International Corporate Rescue

Published by:
Chase Cambria Company (Publishing) Ltd
4 Winifred Close
Barnet, Arkley
Hertfordshire EN5 3LR
United Kingdom

Annual Subscriptions:
Subscription prices 2011 (6 issues)
Print or electronic access:
EUR 695.00 / USD 845.00 / GBP 495.00
VAT will be charged on online subscriptions.
For 'electronic and print' prices or prices for single issues, please contact our sales department at:
+ 44 (0) 207 014 3061 / +44 (0) 7977 003627 or sales@chasecambria.com

International Corporate Rescue is published bimonthly.

ISSN: 1572-4638

ARTICLE

Nortel Global Businesses Rescued via Formal Insolvency

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Nortel Networks ('Nortel'), a global supplier of end-to-end telecommunication technology products and solutions with global revenues in 2008 of USD 10.4 billion, filed for simultaneous insolvency protection orders in January 2009 in the United States (Chapter 11), Canada (CCAA), and in Europe (English Administration under the EC Regulation on Insolvency Proceedings 2000 ('the EC Regulation')). The insolvency has thus been managed across four broad theatres of activity, the USA, Canada, Europe and the Rest of the World (unfiled – outside formal process).

The Nortel trading insolvency is remarkable demonstrating clearly the ability to trade a global business in insolvency for a significant period, almost two years to date, across numerous jurisdictions with limited disruption to the operational efficiency of the business. There has been minimal requirement for cross border protocols from the European perspective. In Europe there has been a conspicuous absence of unplanned secondary proceedings, a feature and a problem in some recent trading insolvencies. The progress to date is a testament to the effectiveness of the EC Regulation.

Nortel pre insolvency

Nortel is a fallen angel. It originated from the manufacturing division of Bell Telephone Company of Canada which was later spun off and incorporated as Northern Electric & Manufacturing Company Limited in 1895. Following a series of acquisitions and name changes, the group became Nortel. Nortel operated several truly global business lines across three key market segments being;

- Enterprise solutions – providing telecom and technology solutions to large corporations;
- Carrier Networks – providing wireless infrastructure radio technologies, wireline voice products and solutions to telecom service providers; and
- Metro Ethernet Networks – providing optical and data networking products and services to service providers.

Nortel was listed on the Toronto Stock Exchange ('TSX'). At the height of the dot-com boom in 2000, Nortel generated approximately USD 30 billion of revenue and employed approximately 93,000 people worldwide. The market capitalisation of Nortel is reputed itself to have represented more than a third of the total value of all the companies listed on the TSX at its height.

Throughout the last decade Nortel faced increasing challenges owing to market saturation and the end of the technology boom. In response Nortel announced five separate restructuring plans over successive years, each focused on reducing real estate costs and a reduction in headcount. In addition to operational restructuring, Nortel sought to refinance its debt obligations without success. In the sustained adverse climate Nortel suffered a series of credit downgrades. Concurrently Nortel sought several M&A solutions without success. The global and highly integrated nature of its businesses, with, each legal entity typically trading all business lines, created logistical exit hurdles. Prospective purchasers in the pre-insolvency filing era cited complex separation issues and Nortel's debt and cost structure as problematic.

By the end of 2008, Nortel reported global revenues of USD 10.4 billion, a net loss of USD 5.8 billion (including a non-cash write off of goodwill of USD 2.4 billion) and had approximately 30,000 employees. In the final period pre insolvency increasing liquidity pressures including a class action settlement and pending interest on USD 4 billion of debt obligations led the directors to seek creditor protection/ file for insolvency proceedings. Significantly, at the date of filing the Nortel group had approximately USD 2.4 billion of cash and cash equivalents across its 150 entities. The board felt that with this available, restructuring could take place within the filed entities, with a view to an exit, leaner and fitter, at some future date.

