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THE GLOBAL LEGAL AWARDS | DISPUTES

Taming the Perfect Storm

In one of the most complex and contentious cross-border bankruptcies ever, Nortel's battling Canadian, U.S., and European estates finally had to make a deal.

By Emily Barker

BACK IN 2011, WHEN INSOLVENT NORTEL Networks Corp. raised about $4.5 billion by selling off many of its patents in a groundbreaking auction, it seemed like very good news for the company and its creditors. The sell-off of the failed telecom technology company's businesses had brought in another $3.5 billion. "It was much more than could have been hoped for at the start," says Herbert Smith Freehills litigation partner John Whiteoak, who represented Nortel's European arms.

Then things turned ugly, as the various parts of the defunct company battled each other for their share of the proceeds. "There's only one thing worse than a bankruptcy with not enough money," says Jay Carfagnini, head of the restructuring practice at Toronto's Goodmans, who represented the monitor for the Canadian debtor, Ernst & Young Inc. "That's a bankruptcy with too much money." The fight involved multiple mediations; a 21-day trial held simultaneously in American and Canadian courts via video link; almost $2 billion paid out in legal and other professional fees; and finally, in 2016, settlement. The Nortel saga, says bankruptcy partner James Bromley of Cleary Gottlieb Steen & Hamilton, counsel to the U.S. debtor, "is probably one of *the* most complicated international insolvencies to ever occur."

At the time of its bankruptcy in 2008, Nortel had about 30,000 employees in 39 different companies around the world. It spawned three bankruptcy main estates: in Canada, where Nortel was headquartered; in the United States; and in the United Kingdom and Europe. Nortel's business lines, which included wireless and ethernet networking products, spanned national borders and individual subsidiaries; they were so intertwined that early on the Nortel estates and their representatives came to a fateful decision. To maximize returns, Bromley says, "we came to the conclusion that it made sense to sell the businesses to raise money and fight over how to divide up the money later."

"You've got this melting ice cream cone, and you've got to get it sold and figure out who gets the 10 cents later," Carfagnini says.

In addition to raising billions, the rapid sell-off of Nortel businesses in 2009 and 2010 allowed a significant majority of Nortel jobs to move to other companies. "Even though Nortel Networks is no longer out there, its ideas and expertise are still in the marketplace," Bromley says.

But the first attempts to divvy up the $7 billion pie via mediation failed. The lawyers who had worked together to facilitate the sale of assets now battled to increase their clients' share.

The three sides in the dispute were bitterly divided. The U.S. debtor, whose creditors included bondholders such as Elliott Management and Quantum Partners LP, based its claim for more than 70 percent of the proceeds on the fact that most of Nortel's revenues had come from the U.S. market. The Canadian debtor and its monitor contended that the rights to the company's valuable IP were held by its Canadian entity, which should therefore receive more than 80 percent of the proceeds. The U.K. estate, which included 19 other European companies, held out for almost 20 percent, making the argument that much of that IP had been developed in Nortel's European operations. Other creditors and stakeholders raised their voices, too: Early mediations had as many as 200 people in the room.

HONOREES

Herbert Smith Freehills; Debevoise & Plimpton; Hughes Hubbard & Reed; Davies Ward Phillips & Vineberg; Lax O'Sullivan Lisus Gottlieb; Young Conway Stargatt & Taylor; Skadden, Arps, Slate, Meagher & Flom; Goodmans; Allen & Overy; Gowling WLG; Norton Rose Fulbright; Buchanan Ingersoll & Rooney; **Cleary Gottlieb Steen & Hamilton; Morris**, Nichols, Arsht & Tunnell; Torys

In 2014 courts in two countries heard the so-called allocation dispute, via a single trial. While joint U.S.-Canada hearings are not uncommon in cross-border bankruptcies, Carfagnini notes, a full-blown trial was something new. A video internet connection allowed U.S. Bankruptcy Judge Kevin Gross of the District of Delaware and Ontario Superior Court Justice Frank Newbould to hear evidence and arguments in each other's courtrooms, including questioning witnesses. Court procedure was more complicated. While the American and Canadian court systems are similar, there are key differences, especially when it came to conducting witness depositions, Carfagnini says.

"We quite literally had to make up rules for the court, so we used a bit of the Canadian system and a bit of the U.S. system," Whiteoak says.

The trial outcome was a turning point in the case, lawyers say. Both courts united in rejecting the arguments of all three debtors. "The debtors have lost sight of the irrationality of their respective positions," Gross wrote in his May 2015 opinion. Instead, the courts ordered a modified pro rata allocation that would have given the Canadian debtor 63 percent, the U.S. debtor 15 percent, and the European debtors 22 percent.

It was effectively a loss for the United States and Canada, and a win for the European entities. Although the courts' ruling was promptly appealed in both the United States and Canada, it propelled all three debtors back to the negotiating table. "That put a lot of pressure on the parties," Whiteoak says.

Mediation restarted under the supervision of retired federal district judge Joseph Farnum Jr. "We had some extraordinarily difficult meetings," Bromley says, "but we remained in the room."

"In a sense there were so many issues that had to be resolved, that you had to get to a point where you could resolve them all in one go," says Herbert Smith restructuring partner Kevin Pullen. Also increasing the pressure was the time and expense that the case had already cost: By early 2016, professional fees totaled $1.6 billion.

The three sides reached the framework of a deal in July 2016. "We had spent years working together, and years fighting," Bromley says. "It took the better part of a year to negotiate the settlement, get to the handshake, then negotiate the document." In the end, $4.1 billion would go to the Canadian debtor, $1.8 billion to the U.S. debtor, and the remaining $1.3 billion to the European companies. Nortel's creditors began receiving their long-delayed money in summer 2017. "At the end of the day, the decision of the court and settlement that was entered into resulted in unsecured creditors around the world kind of getting the same recovery," Carfagnini says: between about 42 and 50 cents on the dollar, according to media reports.

"I don't think we'll see another case like it," he adds. "It was kind of like a perfect storm."

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