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DATE: 20090601

SUPERIOR COURT OF JUSTICE – ONTARIO
(COMMERCIAL LIST)

RE: 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

APPLICANTS

APPLICATION UNDER THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, R.S.C. 1985, c. C-36, AS AMENDED

BEFORE: MORAWETZ J.

COUNSEL: Alan Merskey and Mario Forte for Nortel Networks Limited et al, Applicants

Jay A. Carfagnini and Christopher Armstrong for Ernst & Young Inc., Monitor

Barry Wadsworth for the CAW-Canada

Leanne Williams for Flextronics Inc.

Susan Philpott for the Former Employees of Nortel

Shayne Kukulowicz for the Unsecured Creditors' Committee

S. Richard Orzy for the Bondholder Committee

Brett Ledger for the Nortel Board of Directors

Lily Harmer and Max Starnino for the Superintendent of Financial Services

HEARD: **May 28, 2009**

ENDORSEMENT

[1] Nortel Networks Limited ("NNL") in its capacities as a debtor company and the sponsor and administrator of the Nortel Networks Negotiated Pension Plan (the "Negotiated Plan") and the Nortel Networks Limited Managerial and Non-Negotiated Pension Plan (the "Non-Negotiated Plan") (collectively, the "Plans") requests advice and directions with respect to the determination of the appropriate transfer ratio ("Transfer Ratio"), as defined in the *Pension Benefits Act*, R.S.O. 1990, c. P. 8 and the Regulations thereto (the "PBA") (the "Regulations"), to be applied to requests for commuted value transfer payments from the Plans.

[2] In bringing this motion, NNL submits that it seeks to:

(a) maintain an equitable distribution of the Plans' assets among all plan beneficiaries, during the pendancy of this restructuring; while

(b) permitting reduced commuted value transfers to locked-in vehicles.

[3] The Plans are in deficit. The PBA does not permit 100% of commuted value to be withdrawn from a plan that has a deficit, except in limited circumstances. Instead, the Transfer Ratio establishes a reduced percentage that may be withdrawn and, in the case of the Plans, the stipulated Transfer Ratio established in accordance with the PBA as of December 31, 2006, is 0.86 and 0.85. The PBA requires that the stipulated Transfer Ratio next be recalculated as of December 31, 2009.

[4] The deficit in the Plans has increased since December 31, 2006. The affidavit of Mr. Doolittle, submitted on behalf of NNL, states that if recalculated today, the underlying Transfer Ratio will have decreased because of the change in the deficit. As at December 31, 2008, NNL believes the Transfer Ratio is approximately 0.69. NNL expects the deficit and the Transfer Ratio to continue to fluctuate.

[5] To address these events, NNL proposes to reduce the Transfer Ratio applied to commuted value payments. NNL submits that the applicable provisions of the PBA, trust law, and the CCAA indicate that a reduction to the Transfer Ratio is the appropriate step. NNL also submits that filing a new actuarial report is not an appropriate alternative in the circumstances. Further, they submit that no prejudice will occur from the proposed reduction and that the fair and even treatment of all members and former members of the Plans (a "Member") is best ensured by preserving the Plans' funded status at the currently estimated Transfer Ratio during the restructuring proceedings. NNL therefore requests a court order authorizing a reduced Transfer Ratio of 0.69.

[6] At present, when a Member's employment is terminated, he or she may:

(a) elect to transfer the accrued benefit – commuted value – from the Plans, to a locked-in retirement vehicle;

(b) direct that the commuted value be used to purchase a life annuity; or

(c) leave the accrued benefit within the Plans.

[7] Regardless of the option selected, the Member is not entitled to access the funds until the age of retirement. At that time, the funds can only be used to provide periodic pension benefits.

[8] Since the Initial Order was granted on January 14, 2009, NNL reports that there have been 197 completed commuted value transfers from the Plans that took place at a Transfer Ratio of 0.86/0.85. These transfers have a total value of approximately $45.4 million. NNL further reports that, had the transfers taken place at a Transfer Ratio of 0.69, the value of funds transferred out of the Plans would have been approximately $9 million lower.

[9] NNL also reports that, at this time, there are approximately 490 individuals who are affected by the timing of any change in the Transfer Ratio. This group is made up of Members who have received election forms to exercise commuted value payments at Transfer Ratios of 0.85/0.86 and who have:

(a) requested but not received a commuted value payment as of May 21, 2009; or

(b) not yet returned their preferred option as of May 21, 2009.

[10] There are approximately 259 individuals in the former group and 231 individuals in the latter group. The total value of the differential in Transfer Ratios is approximately $16.8 million or, 0.65% of the Plans' assets as at December 31, 2008.

[11] A number of these transfers would have been completed on May 25, 2009, but NNL deferred any further payments pending disposition of this motion.