The filing landscape

In order to optimise prospects and value, preserve liquidity and explore a restructuring solution, Nortel's directors ultimately sought simultaneous creditor protection filings in three key geographies in January 2009 as follows:

Geographic area	*2008 revenue USD million*		*Number of filed entities*
Canada	693	7%	Five filed entities, one jurisdiction
United States of America	4,427	42%	Fifteen filed entities, one jurisdiction
EMEA (Europe)	2,422	23%	Nineteen filed entities, seventeen jurisdictions
Asia, Caribbean and Latin America	2,879	28%	Outside formal insolvency protection
	10,421	100%	

- Canada – head office and representing 7% of global revenue – filed for protection under the Companies Creditors Arrangement Act in the Ontario Superior Court of Justice, Canada
- United States – representing 42% of global revenue – filed for Chapter 11 protection under the US Bankruptcy Code in the district of Delaware
- Europe – representing 23% of global revenue – 19 entities across 17 European countries[1] filed for English Administration under the EC Regulation and the English Insolvency Act 1986 in the English High Court
- the Asia Pacific ('APAC') and Caribbean and Latin America ('CALA') regions have not filed for insolvency protection and have continued to trade as part of the group strategy. The procuring of filing protection was made difficult by the broad geography, and, in contrast to Europe with the presence and benefit of the EC Regulation there was no obvious mechanism for avoiding a multiplicity of appointments/office holders. The filings in USA, Canada, and Europe assisted in creating an environment with an appropriate degree of stability. The directors of the APAC and CALA entities continue to monitor their circumstances in the context of being part of a group, the majority of which has sought protection.

Nortel's totally integrated characteristics necessitated a highly coordinated approach to filing and insolvency strategy. The filing process was commenced after considerable pre-appointment planning by the respective debtors. The day one protocols between the filing groups were modest in number but important in content. A cross border protocol was established between the Canadian and US estates. The early day protocol amongst the three main insolvency theatres, Europe, Canada and the US consisted of an agreement to pay for post petition supplies of goods and services intra group without set off for pre-petition liabilities. This simple protocol was incredibly important. Like many global businesses, Nortel operated a transfer pricing system which was evident in the intra-group funding dynamics and aimed to be reflective of the funds flows arising from its various activities including sales, procurement and research and development activities.

In order to continue to trade in insolvency it was imperative that a common insolvency proceeding be utilised as extensively as possible in Europe. In preparing for and procuring the administration orders in Europe it was clearly established that the centre of main interest ('COMI') for eighteen legal entities registered in mainland Europe was England. The registered office presumption was rebutted in favour of a 'European Head Office' for the EMEA region. Thus the EMEA entities have been able to benefit from a single unified approach to the global insolvency. Four administrators from Ernst & Young have been able to provide one voice for a material part of Nortel's operations which required protection. This has been instrumental in maintaining the ability to trade, procuring the operational integrity of the group during the filing, servicing customers, providing requisite confidence to suppliers and protecting the separate interests of the creditor groups of the filed entities. The single administration process has enabled economy of effort in dovetailing with the wider group and notwithstanding the eighteen separate administrations they are almost regarded as a single proceeding by the North American entities and their stakeholders.

Establishing a stable platform in Europe

In order to optimise prospects in administration the joint administrators of the Nortel European entities procured first day orders to bring a measure of local jurisdiction parity to preferential creditors:

Notes

1 English Administration orders were granted in respect of Nortel entities in the following jurisdictions: England, Ireland, France, Spain, Italy, Romania, Hungary, Czech Republic, Germany, Netherlands, Finland, Slovakia, Sweden, Belgium, Poland, Austria, Portugal.

The first day orders provide liberty to the joint administrators to:

– Make such payments to employees as they would receive if secondary proceedings were commenced
– Make such payments to creditors whose claims would be preferential under the laws of the relevant jurisdiction if secondary proceedings were to be commenced.

In addition to the first day order, the English High Court, at the request of the joint administrators wrote to the respective courts of each filed European jurisdiction requesting that those courts notify the English Court of any application to open secondary proceedings and to grant the joint administrators the right to make submissions in respect of any applications to commence secondary insolvency proceedings.

These stabilisation steps have worked very well. The Nortel case is quite remarkable in the absence of secondary proceedings. This has doubtless reduced the complexity and cost of the administration processes throughout Europe. To date, one European Nortel entity has entered into a secondary proceeding, Nortel Networks France SA. A secondary proceeding was commenced at the request of the joint administrators themselves on application to the Tribunal de Commerce of Versailles. This was done in order to take advantage of certain French state funds for dealing with employee claims. The UK administration process is not recognised by the French fund. The joint administrators and the French office holders subsequently appointed have helped the French entity concerned to continue to follow the collective group strategy and optimise prospects for achieving the best outcome for its creditors.

