CITATION: Sproule v. Nortel Networks Corporation, 2009 ONCA 833
DATE: 20091126
DOCKET: C50986 and C50988

COURT OF APPEAL FOR ONTARIO

Goudge, Feldman and Blair JJ.A.

BETWEEN:

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

C50986

Donald Sproule, David D. Archibald and Michael Campbell on their own behalf and on behalf of Former Employees of Nortel Networks Corporation, Nortel Networks Limited, Nortel Networks Global Corporation, Nortel Networks International Corporation and Nortel Networks Technology Corporation

Appellants

and

Nortel Networks Corporation, Nortel Networks Limited, Nortel Networks Global Corporation, Nortel Networks International Corporation and Nortel Networks Technology Corporation, the Board of Directors of Nortel Networks Corporation and Nortel Networks Limited, the Informal Nortel Noteholder Group, the Official Committee of Unsecured Creditors and Ernst & Young Inc. in its capacity as Monitor

Respondents

C50988

AND BETWEEN:

National Automobile, Aerospace, Transportation and General Workers Union of Canada

(CAW-Canada) and its Locals 27, 1525, 1530, 1535, 1837, 1839, 1905 and/or 1915

George Borosh and other retirees of Nortel Networks Corporation, Nortel Networks Limited, Nortel Networks Global Corporation, Nortel Networks International Corporation and Nortel Networks Technology Corporation

Appellants

and

Nortel Networks Corporation, Nortel Networks Limited, Nortel Networks Global Corporation, Nortel Networks International Corporation and Nortel Networks Technology Corporation, the Board of Directors of Nortel Networks Corporation and Nortel Networks Limited, the Informal Nortel Noteholder Group, the Official Committee of Unsecured Creditors and Ernst & Young Inc. in its capacity as Monitor

Respondents

Mark Zigler, Andrew Hatnay and Andrea McKinnon, for the appellants Nortel Networks Former Employees

Barry E. Wadsworth, for the appellant CAW-Canada

Suzanne Wood and Alan Mersky, for the respondents Nortel Networks Limited, Nortel Networks Corporation, Nortel Networks Global Corporation, Nortel Networks International Corporation and Nortel Networks Technology Corporation

Lyndon A.J. Barnes and Adam Hirsh, for the respondents Board of Directors of Nortel Networks Corporation and Nortel Networks Limited

Benjamin Zarnett, for the monitor Ernst & Young Inc.

Gavin H. Finlayson, for the Informal Nortel Noteholder Group

Thomas McRae, for the Nortel Canadian Continuing Employees

Massimo Starnino, for the Superintendent of Financial Services

Heard: October 1, 2009

On appeal from the order of Justice Geoffrey B. Morawetz of the Superior Court of Justice, dated June 18, 2009, with reasons reported at (2009), 55 C.B.R. (5th) 68.

Goudge and Feldman JJ.A.:

[1] On January 14, 2009, the Nortel group of companies (referred to in these reasons as "Nortel") applied for and was granted protection under the *Companies' Creditors Arrangement Act,* R.S.C. 1985 c. C-36, ("*CCAA*").

[2] In order to provide Nortel with breathing space to permit it to file a plan of compromise or arrangement with the court, that order provided, *inter alia*, a stay of all proceedings against Nortel, a suspension of all rights and remedies against Nortel, and an order that during the stay period, no person shall discontinue, repudiate, or cease to perform any contract or agreement with Nortel.

[3] The CAW-Canada ("Union") represents employees of Nortel at two sites in Ontario. The Union and Nortel are parties to a collective agreement covering both sites. On April 21, 2009, the Union and a group of former employees of Nortel ("Former Employees") each brought a motion for directions seeking certain relief from the order granted to Nortel on January 14, 2009. On June 18, 2009, Morawetz J. denied both motions.

[4] The Union and the Former Employees both appealed from that decision. Their appeals were heard one after the other on October 1, 2009. The appeal of the Former Employees was supported by a group of Canadian non-unionized employees, whose employment with Nortel continues. Nortel was supported in opposing the appeals by the board of directors of two of the Nortel companies, an informal Nortel noteholders group, and the Official Committee of Unsecured Creditors of Nortel.