[12] NNL has raised the concern that if the Plans are, in fact, wound up, the difference in Transfer Ratios constitutes a leakage of assets that may not be restored if NNL is unable to fund the pension deficits and, in those circumstances, the leakage would impose a disproportionate burden of the deficits upon those Members remaining in the Plans, including active, deferred vested Members and retirees.

[13] Further transfer requests at a Transfer Ratio of 0.86/0.85 would have a similar effect of increasing the inequality of treatment among plan beneficiaries. The total number of Members who will terminate employment is unknown, but Mr. Doolittle in his affidavit does state that significant additional commuted value transfer requests are expected in the coming months.

[14] NNL submits that consideration of the appropriate treatment of the Transfer Ratios has engaged significant resources by NNL and that the management committees for pension matters, the Retirement Planning Committee ("RPC") and the Pension Investment Committee

("PIC") have been focussed upon this issue and that the pension committee of the Board of Directors, the Pension Fund Investment Committee ("PFIC") (collectively with the RPC and the PIC, the "Pension Committees") has given thorough consideration to the Transfer Ratio to be applied to commuted value payments. Nortel states that the Pension Committees are concerned that a balanced and equitable solution for all Members be adopted.

[15] NNL has reviewed the possibility of applying a reduced Transfer Ratio of 0.69 with the Financial Services Commission of Ontario ("FSCO") and that the FSCO has advised that it supports this step.

[16] The proposal to reduce the Transfer Ratio to 0.69 percent is also supported by Representative Counsel for the Former Employees of Nortel and by counsel on behalf of the Canadian Auto Workers – Canada ("CAW").

[17] All parties are satisfied that I have the jurisdiction to deal with this matter under section 60 of the *Trustee Act*, Rule 14.05 or under the supervisory jurisdiction of the court under section 11 of the CCAA.

[18] The issues for consideration on this motion are:

(a) should NNL apply a Transfer Ratio of 0.69; and

(b) if so, at what date should the new Transfer Ratio take effect.

(a) Should NNL apply a Transfer Ratio of 0.69?

[19] The PBA, at section 42, sets out certain provisions and restrictions for the transfer of commuted value from pension plans upon termination of employment. The restrictions are subject to the limits set out in section 19 of the Regulations. If a transfer is not in accordance with the Regulations, section 42(7) of the PBA provides that the approval of the Superintendent of Financial Services is required.

[20] NNL submits that the Regulations indicate a bias in favour of preserving plans assets as a whole, versus the right of an individual to commuted value payments. However, the Regulations do not address this particular case of substantial declines in a Transfer Ratio that is already lower than 1.0.

[21] NNL submits that section 19(5) provides an exemption for variances of less than 10%. However, section 19(4) only comes into operation where there is already a variance of 10% or more – from 100% (under section 19(3)) to 90% or lower. Section 19(5) therefore suggests that transfers should be halted where there are declines between discounted Transfer Ratios, and not just from 100%. NNL further submits that, to the extent that section 19(4) and (5) do not specifically provide for the situation where the Transfer Ratio has fallen from a ratio less than 100%, the PBA and Regulations are not a complete code. In this situation, NNL submits that it is appropriate to engage the principles of other applicable law where it can be applied harmoniously with the applicable pension legislation.

[22] I accept the above submissions of NNL. In his factum, counsel to NNL discusses the prospect of filing a fresh actuarial valuation with the Superintendent and concludes that this is not a remedy that assists the Members and, on the contrary, NNL expects that a fresh valuation would have the opposite effect as:

(a) NNL would be unlikely to be able to make the increased Special Payments required;

(b) the consequential deemed trust under the PBA would possibly motivate unsecured creditors to pursue a bankruptcy to defeat the deemed trust for missed Special Payments thereby negating any benefit to Members;

(c) creditors would be motivated to oppose the filing of the new actuarial valuation, and seek its restraint, leading to no reduced Transfer Ratio if successful; and

(d) the restructuring would be impaired by the ensuing controversy, prejudicing all stakeholders, including the Members and their interests in the eventual restoration of the deficits.

[23] NNL submits that it is open to the court to supplement the regulatory regime through the application of trust law and the CCAA. Trust law requires administrators of a pension plan to treat beneficiaries with an even hand. NNL submits that application of the even-handed principle is in direct accord with the principles and provisions of the pension legislation. NNL concludes that, in these circumstances, even-handed treatment of beneficiaries favours a reduction in Transfer Ratio to 0.69.

[24] The position of NNL is supported by Representative Counsel, counsel to the Board of Directors, CAW, the FSCO, and the Monitor. No party is opposed.

[25] It seems to me that the proposed reduction is consistent with the application of trust principles and treats all beneficiaries with an even hand. I am satisfied that, in view of the apparent gap in the PBA and the Regulations, I have the jurisdiction, either inherent jurisdiction or under section 11 of the CCAA, to authorize NNL to apply a reduced Transfer Ratio, without the filing of additional actuarial reports, to requests for commuted value transfers of 0.69 from the Plans.

