UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

☒ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2008

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from   to

Commission file number 001-07260

Nortel Networks Corporation
(Exact name of registrant as specified in its charter)

Canada *(State or other jurisdiction of incorporation or organization)*	**98-0535482** *(I.R.S. Employer Identification No.)*
195 The West Mall, Toronto, Ontario, Canada *(Address of principal executive offices)*	**M9C 5K1** *(Zip Code)*

Registrant's telephone number including area code: (905) 863-7000

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common shares without nominal or par value	**Toronto Stock Exchange**

Securities registered pursuant to Section 12(g) of the Act: None

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Indicate by check mark if the registrant is a well known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☐ No ☒

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☒

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to filing requirements for the past 90 days. Yes ☒ No ☐

Inventories—net:

	2008	2007
Raw materials	$ 249	$ 610
Work in process	4	10
Finished goods	721	800
Deferred costs	1,130	1,698
	2,104	3,118
Less: provision for inventories	(481)	(907)
Inventories—net	1,623	2,211
Less: long-term deferred costs [(a)]	(146)	(209)
Current inventories—net	$1,477	$2,002

(a) Long-term portion of deferred costs is included in other assets.

Other current assets:

	2008	2007
Prepaid expenses	$ 98	$152
Income taxes recoverable	107	77
Current investments	21	15
Other	229	223
Other current assets	$455	$467

Investments:

Investments included $73 and $101 as of December 31, 2008 and 2007, respectively, related to long-term investment assets held in an employee benefit trust in Canada, and restricted as to their use in operations by Nortel. In prior years, Nortel classified its auction rate securities as available-for-sale and current assets. In October 2008, Nortel entered into an agreement with the investment firm that sold Nortel a portion of its auction rate securities and as a result Nortel transferred these auction rate securities from available-for-sale to trading investment securities. During the current year, Nortel held $28 in auction rate securities, which after partial redemptions throughout the year and the agreement have been recorded as $16 of trading securities as current assets and $3 as a long term investment as of December 31, 2008. See note 11 for more information.

Plant and equipment—net:

	2008	2007
Cost:		
Land	$ 31	$ 38
Buildings	991	1,137
Machinery and equipment	1,761	2,176
Assets under capital lease	193	215
Sale lease-back assets	90	97
	3,066	3,663
Less accumulated depreciation:		
Buildings	(369)	(395)
Machinery and equipment	(1,307)	(1,608)
Assets under capital lease	(98)	(107)
Sale lease-back assets	(20)	(21)
	(1,794)	(2,131)
Plant and equipment—net[(a)]	$ 1,272	$ 1,532

resulted in gross proceeds of $320, adjusted primarily for warranty liabilities, for net proceeds of $306 all of which were received in the fourth quarter of 2006. In addition, Nortel provided Alcatel-Lucent with a $23 promissory note in lieu of transferring working capital, which was paid in the first quarter of 2007. The proceeds are subject to post-closing adjustments for the finalization of the book value of the assets transferred and liabilities assumed by Alcatel-Lucent which are not expected to be significant.

In 2008, Nortel did not record any adjustments to the net assets net gain from this divestiture.

Manufacturing operations

In 2004, Nortel entered into an agreement with Flextronics for the divestiture of substantially all of Nortel's remaining manufacturing operations and related activities, including certain product integration, testing, repair operations, supply chain management, third party logistics operations and design assets. Nortel and Flextronics have also entered into a four-year supply agreement for manufacturing services and a three-year supply agreement for design services. Nortel received $599 of gross proceeds as of December 31, 2007.

On October 18, 2006, Nortel signed amendments to various agreements with Flextronics, including the sale agreement, and the supply and design services agreements to restructure Nortel's purchase commitments and increase Nortel's obligation to reimburse Flextronics for certain costs associated with the transaction.