[5] We will address each of the two appeals in turn.

THE UNION APPEAL

Background

[6] The collective agreement between the Union and Nortel sets out the terms and conditions of employment of the 45 employees that have continued to work for Nortel since January 14, 2009. The collective agreement also obliges Nortel to make certain periodic payments to unionized former employees who have retired or been terminated from Nortel. The three kinds of periodic payments at issue in this proceeding are monthly payments under the Retirement Allowance Plan ("RAP"), payments under the Voluntary Retirement Option ("VRO"), and termination and severance payments to unionized employees who have been terminated or who have severed their employment at Nortel.

[7] Since the January 14, 2009 order, Nortel has continued to pay the continuing employees their compensation and benefits as required by the collective agreement. However, as of that date, it ceased to make the periodic payments at issue in this case.

[8] The Union's motion requested an order directing Nortel to resume those periodic payments as required by the collective agreement. The Union's argument hinges on s. 11.3(a) of the *CCAA*. At the time this appeal was argued, it read as follows:[1]

> 11.3 No order made under section 11 shall have the effect of
>
> (a) prohibiting a person from requiring immediate payment for goods, services, use of leased or licensed property or other valuable consideration provided after the order is made.

[9] The Union's argument before the motion judge was that the collective agreement is a bargain between it and Nortel that ought not to be divided into separate obligations and therefore the "compensation" for services performed under it must include all of Nortel's monetary obligations, not just those owed specifically to those who remain actively employed. The Union argued that the contested periodic payments to Former Employees must be considered part of the compensation for services provided after January 14, 2009, and therefore exempted from the order of that date by s. 11.3(a) of the *CCAA*.

[10] The motion judge dismissed this argument. The essence of his reasons is as follows at para. 67:

> The flaw in the argument of the Union is that it equates the crystallization of a payment obligation under the Collective Agreement to a provision of a service within the meaning of s. 11.3. The triggering of the payment obligation may have arisen after the Initial Order but it does not follow that a service has been provided after the Initial Order. Section 11.3 contemplates, in my view, some current activity by a service provider post-filing that gives rise to a payment obligation post-filing. The distinction being that the claims of the Union for termination and severance pay are based, for the most part, on services that were provided pre-filing. Likewise, obligations for benefits arising from RAP and VRO are again based, for the most part, on services provided pre-filing. The exact time of when the payment obligation crystallized is not, in my view, the determining factor under section 11.3. Rather, the key factor is whether the employee performed services after the date of the Initial Order. If so, he or she is entitled to compensation benefits for such current service.

[11] The Union challenges this conclusion.

[12] In this court, neither the Union nor any other party argues that Nortel's obligation to make the contested periodic payments should be decided by arbitration under the collective agreement rather than by the court.

[13] Nor does the Union argue that any of the unionized former employees, who would receive these periodic payments, have themselves provided services to Nortel since the January 14, 2009 order.

[14] Rather, the Union reiterates the argument it made at first instance, namely that these periodic payments are protected by s. 11.3(a) of the *CCAA* as payment for service

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[1] The analogous section to the former s. 11.3(a) is now found in s. 11.01(a) of the recently amended *CCAA*.

provided after the January 14, 2009 order was made by the Union members who have continued as employees of Nortel.

[15] In our opinion, this argument must fail.

Analysis

[16] Two preliminary points should be made. First, as the motion judge wrote at para. 47 of his reasons, the acknowledged purpose of the *CCAA* is to facilitate the making of a compromise or arrangement between an insolvent debtor company and its creditors, to the end that the company is able to continue in business. The primary instrument provided by the *CCAA* to achieve its purpose is the power of the court to issue a broad stay of proceedings under s. 11. That power includes the power to stay the debt obligations of the company. The order of January 14, 2009 is an exercise of that power, and must be read in the context of the purpose of the legislation. Nonetheless, it is important to underline that, while that order stays those obligations, it does not eliminate them.

