

Self-Insured LTD Retroactive Eligible Financial Contract with No Pension Changes July 7, 2016

We have been [communicating with Minister Navdeep Bains](#) and staff of the Ministry of Innovation, Science and Economic Development since November 30, 2015 on the subject of [Bill C-624](#) being re-introduced, or self-insured group long term disability benefit plans being prescribed as an [Eligible Financial Contract within the Companies' Creditors Arrangement Act](#). The PMO's office, Senator Art Eggleton and MP Rob Oliphant have written to Minister Navdeep Bains encouraging him to consider this [Federal disability policy change](#).

During 2010 to 2011 there were federal bills introduced to raise the priority of both self-insured group long term disability ("LTD") benefit plans and pension plans above the unsecured creditors in bankruptcy. We thought it would be helpful to consider the reasons for the Nortel LTD employees getting a retroactive change in legislation or regulations today, while the Nortel pensioners have no changes.

We have 15 different reasons as follows:

- 1) Nortel LTD former employees had constructive fraud in the Health and Welfare Trust ("HWT") determined by J. Paul Perell in his [February 11, 2014 Ontario Superior Court of Justice decision](#). There were no wrongdoings in the Nortel pension plans, with mandatory contributions made under strict government regulation. The Nortel pension deficits were caused by the stock market crash during the 2008-09 financial crisis.

The constructive fraud in the HWT was without a court remedy (\$60 million plus interest) due to J. Perell's view that (i) J. Geoffrey Morawetz knew there was constructive fraud when he approved the [March 30, 2010 restated settlement agreement](#) on March 31, 2010, which paid 9 months of benefits in exchange for the legal release, and (ii) the limitation period started at February 18, 2010, while the Nortel HWT class action fraud claim was filed six months too late at August 27, 2010. J. Perell dismissed the Nortel HWT fraud class action in a summary judgement without a certification trial. [The affidavits containing the evidence supporting the fraud claim](#) never made it to trial.

Here is our perspective on these two reasons for no remedy of the constructive fraud.

- i. The settlement agreement contained a legal release of litigation, except for fraud. J. Morawetz could not have known about the constructive fraud when he approved the settlement's legal release on March 31, 2010, because [Ernst & Young, the Court Monitor, had explicitly refused to release the historical financial statements and actuarial reports of the Health and Welfare Trust](#), which contained the evidence of fraud (just the 2008 HWT financial statement was released to the court prior to the settlement agreement, which showed a deficit in HWT funding but not the fraudulent reasons for it occurring during 2005 and 2006.)
- ii. [J. Strathy, Rouleau and Hourigan of the Court of Appeal of Ontario on Oct. 21, 2014](#) did not overturn J. Perell's constructive fraud decision, but nonetheless concurred with the lower court's summary dismissal of the fraud class action on the grounds of missed limitation period. These appeal judges had the view that financial expert Diane Urquhart and lead Nortel LTD plaintiff Jennifer Holley knew there was fraud based on the February 18, 2010 disclosure of the

HWT 2008 financial statement, and so the class action counsel was six months too late in filing the fraud class action claim. [Ernst & Young, who itself has received fees of US\\$500 million](#) from the Nortel bankruptcy proceeding, successfully created ambiguity on the limitation period, by its delay in the disclosure of [the relevant historical HWT financial statement and actuarial reports until August 27, 2010](#).

- 2) Nortel LTD employees had [misrepresentations](#) about their group LTD benefits being insured up to 2005, and then after, that “Nortel plays a role similar to that of an insurance company for its employees.” Nortel pension plans were known to be deferred savings vehicles for all employees and not insurance for contingencies, like debilitating accidents and illnesses, which affect about 1% of the workforce.
- 3) LTD’s HWT settlement was reduced from 82% to 38% of the actuarial liability for LTD income due to [J. Morawetz’s November 9, 2010 decision](#) to include pensioners’ life insurance benefits amongst the HWT obligations. Death benefits paid to pensioners’ successors were treated equally to income for currently disabled persons primarily because of an [Advance Income Tax Ruling dated December 28, 1979 from Revenue Canada](#), which approved the transfer of \$10 million from a Mutual Life premium surplus account relating to Nortel group life insurance policies into the newly created HWT on January 1, 1980. The Federal Government had just passed [Income Tax Act Amendment S. 18 \(9\) \(a\) \(iii\) Dec. 11, 1979](#), which did not permit corporations to deduct employer contributions it paid in respect to insurance where claims occurred beyond the current year. The Mutual Insurance initial transfer appears to have been an exemption from the new amendment, and the limited evidence disclosed suggests that Mutual Life’s life insurance premium reimbursements for both active employees and the pensioners and the Mutual Life demutualization payment in 2009 were placed directly into the HWT without restatement of Nortel employer contribution deductions for life insurance and these being used in respect to insurance claims occurring beyond the current year.
- 4) The HWT settlement ratio was 38% compared to the [pension plan settlement ratios](#) as follows:

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| Ontario- | First \$12,000 pension | 100% | (Due to Ontario Pension Benefit Guaranty Fund Payment) |
| | Pension above \$12,000 | 80% | |
| | No CPI indexing | | |
| Nova Scotia- | Pension | 69% | |
| | No CPI Indexing | | |
| Other Provinces- | | 57% | |
- 5) Ontario [Nortel pensioners received an estimated \\$340 million from the Ontario Pension Benefit Guaranty Fund](#), which guaranteed the first \$1000 of pension income per month for pensioners who worked in Ontario.
- 6) The Nortel LTD benefit plan had an option for employees to purchase additional insurance of up to 70% of their pre-disability income, above the 50% of their pre-disability income which was non-contributory, which means Nortel paid all of the contributions for the first 50% coverage. Of note is that the HWT settlement of 38% of the LTD actuarial liabilities came close to paying back just the employee contributions, which were 38% to 42% of the total employer and employee contributions costs for the LTD benefit plan as shown in [employee Nortel FLEX benefits confirmation statements for 2000 to 2003](#). The employees paid more than their fair share of the disability insurance

coverage considering their costs were 38% to 42% of the combined employer and employee cost, whereas the incremental coverage bought was just 29% of the total coverage amount.

Nortel's post retirement life insurance benefit was non-contributory and the court ordered that the HWT pay out 38% for the actuarial liability for this benefit. The LTD did not get any prior payment for the return of their employee contributions, so that the pensioners' life insurance and LTD income beneficiaries got the same HWT settlement relative to their respective non-contributory actuarial liabilities.

Nortel pension plans were non-contributory, where the employer paid all of the contributions.

- 7) CPP pays substantially less for disability income than the [combined CPP and OAS](#) for pensioners:
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| CPP disability income- | \$15,490 |
| | Additional \$ 2,852 per dependent child |
| Combined CPP and OAS pension income- | \$19,956 |

350 Nortel LTD have 120 dependent children

- 8) [Nortel LTD medical and dental costs](#) were about \$7,588 per person per annum in 2010. By comparison, [Nortel pensioners' medical and dental costs](#) were about \$1,756 per person per annum in 2010.
- 9) Hypothetically, if the average LTD former employee was able to live on his 62% compromised Nortel disability income of \$11,715 at 2010, plus his maximum CPP disability income of \$13,521 at 2010, the combined disability income in 2010 from the two sources was \$25,236. However, in practical terms, an LTD former employee, with bare minimum annual expenses of \$35,000 for shelter, food and other basic living expenses, would have used up his average 2010 HWT settlement of \$78,333 within four years by 2014. The Nortel LTD are forced to live on the current CPP disability income of \$15,490 per year, which is impossible to do with dignity.

Prime Minister Justin Trudeau spoke about Canada's "... deep sense of fairness, ... everyone to have a real and fair chance of success" in his [2016 Canada Day remarks](#). This Nortel LTD group have had their futures squashed by the legal system, rather than protected by the current legislation and common law governing trusts and [consumer services such as unregulated insurance](#).