(b) At what date should the Transfer Ratio of 0.69 apply?

[26] The second issue is to establish the effective date for the reduction of the Transfer Ratio. There would appear to be two options. The first option is to apply the reduced Transfer Ratio, with immediate effect. This option would negatively impact the 259 individuals who have requested a commuted value payment based on a 0.86/0.85 Transfer Ratio but who have not received a commuted value payment as of May 21, 2009, as well as the 231 individuals who have received election forms based on the 0.86/0.85 Transfer Ratio but who have not yet returned their preferred option as of May 21, 2009 (collectively, the "Transition Members"). The second option is to apply the 0.69 Transfer Ratio to future terminated employees, but not to Transition Members.

[27] The FSCO is in favour of the first option. NNL, the Board of Directors, Representative Counsel, the CAW and the Monitor are in favour of the second option. Each position has merit.

[28] The FSCO takes the position that fair and even-handed treatment requires that the new Transfer Ratio be implemented immediately. Counsel to the FSCO submits that the warning signals of the declining financial position of the Plans were such that this issue was identifiable at an earlier point in time and that to continue to make the payments based on a Transfer Ratio of 0.86 or 0.85 has the effect of preferring the Transition Members over the remaining Members. Counsel submits that this enhanced payment is inconsistent with the fiduciary obligation of the plan administrator and the Board. It is the position of the FSCO that the Board is accountable to all pensioners, and having regard to all pensioners and having determined that a change in the Transfer Ratio is required, fairness dictates that no further payments be made at the 0.86 or 0.85 Transfer Ratio.

[29] The other side of the argument is based on the promises made to the Transition Members who have elected or who have been provided with the option of making the election in response to the offer of NNL based on a 0.86 or 0.85 Transfer Ratio and that fairness and equity requires this promise to be honoured. Representative Counsel made reference to the affidavit of Mr. Campbell to support the claim that Transition Members will have relied upon the communication received from NNL to the effect that they would receive their payout based on 0.86/0.85 Transfer Ratio. In addition, counsel references hardship issues that have been suffered as a result of the failure of NNL to make the payment as scheduled on May 25, 2009.

[30] In my view, the position put forth by NNL as supported by Representative Counsel, the CAW and the Monitor is the most equitable option. At the time that the election forms were sent, the Transfer Ratio was 0.86/0.85 which was a statutorily approved calculation, notwithstanding apparent declines in the value of the Plans. In my view, Transition Members who received the election form are entitled to rely on the contents of the form. The election form does contain a reference in the covering letter to the effect that Nortel has filed under the CCAA and, as a result, some of the Members' entitlements outlined in the enclosed form may be affected and there could be future changes or impact. However, a reasonable interpretation of this statement is that it does not necessarily refer to payments under the Plans.

[31] It seems to me that the intention of NNL, in such circumstances, is not to prefer the Transition Members, but to honour a commitment made to the Transition Members.

[32] I also accept that the Board was aware of the Transfer Ratio issue at the outset of these proceedings and that they did take steps to address this issue. However, it takes some time to obtain an estimate of a revised Transfer Ratio. In this case, when this report was received, NNL did take action. In the perfect world, the Board may have requested an updated report earlier in the process, but there is nothing on the record to suggest that the Board did not discharge its duties in an acceptable manner.

[33] On balance, I have concluded that the Members who did receive the election form based on a Transfer Ratio of 0.86/0.85 are entitled to rely on this document. At the time the election

form was sent, 0.86/0.85 was the stipulated Transfer Ratio established in accordance with the PBA. The form is capable of acceptance without further input from NNL. It seems to me that it is only fair and equitable to permit Transition Members to receive a payout based on the Transfer Ratio outlined in the election form provided to them by NNL.

[34] Representative counsel relies on *Anova Inc. Employee Retirement Pension Plan v. Manufacturers Life Insurance Co.* (1994) 121 D.L.R. (4th) 162 (Ont. Gen. Div.) for the proposition that the duty of fairness does not always require strict equality between the treatment of different groups of beneficiaries. That is the situation in this case. It seems to me that the duty of fairness necessitates that Transition Members be entitled to rely on the election form and the 0.86/0.85 Transfer Ratio notwithstanding that the remaining Members will not, at this stage, be treated equally.

[35] In all of the circumstances, and given the relevant factors and balance of interests of the Members, I have concluded that the administrator of the Plans must permit the Transition Members to transfer their entitlements at the Transfer Ratio of 0.86/0.85, and require all future terminated employees to transfer their entitlements at the new Transfer Ratio of 0.69.

[36] If counsel are unable to agree on a form of order to give effect to the foregoing, arrangements can be made through the Commercial List Office to schedule an appointment to settle the appropriate form of the order.

MORAWETZ J.

DATE: June 1, 2009