It was necessary that the European entities (in common with all global entities) balance their books in administration in order that they could continue to trade. Thus it was necessary to reduce operational costs. Throughout Europe a number of measures were undertaken to reduce headcount to reflect declining revenues and address the cash flow deficit. The administration process has of course not obviated the necessity to follow the local law in respect of a group wide redundancy process. In Europe the requisite processes are diverse in terms of technique, timescale and expectation. This redundancy process has involved significant interaction with local works-councils throughout Europe, and implementation of bespoke measures in various jurisdictions including establishing a transfer company in Germany and, where possible, accessing local redundancy support funds for the benefit of the employees. Real estate obligations were reduced and where necessary alternative working arrangements were established to minimise business disruption.

Survival of the businesses – business and asset disposals via Chapter 11 s. 363 auctions

Having established a stable trading platform following the global filings, and the Canadian board having explored various restructuring options, Nortel concluded that the best value for creditors could be achieved by pursuing separate sales of its various global businesses.

The extent of the inter-linked nature of the six Nortel businesses was all pervading. In order to market and sell the six businesses, a carve out process was undertaken to make each business stand alone. From a practical perspective migration to a purchaser could never be instantaneous. Thus transitional services infrastructure was established to provide requisite IT and logistical support to respective buyers for a period of up to eighteen months post sale.

All six global businesses have now been sold raising USD 3.2 billion in sale proceeds. Each business was marketed and structured as a global asset sale, rather than local entity sales. The sales were particularly complex owing to the need to dovetail respective local employment, tax and insolvency laws.

The businesses have been sold using the established Chapter 11 stalking horse process, under s. 363(b) of the US Bankruptcy Code. This has worked well and is a powerful model to demonstrate and maximise value for stakeholders. Under the s. 363 procedure a two stage sale process is followed whereby a stalking horse bidder is selected following a competitive marketing phase and sale documentation negotiated and executed. In most of the Nortel transactions the stalking horse bid was subsequently taken to auction where alternative bidders sought to acquire the business. The two stage process generated an additional USD 1 billion of value to Nortel increasing the aggregate stalking horse bid values from approximately USD 2 billion to USD 3.2 billion at auction.

Thus the business disposal strategy has generated value for the Nortel estates through both sale proceeds and migrating customer and employee contracts. For each transaction and throughout the trading period the EMEA administrators have continuously assessed at an individual entity level the likely merits of following the group disposal strategy to ensure that at all times a particular course of action is in the best interests of the creditors of each entity.

Allocation of disposal proceeds across the vendor entities, virtually the entire group in each instance, is an obvious and inevitable question for the estates, their creditors, administrators, fiduciaries in various insolvency proceedings and the directors of the non filed entities. The estates agreed amongst themselves that the priority was to focus efforts on getting the best value from the sale processes and avoid inter-estate interests interfering with an efficient sale strategy. Thus an agreement was made to place all sale proceeds generated from asset sales into escrow 'lock boxes' pending

agreement on allocation. This at a practical level is the second significant intra estate protocol that has been vital to the global insolvency. Having achieved sales of all six global businesses, the group is now focused on marketing its residual assets including a significant patent portfolio and certain equity interests whilst moving forward with inter-estate discussions on allocation of over USD 3 billion of proceeds currently in the lock box.

This case is an endorsement of the importance of having flexible insolvency proceedings capable of creating stable insolvency platforms from which to trade groups during a period of prolonged protection. From the European perspective the case demonstrates the necessity of having appropriate legislation on hand to give effect to common style insolvency proceedings across member states. It is very difficult to envisage that the outcome of the Nortel insolvency would have achieved this absent the EC Regulation. The case also illustrates that stakeholder groups can focus on common goals with the minimum formality where needs must. The case is not over yet as there are a number of important intra estate matters to resolve. But without a doubt, the first part has gone well.

The key issues now confronting the estates in the second phase of the global insolvency are:

- The purchase price allocation process
- The agreement of inter-company claims
- The disposal of the residual businesses
- The provision of transitional services to purchasers
- The implementation of various schemes to enable value to flow to creditor groups in different jurisdictions

Given the breadth of issues, a second article will follow.

International Corporate Rescue

International Corporate Rescue addresses the most relevant issues in the topical area of insolvency and corporate rescue law and practice. The journal encompasses within its scope banking and financial services, company and insolvency law from an international perspective. It is broad enough to cover industry perspectives, yet specialized enough to provide in-depth analysis to practitioners facing these issues on a day-to-day basis. The coverage and analysis published in the journal is truly international and reaches the key jurisdictions where there is corporate rescue activity within core regions of North and South America, UK, Europe Austral Asia and Asia.

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