- 10) Nortel LTD suffered accidents and illnesses at ages less than 65, so the Nortel pension non-contributory contributions continued after their disability and their personal savings were far less due to their lower working incomes compared to pensioners who were able to work until age 65. There were no CPP pension employer or employee contributions after their disability. So, not only are these LTD people suffering now, they are destined to live in poverty post age 65 too, through absolutely no fault of their own.
- 11) Nortel LTD could not opt out of the Nortel LTD benefit plan and buy a personal LTD insurance coverage at 50% to 70%, since the combined coverage would be 100% to 120%, which a private insurer would not permit. Purchasing duplicate personal disability insurance would make the combined costs expensive, while duplicate disability income benefits would not be permitted. It goes without saying that you cannot purchase personal disability insurance after you have become

LTD. By comparison, the Nortel pensioners would generally have had the opportunity to set aside personal savings for retirement, including equity within their homes.

- 12) The Federal and Ontario governments have already recognized the problem of self-insured LTD benefits due to the experience of the Nortel LTD. Making self-insured LTD benefit plans an Eligible Financial Contract benefits all employees who are receiving LTD benefits that were not covered by the [mandatory disability insurance adopted by the Federal Government at June 29, 2012](#) and the [Ontario Government at July 24, 2014](#), as they were precluded from benefiting from these legislative changes under their transitional provisions. The number of Canadians affected are as follows:
 - 350 Nortel LTD and 120 dependents in an already bankrupt company
 - 10,000 disabled others \approx 1% of the 900,000 employees or 5% of all employees in Canada that were in self-insured group LTD benefit plans according to CLHIA 2014, amongst which will be those that are impacted in the future if their employer goes bankrupt.

- 13) There is plenty of money in the Nortel Canadian estate to pay for the retroactive status of the Nortel benefit plan becoming an Eligible Financial Contract. [Total LTD CCAA claims](#) are \$80 million, \$50 million for lost income and \$30 million for lost medical and dental benefits. While details of the court's Nortel allocation decision for the US\$7.3 billion in the lock-box have not been disclosed, we estimate that the Nortel Canada estate has approximately US\$3.4 billion or Cdn\$4.4 billion. The total Nortel global estate has US\$8.5 billion or Cdn\$10.9 billion.

- 14) Nortel Canadian LTD are the worst impacted creditor group from the Nortel bankruptcy because of their low Canadian HWT settlement and the Canada estate getting the lowest cash settlement ratio of the three regional estates, Canada, US and UK/EMEA. A pure pro rata approach for the Nortel cash distribution would have allowed all creditors to recover an estimated 71 cents on the dollar. However, [J. Kevin Gross and Frank Newbould, in their rulings of May 2015](#), went with a "modified pro rata" theory for distribution of the \$7.3 billion in the lock-box. The modifications are that: (i) the US\$1.2 billion in cash on hand with the debtors outside of the lock-box are not part of the allocation decision, down from \$2.4 billion at the time of bankruptcy filing; (ii) the courts left in place \$3.8 billion of intra-company bond guarantees, so that the bond owners get cash from both the US and Canada estates; (iii) the intra-company debt of \$2.5 billion payable from the Canadian estate to the U.S. estate and \$0.5 billion payable from the Canadian estate to the UK pension plan have to be honoured by the Canada estate. The net result of these modifications estimated by the Canadian analyst, Diane Urquhart, is that U.S. claims will recover about 85 cents on the dollar, U.K./EMEA claims about 65 cents and Canadian claims about 45 cents.

Assuming that the Canadian CCAA cash settlement ratio is 45% the incremental cost of the Nortel LTD benefit plan being prescribed as an EFC is Cdn\$44 million. This is 1.0% of the Canada estate. It is 0.4% of the Nortel global estate.

- 15) The incremental cost amount at Cdn\$44 million or 1% for correcting the injustice of the Nortel Canadian LTD compares to Canadian bankruptcy professional fees of Cdn\$650 million disclosed to date, which is 15% of the estimated Canada estate today. [Global bankruptcy professional fees](#) of Cdn\$2,423 million are 22% of the estimated global estate today. [While lawyers received the majority of the fees](#), Ernst & Young's US\$500 million of fees for its roles as an officer of both the Canada and UK bankruptcy courts and tax advisor to the US Unsecured Creditor Committee are shockingly high. This is especially so since Ernst & Young is largely responsible for the Nortel Canadian LTD not getting justice in the courts due to its intentional six month delay of relevant historical HWT financial statements and actuarial reports until after the March 30, 2010 restated settlement agreement was approved by the court.