[17] Second, we also agree with the motion judge when he stated at para. 66:

> In my view, section 11.3 is an exception to the general stay provision authorized by section 11 provided for in the Initial Order. As such, it seems to me that section 11.3 should be narrowly construed.

[18] Because of s. 11.3(a) of the *CCAA*, the January 14, 2009 order cannot stay Nortel's obligation to make immediate payment for the services provided to it after the date of the order.

[19] What then does the collective agreement require of Nortel as payment for the work done by its continuing employees? The straightforward answer is that the collective agreement sets out in detail the compensation that Nortel must pay and the benefits it must provide to its employees in return for their services. That bargain is at the heart of the collective agreement. Indeed, as counsel for the Union candidly acknowledged, the typical grievance, if services of employees went unremunerated, would be to seek as a remedy not what might be owed to former employees but only the payment of compensation and benefits owed under the collective agreement to those employees who provided the services. Indeed, that package of compensation and benefits represents the commercially reasonable contractual obligation resting on Nortel for the supply of services by those continuing employees. It is that which is protected by s. 11.3(a) from the reach of the January 14, 2009 order: see *Re: Mirant Canada Energy Marketing Ltd.* (2004), 36 Alta. L.R. (4th) 87 (Q.B.).

[20] Can it be said that the payment required for the services provided by the continuing employees of Nortel also extends to encompass the periodic payments to the former employees in question in this case? In our opinion, for the following reasons the answer is clearly no.

[21] The periodic payments to former employees are payments under various retirement programs, and termination and severance payments. All are products of the ongoing collective bargaining process and the collective agreements it has produced over time. As Krever J.A. wrote regarding analogous benefits in *Metropolitan Police Service Board v. Ontario Municipal Employees Retirement Board et al.* (1999), 45 O.R. (3d) 622 (C.A.) at 629, it can be assumed that the cost of these benefits was considered in the overall compensation package negotiated when they were created by predecessor collective agreements. These benefits may therefore reasonably be thought of as deferred compensation under those predecessor agreements. In other words, they are compensation deferred from past agreements but provided currently as periodic payments owing to former employees for prior services. The services for which these payments constitute "payment" under the *CCAA* were those provided under predecessor agreements, not the services currently being performed for Nortel.

[22] Moreover, the rights of former employees to these periodic payments remain currently enforceable even though those rights were created under predecessor collective agreements. They become a form of "vested" right, although they may only be enforceable by the Union on behalf of the former employees: see *Dayco (Canada) Ltd. v. CAW-Canada,* [1993] 2 S.C.R. 230 at 274. That is entirely inconsistent with the periodic payments constituting payment for current services. If current service was the source of the obligation to make these periodic payments then, if there were no current services

being performed, the obligation would evaporate and the right of the former employees to receive the periodic payments would disappear. It would in no sense be a "vested" right.

[23] In summary, we can find no basis upon which the Union's position can be sustained. The periodic payments in issue cannot be characterized as part of the payment required of Nortel for the services provided to it by its continuing employees after January 14, 2009. Section 11.3(a) of the *CCAA* does not exclude these payments from the effect of the order of that date.

[24] The Union's appeal must be dismissed.

THE FORMER EMPLOYEES' APPEAL

Background

[25] The Former Employees' motion was brought by three men as representatives of former employees including pensioners and their survivors. On the motion their claim was for an order varying the Initial Order to require Nortel to pay termination pay, severance pay, vacation pay, an amount for continuation of the Nortel benefit plans during the notice period in accordance with the *Employment Standards Act, 2000*, S.O. 2000, c. 41 ("*ESA*") and any other provincial employment legislation. The representatives also sought an order varying the Initial Order to require Nortel to pay the Transitional Retirement Allowance ("TRA") and certain pension benefit payments to affected former employees. The motion judge described the motion by the former employees as "not

dissimilar to the CAW motion, such that the motion of the former employees can almost be described as a "Me too motion."

