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In re Nortel Networks Inc
669 F3d 128 (3d Cir 2011) 29th December 2011 Opinion of Circuit Judge Fuentes filed 6th December 2013 in relation to Case no 13-2739 of the United States Court of Appeals for the Third Circuit
United States, Canada, UK
United States Court of Appeals for the Third Circuit

Key Words
Reorganisation; co-operation; agreed protocols on asset distribution and asset disposition; group companies; insolvency; chapter 11; chapter 15; administration; multi-national companies; cross-border protocol.

Summary of Facts of the Case
Nortel was a multinational group of high-tech companies with the parent company in Canada and much of its business occurring in the United States. Insolvency proceedings were filed in Canada, the USA and the UK. The amounts at issue were in the area of USD 8-9 billion. In 2009 Nortel employed 24,000 employees worldwide and due to changes in the industry, rising pension obligations, and the general downturn in the global economy Nortel was facing a crisis of liquidity and decided to enter into a financial and business restructuring in multiple jurisdictions. Chapter 11 was filed in the Delaware bankruptcy court while the holding company listed on the Toronto Stock Exchange entered proceedings in Canada and the UK company was placed in administration. The US court recognised both the Canadian and UK proceedings as 'foreign main proceedings' pursuant to the Chapter 15 procedure, which implements the UNCITRAL Model Law on Cross-border insolvency proceedings. A global automatic stay came into effect. The day after the filing, a cross-border protocol for coordinating US and Canadian proceedings was devised. This was followed on 9th June by an Interim Funding and Settlement Agreement entered by multiple debtors of the group (USA, Canada, Europe, Middle East, and Africa), which provided for the parties' cooperation in the global sales of Nortel's business units and agreement that any proceeds of sale will be held in escrow until the parties reached a consensual allocation or obtained a binding procedure for the allocation pursuant to an agreed upon protocol. The Trustee of the Nortel Networks UK Pension Plan and the UK Board of the Pension Protection Fund (PPF) appealed from a District Court order affirming the decision of a Bankruptcy court to

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enforce the automatic stay against participation in the UK pension proceedings which averred that the relevant pension plan was being underfunded by several billion pounds. The Trustee and PPF claimed that the pension proceedings fell within the police power exception to the global stay, which allows a governmental unit to bring or continue actions against a debtor to prevent or stop violations of the law affecting matters of public health, safety, or welfare. It was argued in contrast that the Trustee and the PPF were private parties rather than governmental units as defined by the Bankruptcy Code. The case before the court in *In re Nortel Networks Inc* 669 F3d 128 (3d Cir 2011) was to determine whether the police power applies to the Appellants' participation in the UK proceedings.

This is an extremely complex case with multiple claims and proceedings in relation to it. The facts can be derived from any number of opinions and case reports from a variety of jurisdictions. For the purpose of this case note, the protocol and its relative success at providing an effective and efficient resolution to the multinational bankruptcy will be the focus.

Cooperation and/ or Coordination Issue

As a transnational company with numerous subsidiaries located in multiple jurisdictions, Nortel's insolvency posed challenges of both coordination and timing. Given the scope of intellectual property comprising the Nortel brand, any plan to sell or reorganise would have to accommodate multiple, and possibly conflicting, interests.

In order to preserve value, a protocol needed to be agreed quickly. The debtors faced a conflict between their mutual interest in quick sales and their individualised interest in receiving a big share of each sale.

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Resolution

The protocol agreed created a framework for selling the assets without agreeing how the proceeds would then be allocated among the debtors. Rather Section 12(c-d) of the protocol simply states that the parties should negotiate in good faith and attempt to reach agreement on a timely basis for resolving disputes related to the allocation of proceeds and that failing such agreement, the Interim Sales Protocol would apply to determine the allocation of the relevant sale proceeds. The courts approved the relevant protocols, after which nine auctions were held that raised around USD7.5 billion in proceeds which were placed in escrow per the protocols agreed. Although substantial progress was made toward agreeing a protocol as to how to allocate the proceeds, the parties failed to ever execute a draft protocol that could carry them through this last phase of the process.

