Affidavit”) at para. 6.

⁴⁴ Memorandum at para. 41.

⁴⁵ *Maschinenfabrik Seydelmann K-G v. Presswood Brothers Ltd.* (1965), 53 D.L.R. (2d) 224 (Ont. C.A.) at 229; *Beer v. Townsgate I Ltd.*, 1997 CarswellOnt 3753 (C.A.).

law) and not in respect of claims which may occur in the future such as the payment of life insurance premiums (for which no deductions are permitted).

71. An interpretation that Pensioner Life benefits can participate in the HWT distribution would mean that the Nortel HWT was not tax compliant and would suggest that Nortel had been claiming deductions to which it was not entitled. There is a current prohibition against deducting prepaid insurance considerations (subparagraph 18(9)(a)(iii) of the *Income Tax Act* (Canada)). 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.⁴⁶

72. In summary, the wind up liabilities should be interpreted in accordance with a funding basis consistent with the tax considerations that apply to the HWT, particularly when such a result best reflects the plain meaning of the Termination Provision and the evidence before the Court regarding actuarial practice.

73. In an attempt to justify the inflated interpretation of the Termination Provision, the Monitor suggests that significance should be placed on the fact that Pensioner Life benefits were part of a reserved plan. However, as confirmed by Nortel's past Treasurer, Pensioner Life benefits were initially paid on a pay-as-you-go basis and only began to be paid out of the HWT assets after Nortel had determined earlier in the decade that it was not obliged to pre-fund pensioners' future life insurance premiums.⁴⁷ Further, the reason why book-keeping reserves appear to be held for the Pensioner Life Insurance relates to

⁴⁶ Supplementary Williams Affidavit at para. 10.

⁴⁷ McCorkle Affidavit at paras. 5, 6

the fact that \$11 million was initially transferred into the HWT at the time of its inception in respect of the Pensioners' Insurance Fund ("PIF").

74. The original PIF does not constitute evidence that the pensioners are beneficiaries of the HWT today on its wind-up and should have no bearing on the interpretation to be taken to the Termination Provision. First, there is no dispute that the transfer of PIF related assets was into a single trust, with these assets commingled with the other assets funding the long term disability income and survivor income benefits. Second, the CRA tax regime changed such the HWT's were no longer to be used to fund future pensioners' life insurance premiums. Third, 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 in 2002, when Nortel received its last actuarial report for funding of the Pensioners Life Insurance Plan; and, (iv) the grandfathered reserve of assets legitimately allocated to the Pensioners Life Insurance Plan at December 31, 1986 was more than used up by the payment of pensioners' life insurance premiums during 2000 to 2010 from the HWT assets.⁴⁸

75. But for this \$11 million initial contribution, the nature of the Pensioner Life benefit, namely, the payment of premiums for one year term life policies, suggests that Pensioner Life benefits would be treated as pay-as-you-go claims for which no pre-funding was permitted and which would clearly not have required a book-keeping reserve. Accordingly, the notional reserve for the Pensioners' Life Insurance Plan is distinguishable from the reserve for the LTD and Survivor Income Plans for which Nortel

⁴⁸ Urquhart Affidavit at para. 33, Table 8; Supplementary Williams Affidavit at para. 15.

recognized an obligation to accumulate funds and ought not to have any significance on the interpretation of the Termination Provision.

76. Based on the foregoing factors, future Pensioner Life benefits should not be participating claims in the termination of the HWT. This would require an interpretation of the Termination Provision that is unreasonable in light of its plain meaning and is entirely inconsistent with the purpose for which Nortel created the trust: to secure the favourable tax treatment afforded to such trust arrangements. The LTD Beneficiaries therefore ask that this Court approve the distribution methodology set out in Scenario 3.

C. Application of the Maxim “Equality is Equity” Is Not Appropriate

77. The Termination Provision does not specify how the Trust Fund is to be shared on the dissolution of the Nortel HWT. The Monitor proposes that this Court apply the maxim “equality is equity” because of “the absence of sufficient reason for dividing property on any other basis.”