[26] After he dismissed the union motion, the motion judge turned to the "me too" motion of the former employees. The former employees wanted to achieve the same result as the unionized employees. The motion judge described their argument as based on the position that Nortel could not contract out of the *ESA* of Ontario or another province. However, as he noted, rather than trying to contract out, it was acknowledged that the *ESA* applied, except that immediate payment of amounts owing as required by the *ESA* were stayed during the stay period under the Initial Order, so that the former employees could not enforce the acknowledged payment obligation during that time. The motion judge concluded that on the same basis as the union motion, the former employees' motion was also dismissed.

[27] For the purposes of the appeal, the former employees narrowed their claim only to statutory termination and severance claims under the *ESA* that were not being paid by Nortel pursuant to the Initial Order, and served a Notice of Constitutional Question. The appellant asks this court to find that judges cannot use their discretion to order a stay under the *CCAA* that has the effect of overriding valid provincial minimum standards legislation where there is no conflict between the statutes and the doctrine of paramountcy has not been triggered.

[28] Neither the provincial nor the federal governments responded to the notice on this appeal.

[29] Paragraphs 6 and 11 of the Initial Order (as amended) provide as follows:

> 6. THIS COURT ORDERS that each of the Applicants, either on its own or on behalf of another Applicant, *shall be entitled but not required to pay* the following expenses whether incurred prior to, on or after the date of this Order:
>
> (a) all outstanding and future wages, salaries and employee benefits (including but not limited to, employee medical and similar benefit plans, relocation and tax equalization programs, the Incentive Plan (as defined in the Doolittle affidavit) and employee assistance programs), current service, special and similar pension benefit payments, vacation pay, commissions and employee and director expenses, in each case incurred in the ordinary course of business and consistent with existing compensation policies and arrangements;
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> 11. THIS COURT ORDERS that each of the Applicants shall have the right to:
>
> ...
>
> (b) terminate the employment of such of its employees or temporarily lay off such employees as it deems appropriate *and to deal with the consequences thereof in the Plan or on further order of the Court.*
>
> ...
>
> all of the foregoing to permit the Applicants to proceed with an orderly restructuring of the Business. [Emphasis added.]

[30] Pursuant to these paragraphs, from the date of the Initial Order, Nortel stopped making payments to former employees as well as employees terminated following the Initial Order for certain retirement and pension allowances as well as for statutory severance and termination payments. The *ESA* sets out obligations to provide notice of termination of employment or payment in lieu of notice and severance pay in defined circumstances. By virtue of s. 11(5), those payments must be made on the later of seven days after the date employment ends or the employee's next pay date.

[31] As the motion judge stated, it is acknowledged by all parties on this motion that the *ESA* continues to apply while a company is subject to a *CCAA* restructuring. The issue is whether the company's provincial statutory obligations for virtually immediate payment of termination and severance can be stayed by an order made under the *CCAA*.

[32] Sections 11(3), dealing with the initial application, and (4), dealing with subsequent applications under the *CCAA* are the stay provisions of the Act. Section 11(3) provides:

> 11. (3) A court may, on an initial application in respect of a company, make an order on such terms as it may impose, effective for such period as the court deems necessary not exceeding thirty days,
>
> (a) staying, until otherwise ordered by the court, all proceedings taken or that might be taken in respect of the company under an Act referred to in subsection 1; [the Bankruptcy and Insolvency Act and the Winding Up Act]

> (b) restraining, until otherwise ordered by the court, further proceedings in any action, suit or proceeding against the company;
>
> (c) prohibiting, until otherwise ordered by the court, the commencement of or proceeding with any other action, suit or proceeding against the company.