The results of this case indicate both the best of co-operation and the worst. Although reorganisation failed, the parties were able to co-operate to sell the debtor's global assets in large pieces spanning many different countries. Cooperating with the disposition of the assets produced more value than would have happened if individual jurisdictions had dealt only with their domestic assets. However, the parties could not then agree on how to allocate the proceeds of sale without resolution through the courts, which heavily dissipated the benefits gained from the initial cooperative efforts (Westbrook 2018).

See Jay L Westbrook, 'Global Insolvency Proceedings for a Global Market: The Universalist System and the Choice of a Central Court' (2018) 96 Tex L Rev 1473, 1490-1491

Applicability to Preventive Restructuring

A key take-away from this (failed) protocol is that any discussion of the distribution or sale of assets should be accompanied by a clear framework on how any proceeds should be distributed. This could also be relevant in a restructuring, given debtors will agree to 'haircuts' on the debts they are owed in order to ensure that they will not lose more in a liquidation. Thus, a plan should include a full description of all relevant factors that will effectively resolve the debtor's financial distress to the benefit of all participating creditors and stakeholders. In this regard, consideration should be had to how parties should ensure fairness of distribution, of which there are several choices under the Preventive Restructuring Directive in Article 11. These tests of fairness provide useful starting points against which the negotiation of the distribution of proceeds can be set.

It is not out of the question that a multinational restructuring along the lines of Nortel could occur in the future. Preventive procedures could be used to rescue individual entities or indeed a whole global group. The coordination of such procedures are aided now by the company group provisions in the EIR Recast (see below).

Applicability of Existing Rules and Guidelines

The EIR Recast

Of particular interest for a case like Nortel is the introduction of Group Company rules under the EIR Recast. Specifically, Article 56 of the EIR Recast specifies that an insolvency practitioner appointed in proceedings concerning a member of a group of companies is required to participate with the insolvency practitioners appointed in other proceedings to facilitate effective administration. Such cooperation and communication should be done as soon as possible and should include any relevant information. Coordination includes the consideration of restructuring as an alternative to a liquidation (Article 56(2)(c). It is also an option to appoint a single insolvency practitioner with additional powers if it is the will of the other practitioners in the group company case. Article 57 requires cooperation and communication between courts where two or more members of a group of companies have opened proceedings as long as the cooperation is appropriate to facilitate the effective administration of proceedings and not incompatible with the rules applicable or present a conflict of interest. Article 58 then governs communication and cooperation between insolvency practitioners and the courts, which requires that practitioners cooperate and communicate with any court before which there is a request to open proceedings and may also request information from the court, subject to the same caveats as the courts in Article 57.

Guidelines and Recommendations

The guidelines already provided by CoCo and JudgeCo also offer some suggestions on how to coordinate complex proceedings. There did not appear to be any issue with the sharing of information or indeed communication in the Nortel protocol. What was at issue and what eventually caused the protocol to fail was the lack of determination on how to allocate proceeds following the individual auctions. In terms of asset coordination, to which the distribution of proceeds relates, the JudgeCo and CoCo guidelines merely suggest ensuring full cooperation and cooperation with other insolvency practitioners in courts when seeking to coordinate assets, and to minimise conflicts. While these guidelines do not say HOW to deal with the allocation of

proceeds, it does imply that such a decision should have been included in a plan conceived for the coordination of assets, such as the protocol devised in Nortel.

The ELI Report does, however, offer a specific suggestion in Recommendation 9.02 on the need for a coordinated strategy for the insolvency or restructuring of group companies by exhorting the courts to verify whether a coordinated strategy is being considered for the group when deciding on the opening of insolvency proceedings. A court today following the ELI guidance might examine the Nortel protocol and note a key missing element and rather than approve the protocol, suggest that the proceeds should also be dealt with in terms of their allocation before proceeding through the auction process.