78. It bears noting that the maxim of “equality is equity” is a principle of **last resort** not a *prima facie* presumption.⁴⁹ Like all equitable maxims, “equality is equity” can only apply if there is not some good reason in law and equity why it ought not to apply.⁵⁰ A determination of the appropriate allocation should reflect the intention of the parties when the transactions were entered into and the necessity for fairness in the ultimate result.⁵¹

⁴⁹ *Buckley v. B.C.T.F.*, 1996 CarswellBC 907 (S.C.) at para. 72.

⁵⁰ *Affiliated FM Insurance Co. v. Quintette Coal Ltd.*, 1998 CarswellBC 74 (C.A.) at para. 52.

⁵¹ *Winnipeg Mortgage Exchange Ltd. v. Winnipeg Mortgage Holdings Ltd.*, 1982 CarswellMan 14 (C.A.) at para. 14.

79. Assuming that the Monitor's interpretation of the Termination is correct and that Pensioner Life benefits should participate on termination, the Dissenting LTD Beneficiaries submit that this is not an appropriate case to apply the maxim "equality is equity."

80. Equal treatment of incurred claims of the LTD beneficiaries and survivors and the contingent claims of pensioners in respect of future Pensioner Life benefits is inconsistent with the purpose for which Nortel established the Nortel HWT. Further, such equal treatment would be patently unfair to the LTD Beneficiaries, who have a profound interest in the HWT and who were the most harshly impacted by the Settlement Agreement which, among other things, prevents them from seeking legal redress for a massive funding shortfall.

81. The maxim of "equality is equity" should have no bearing on these facts. There are compelling reasons why this Court should not apply the principle in this case:

- a) The pensioners have not incurred any insurable events in respect of the life insurance policies Nortel has with third-party insurers, which policies will be terminated as part of Nortel's ultimate liquidation. In contrast, Nortel self-insured LTD income loss replacement benefits for which insurable events (the filing of disability claims) have already occurred;
- b) The methodology set forth in Scenario has a more meaningful income benefit to individual LTD Beneficiaries of a self-insured plan when compared with the loss to the average pensioner of future life insurance premiums on third-party insurance. Under the former scenario, the average pensioner loses \$3,477 whereas the average LTD Beneficiary gains \$72,000.
- c) Any gain to the average LTD Beneficiary is in respect of an incurred claim, namely the disability from which they suffer on an ongoing basis, and will go toward essential living expenses for

themselves and, in many cases, their dependant children. In contrast, the gain obtained by the average pensioner under the Monitor's proposed methodology, if used to buy replacement life insurance, benefits the grown children of pensioners and other named beneficiaries of their life insurance policies;

- d) Under the Monitor's proposed methodology, the average LTD Beneficiary will face a life in poverty, since the government's Canada Pension Plan Disability income provides an average of only \$9,700 per year, up to a maximum of \$13,500 per year.⁵² Given that most of the LTD Beneficiaries will likely never be gainfully employed as a result of their disabilities, the distribution of the Nortel HWT should help ensure that the LTD Beneficiaries can pay essential living expenses until they reach the age of 65;
- e) the *corpus* of the Nortel HWT was depleted by the payment of pay-as-you-go medical claims and life insurance premiums which overwhelmingly benefitted pensioners when the purpose of the HWT assets was to fund the incurred claims of the LTD Beneficiaries and survivors;
- f) the LTD Beneficiaries are the stakeholders that were most deeply impacted by the Settlement Agreement. In exchange for the payment of limited benefits pending a December 31, 2010 cut-off date, the Settlement Agreement entirely released those responsible for breaches of trust in relation to an HWT funding shortfall and depletion of trust assets;
- g) the grandfathered reserve of assets legitimately allocated to the Pensioners Life Insurance Plan at December 31, 1986 was more than used up by the payment of pensioners' life insurance premiums during 2000 to 2010 from the HWT assets; and,
- h) the pensioners would still receive approximately \$7.8 million under Scenario 3 as a result of the terms of the Settlement Agreement.

82. The LTD Beneficiaries submit that an equitable distribution of the Nortel HWT is one that will take the foregoing circumstances into account.