Analysis

[33] As earlier noted, the stay provisions of the *CCAA* are well recognized as the key to the successful operation of the *CCAA* restructuring process. As this court stated in *Stelco Inc. (Re)* (2005), 75 O.R. (3d) 5 at para. 36:

> In the CCAA context, Parliament has provided a statutory framework to extend protection to a company while it holds its creditors at bay and attempts to negotiate a compromised plan of arrangement that will enable it to emerge and continue as a viable economic entity, thus benefiting society and the company in the long run, along with the company's creditors, shareholders, employees and other stakeholders. The s. 11 discretion is the engine that drives this broad and flexible statutory scheme…

[34] Parliament has carved out defined exceptions to the court's ability to impose a stay. For example, s. 11.3(a) prohibits a stay of payments for goods and services provided after the initial order, so that while the company is given the opportunity and privilege to carry on during the *CCAA* restructuring process without paying its existing creditors, it is on a pay-as-you-go basis only. In contrast, there is no exception for statutory termination

and severance pay.[2] Furthermore, as the respondent Boards of Directors point out, the recent amendments to the *CCAA* that came into force on September 18, 2009 do not address this issue, although they do deal in other respects with employee-related matters.

[35] As there is no specific protection from the general stay provision for *ESA* termination and severance payments, the question to be determined is whether the court is entitled to extend the effect of its stay order to such payments based on the constitutional doctrine of paramountcy: *Crystalline Investments Ltd. v. Domgroup Ltd.*, [2004] 1 S.C.R. 60 at para. 43.

[36] The scope, intent and effect of the operation of the doctrine of paramountcy was recently reviewed and summarized by Binnie and Lebel JJ. in *Canadian Western Bank v. Alberta*, [2007] 2 S.C.R. 3 at paras. 69-75. They reaffirmed the "conflict" test stated by Dickson J. in *Multiple Access Ltd. v. McCutcheon*, [1982] 2 S.C.R.161:

> In principle, there would seem to be no good reasons to speak of paramountcy and preclusion except where there is actual conflict in operation as where one enactment says "yes" and the other says "no"; "the same citizens are being told to do inconsistent things"; compliance with one is defiance of the other. [p. 191]

[2] The issue of post-initial order employee terminations, and specifically whether any portion of the termination or severance that may be owed is attributable to post-initial order services, was not at issue in this motion. In *Windsor Machine & Stamping Ltd. (Re)* [2009] O.J. No. 3195, decided one month after this motion, the issue was discussed more fully and Morawetz J. determined that it could be decided as part of a post-filing claim. Leave to appeal has been filed.

[37] However, they also explained an important proviso or gloss on the strict conflict rule that has developed in the case law since *Multiple Access*:

> Nevertheless, there will be cases in which imposing an obligation to comply with provincial legislation would in effect frustrate the purpose of a federal law even though it did not entail a direct violation of the federal law's provisions. The Court recognized this in Bank of Montreal v. Hall, [1990] 1 S.C.R. 121, in noting that Parliament's "intent" must also be taken into account in the analysis of incompatibility. The Court thus acknowledged that the impossibility of complying with two enactments is not the sole sign of incompatibility. The fact that a provincial law is incompatible with the purpose of a federal law will also be sufficient to trigger the application of the doctrine of federal paramountcy. This point was recently reaffirmed in Mangat and in Rothmans, Benson & Hedges Inc. v. Saskatchewan, [2005] 1 S.C.R. 188, 2005 SCC 13. (para. 73)

[38] Therefore, the doctrine of paramountcy will apply either where a provincial and a federal statutory provision are in conflict and cannot both be complied with, or where complying with the provincial law will have the effect of frustrating the purpose of the federal law and therefore the intent of Parliament. Binnie and Lebel JJ. concluded by summarizing the operation of the doctrine in the following way:

> To sum up, the onus is on the party relying on the doctrine of federal paramountcy to demonstrate that the federal and provincial laws are in fact incompatible by establishing either that it is impossible to comply with both laws or that to apply the provincial law would frustrate the purpose of the federal law. (para. 75)

[39] The *CCAA* stay provision is a clear example of a case where the intent of Parliament, to allow the court to freeze the debt obligations owing to all creditors for past

services (and goods) in order to permit a company to restructure for the benefit of all stakeholders, would be frustrated if the court's stay order could not apply to statutory termination and severance payments owed to terminated employees in respect of past services.