As of December 31, 2007, Nortel had transferred approximately $404 of inventory and equipment to Flextronics relating to the transfer of the optical design activities in Monkstown, Northern Ireland and Ottawa, Canada and the manufacturing activities in Montreal and Calgary in Canada and Chateaudun, France. Flextronics had the ability to exercise its unilateral rights to return certain inventory and equipment to Nortel after the expiration of a specified period following each respective transfer date of the activities at the aforementioned facilities (up to fifteen months). Flextronics has exercised all of its rights with respect to the inventory and equipment as at December 31, 2007, and as a result, Nortel retained $10 of inventory and equipment. Nortel recognized a gain of $21 on this transaction in 2007 as a result of the expiration and satisfaction of the rights held by Flextronics described above.

11. Fair Value

Nortel adopted the provisions of SFAS 157 applicable to financial assets and liabilities and to certain non-financial assets and liabilities that are measured at fair value on a recurring basis, effective January 1, 2008. SFAS 157 defines fair value, establishes a consistent framework for measuring fair value and expands disclosure requirements about fair value measurements. SFAS 157, among other things, requires Nortel to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

Fair value hierarchy

SFAS 157 provides a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect Nortel's assumptions with respect to how market participants would price an asset or liability. These two inputs used to measure fair value fall into the following three different levels of the fair value hierarchy:

Level 1: Quoted prices for identical instruments in active markets that are observable.

Level 2: Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are non-active; inputs other than quoted prices that are observable and derived from or corroborated by observable market data.

Level 3: Valuations derived from valuation techniques in which one or more significant inputs are unobservable.

This hierarchy requires the use of observable market data when available.

Determination of fair value

The following section describes the valuation methodologies used by Nortel to measure different instruments at fair value, including an indication of the level in the fair value hierarchy in which each instrument is classified. Where applicable, the descriptions include the key inputs and significant assumptions used in the valuation models.

Investments

When available, Nortel uses quoted market prices to determine fair value of certain exchange-traded equity securities; such items are classified in Level 1 of the fair value hierarchy.

Certain investments are valued using the Black-Scholes-Merton option-pricing model. Key inputs include the exchange-traded price of the underlying security, exercise price, shares issuable, risk-free rate, forecasted dividends and volatility. Such items are classified in Level 2 of the fair value hierarchy.

Nortel has an investment in a money market fund, which, prior to the suspension of trading activities of the fund's shares, was classified as cash and cash equivalents. The fund recently announced that its net asset value had declined to $0.97 per share relative to par of $1.00 per share and that it was temporarily suspending redemption rights as it sought SEC approval of its plan for orderly liquidation of its assets. These investments are currently classified in Level 2 of the fair value hierarchy. See notes 4 for more information.

In October 2008, the Company entered into an agreement ("Agreement") with the investment firm that sold Nortel a portion of its auction rate securities, which have a par value of $19 at December 31, 2008. By entering into the Agreement, the Company (1) received the right ("Put Option") to sell these auction rate securities back to the investment firm at par, at its sole discretion, anytime during the period from June 30, 2010 through July 2, 2012, and (2) gave the investment firm the right to purchase these auction rate securities or sell them on the Company's behalf at par anytime after the execution of the Agreement through July 2, 2012. The Company elected to measure the Put Option under the fair value option of SFAS 159, and recorded income of approximately $3 pre-tax, and recorded a corresponding long term investment. Simultaneously, the Company transferred these auction rate securities from available-for-sale to trading investment securities. As a result of this transfer, the Company recognized an impairment loss of approximately $3 pre-tax. The recording of the Put Option and the recognition of the impairment loss resulted in no net impact to the results of operations for the year ended December 31, 2008. The Company anticipates that any future changes in the fair value of the Put Option will be offset by the changes in the fair value of the related auction rate securities with no material net impact to the results of operations. The Put Option will continue to be measured at fair value utilizing Level 3 inputs until the earlier of its maturity or exercise.

Derivatives

The majority of derivatives entered into by Nortel are valued using standard valuation techniques as no quoted market prices exist for the instruments. The valuation technique used and inputs required depend on the type of derivative. The principal techniques used to value these instruments are through comparing the rates at