Guest post: How to run up a $1.6bn legal bill – the Nortel bankruptcy should be a wake-up call for the insolvency industry

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by Guest Blog

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What is a fair and equitable distribution of $7.3bn of global bankruptcy assets between multinational creditors where no legal mechanism exists? This is the unenviable question which the US and Canadian courts sought to answer by their joint rulings in the Nortel Bankruptcy in May 2015, and which the parties will be attempting to renegotiate when they commence further dispute resolution meetings today.

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Nortel's three global units - the Canadian parent company, and US and EMEA operating units - each argued for allocation on different bases in an unprecedented form of proceedings heard simultaneously by the courts of Delaware and Ontario. Rejecting all of the distribution methods proposed by the groups (respectively based on IP ownership, revenue share and contribution to development), the two courts jointly ruled that allocation should be made on a pro-rata formula of their own creation but largely based on creditors' claims.

Not only did no party argue for this option, but the decision resulted in a windfall for the EMEA unit, which reportedly would receive a share of 24% under the joint rulings, when it only had sought 18% of the global assets (the US unit argued EMEA should receive 17%, the Canadian unit argued 4%). Further the US unit was apparently 'punished' for its previous proactive settlement of claims which reduced its pro rata allocation of the assets, and the large bond component of its claim was discounted, whereas equivalent bond claims of the Canadian and EMEA units were, by contrast, included in calculating their allocations.

Not surprising then that the US and Canadian groups want to remedy what they see as injustices caused by the joint decisions, and are appealing them in the US and Canadian Courts alongside attempting to reach a resolution with EMEA. The EMEA group might see no reason to engage in dispute resolution because of its favourable allocation by the courts, but it faces real risk of that decision being overturned on appeal.

In such unprecedented proceedings as these, where there is no applicable black letter law for the courts to follow, the appeal courts may reach a completely different decision to the May 2015 ones. Indeed, the US and EMEA groups argued that the pro rata distribution was not legally or factually sustainable, and US Bankruptcy Judge Kevin Gross

himself described the decision as 'an extraordinary result'. As a result it is widely expected that the May 2015 decisions will be overturned on appeal. The real risk to EMEA of losing out at the appeal stage should mitigate in favour of EMEA's engagement with mediation now.

The Nortel case highlights the frustrating and costly difficulties faced by parties in large and complex international insolvency proceedings. Such proceedings, however, are nothing new and not going to go away in the wake of the global financial crisis - the ongoing Lehman Brothers insolvency being the paramount example. But even the Lehman bankruptcy, which had almost $680bn more in assets than Nortel at the time of their Chapter 11 filings, was settled in half the time that Nortel has been pending.

A significant problem is finding an appropriate forum for the bankruptcy proceedings, and the complicated joint procedure that resulted in the May 2015 decisions may not be a sustainable option in all cases. That too might be the conclusion of either of the appeal courts in the US or in Canada. Some commentators call for the establishment of an international bankruptcy court applying a new international bankruptcy law, which is an attractive long-term option, but offers no solutions to the parties involved in Nortel.

In the meantime, any informed outsider can see that the most sensible option for the Nortel groups is serious engagement in dispute resolution, which will bring certainty and an end to the expensive litigation in which they are currently embroiled. While EMEA would need to be willing to concede some of its unexpected 24% allocation, it might remember that its original claim before the courts was for just 1% more than the US group argued the EMEA unit should be allocated.

Perhaps the only certainty for the Nortel groups at this time is the mounting legal costs faced by them all, which already totalled $1.6 billion from Nortel's bankruptcy in 2009 up to the joint decisions in May 2015 and expected to exceed $2bn in the near future. The cost factor alone should drive the units to reach a compromise, and quickly. The EMEA unit is responsible for 45% of those costs, and must seriously question how much further expenditure it can spend seeking to protect an obviously precarious position.

Surely now is the time for the Nortel groups to come back to the 'One Nortel' family through which the international companies operated and reach a pragmatic and sensible distribution by consent. That will be how to achieve the most fair and equitable distribution of the $7.3 billion bankruptcy assets. With all at stake in two appeal courts it might also be EMEA's own best move.

***Simon Davenport QC** (supported by Olivia Wybraniec) appeared as co-counsel for CCA Bahamas Limited in the Bahe Mar litigation in the Delaware Bankruptcy Court in September 2015, successfully moving to dismiss the Chapter 11 proceedings there.*

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