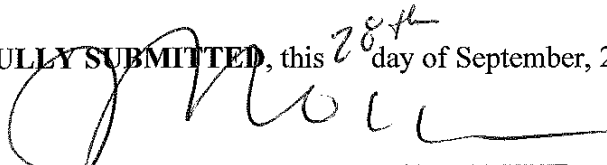
⁵² Borenstein Affidavit at para. 29.

83. Further, the proposed *pro rata* distribution method is inappropriate as it does not take into consideration the fact that many LTD Beneficiaries made employee contributions to raise their disability income benefit coverage from 50% to 70% of their pre disability income. Although there has been no accounting on this to date, a sizeable portion of the HWT assets appear to be the result of employee contributions for this optional disability income benefit coverage and should arguably be distributed to the LTD Beneficiaries who used their own money to purchase this optional top up as a first charge on the trust assets before the balance in the HWT is distributed amongst all the participating beneficiaries.

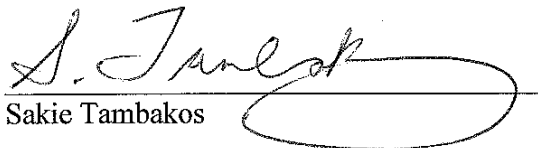
PART V: THE ORDER REQUESTED

84. The Dissenting LTD Beneficiaries respectfully submit that this Court approve a distribution of the HWT assets based on the methodology set out in Scenario 3.

ALL OF WHICH IS RESPECTFULLY SUBMITTED, this 28th day of September, 2010.



Joel Rochon



Sakie Tambakos

Lawyers for the Dissenting LTD Beneficiaries

Schedule "A"

1. *Affiliated FM Insurance Co. v. Quintette Coal Ltd.*, 1998 CarswellBC 74 (C.A.)
2. *Beer v. Townsgate Ltd.*, 1997 CarswellOnt 3753 (C.A.)
3. *Buckley v. B.C.T.F.*, 1996 CarswellBC 907 (S.C.)
4. *Canadian Pacific Ltd. v. Ontario (Minister of Revenue)*, 1998 CarswellOnt 3537 (C.A.)
5. *Electrical Industry of Ottawa Pension Plan v. Cybulski*, [2001] O.J. No. 4593 (Ont. S.C.J.)
6. *Gilchrist v. Western Star Trucks Inc.*, [2000] B.C.J. No. 164 (B.C. C.A.)
7. *Maschinenfabrik Seydelmann K-G v. Presswood Brothers Ltd.* (1965), 53 D.L.R. (2d) 224 (Ont. C.A.)
8. *Pass Creek Enterprises Ltd. v. Kootenay Custom Log Sort Ltd.*, [2003] B.C.J. No. 2508 (B.C. C.A.)
9. *Schmidt v. Air Products of Canada Ltd.*, [1994] 2 S.C.R. 611
10. *Ventas Inc. v. Sunrise Senior Living Real Estate Investment Trust*, [2007] O.J. No. 1083 (Ont. C.A.)
11. *Winnipeg Mortgage Exchange Ltd. v. Winnipeg Mortgage Holdings Ltd.*, 1982 CarswellMan 14 (C.A.)

Schedule "B"

Income Tax Act, R.S.C. 1985, c. 1 (5th Supp.)

18 .Limitation respecting prepaid expenses

(9) Notwithstanding any other provision of this Act,

(a) in computing a taxpayer's income for a taxation year from a business or property (other than income from a business computed in accordance with the method authorized by subsection 28(1)), no deduction shall be made in respect of an outlay or expense to the extent that it can reasonably be regarded as having been made or incurred

(iii) as consideration for insurance in respect of a period after the end of the year, other than

(A) where the taxpayer is an insurer, consideration for reinsurance, and

(B) consideration for insurance on the life of an individual under a group term life insurance policy where all or part of the consideration is for insurance that is (or would be if the individual survived) in respect of a period that ends more than 13 months after the consideration is paid;

Court File No.: 09-CL-7950

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

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

PROCEEDING COMMENCED AT
TORONTO

**FACTUM OF THE DISSENTING LTD
BENEFICIARIES**

(HWT Distribution Motion returnable
September 29, 2010)

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