[40] The record before the court indicates that the motion judge made the initial order and the amended order in the context of the insolvency of a complex, multinational conglomerate as part of co-ordinated proceedings in a number of countries including the U.S. In June 2009, an Interim Funding and Settlement Agreement was negotiated which, together with the proceeds of certain ongoing asset sales, is providing funds necessary in the view of the court appointed Monitor, for the ongoing operations of Nortel during the next few months of the *CCAA* oversight operation. This funding was achieved on the basis that the stay applied to the severance and termination payments. The Monitor advises that if these payments were not subject to the stay and had to be funded, further financing would have to be found to do that and also maintain operations.

[41] In that context, the motion judge exercised his discretion to impose a stay that could extend to the severance and termination payments. He considered the financial position of Nortel, that it was not carrying "business as usual" and that it was under financial pressure. He also considered that the *CCAA* proceeding is at an early stage, before the claims of creditor groups, including former employees and others have been

considered or classified for ultimate treatment under a plan of arrangement. He noted that employees have no statutory priority and their claims are not secured claims.

[42] While reference was made to the paramountcy doctrine by the motion judge, it was not the main focus of the argument before him. Nevertheless, he effectively concluded that it would thwart the intent of Parliament for the successful conduct of the *CCAA* restructuring if the initial order and the amended order could not include a stay provision that allowed Nortel to suspend the payment of statutory obligations for termination and severance under the *ESA*.

[43] The respondents also argued that if the stay did not apply to statutory termination and severance obligations, then the employees who received these payments would in effect be receiving a "super-priority" over other unsecured or possibly even secured creditors on the assumption that in the end there will not be enough money to pay everyone in full. We agree that this may be the effect if the stay does not apply to these payments. However, that could also be the effect if Nortel chose to make such payments, as it is entitled to do under paragraph 6 (a) of the amended initial order. Of course, in that case, any such payments would be made in consultation with appropriate parties including the Monitor, resulting in the effective grant of a consensual rather than a mandatory priority. Even in this case, the motion judge provided a "hardship" alleviation program funded up to $750,000, to allow payments to former employees in clear need.

This will have the effect of granting the "super-priority" to some. This is an acceptable result in appropriate circumstances.

[44] However, this result does not in any way undermine the paramountcy analysis. That analysis is driven by the need to preserve the ability of the *CCAA* court to ensure, through the scope of the stay order, that Parliament's intent for the operation of the *CCAA* regime is not thwarted by the operation of provincial legislation. The court issuing the stay order considers all of the circumstances and can impose an order that has the effect of overriding a provincial enactment where it is necessary to do so.

[45] Morawetz J. was satisfied that such a stay was necessary in the circumstances of this case. We see no error in that conclusion on the record before him and before this court.

[46] Another issue was raised based on the facts of this restructuring as it has developed. It appears that the company will not be restructured, but instead its assets will be sold. It is necessary to continue operations in order to maintain maximum value for this process to achieve the highest prices and therefore the best outcome for all stakeholders. It is true that the basis for the very broad stay power has traditionally been expressed as a necessary aspect of the restructuring process, leading to a plan of arrangement for the newly restructured entity. However, we see no reason in the present circumstances why the same analysis cannot apply during a sale process that requires the business to be carried on as a going concern. No party has taken the position that the

CCAA process is no longer available because it is not proceeding as a restructuring, nor has any party taken steps to turn the proceeding into one under the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3.

[47] The former employee appellants have raised the constitutional question whether the doctrine of paramountcy applies to give to the *CCAA* judge the authority, under s. 11 of the Act, to order a stay of proceedings that has the effect of overriding s. 11(5) of the *ESA*, which requires almost immediate payment of termination and severance obligations. The answer to this question is yes.

[48] We note again that the question before this court was limited to the effect of the stay on the timing of required statutory payments under the *ESA* and does not deal with the inter-relation of the *ESA* and the *CCAA* for the purposes of the plan of arrangement and the ultimate payment of these statutory obligations.

[49] The appeal by the former employees is also dismissed.

RELEASED: NOV 26 2009

"R. Roulph J.A."
"K. Feldman J.A."
"I agree R.S. Blair J.A."