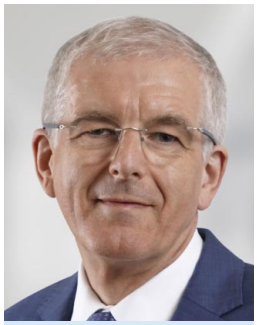
Lessons to be learned from the Nortel Case

Reinhard Dammann asks what are the lessons to be learnt from the recent case with main and secondary proceedings in the UK and France



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The multibillion-dollar insolvency of Nortel, which started in 2009, is the most complex cross-border insolvency case of the last decade, involving proceedings opened in Canada, the US and in Europe.

Pursuant to Article 3 of the EIR 1346/2000, the High Court in London found that the COMI of all Nortel's European subsidiaries was located in the UK. Hence, main insolvency proceedings were opened in London for all 17 Nortel European entities, and notably for its French entity Nortel Networks SA (**NNSA**). At the request of NNSA's UK Joint administrators, in May 2009, the Commercial Court of Versailles opened secondary proceedings, adding an additional layer of complexity to the process. NNSA's insolvency proceedings are about to be closed with an extraordinary result: the payment of 100% of all claims plus interests.

At a time when legislators are competing in Europe to establish the most efficient insolvency and restructuring framework, the Nortel case provides a unique case study. What are the lessons to be learned?

Protocol for success

The first stage of the Nortel case was a real success story. The insolvency practitioners of all the involved estates agreed on a protocol to optimise the value generated under the supervision of the US insolvency court, acting in perfect cooperation with their Canadian colleagues. The Chapter 11 stalking-horse bidding procedure achieved an extraordinary $7.7 billion price for Nortel's IP rights which was placed in a lockbox with JP Morgan in New York.

All European proceedings were centralised in London, where the same joint administrators were appointed for all proceedings in order to facilitate the international cooperation and coordination.

However, serious disagreements arose with respect to the distribution of the proceeds in the lockbox. As the distribution key had not been agreed upon before the auction process, the allocation of the sums became the subject of litigation among the office holders of the American, Canadian, British main proceedings and French secondary proceedings. It also involved US bondholders and the UK pension fund. These disputes lasted nearly for a decade, creating a lot of frustration among unsatisfied creditors. The cross-border implications made it extremely difficult to reach a final, mutually acceptable settlement. The intervention of mediators and independent conflict administrators proved to be very helpful to cut the Gordian knot.

Hence, the first lesson from the Nortel case is very clear: In a cross-border case, the protocol needs to address not only an efficient auction procedure but also the distribution of the amounts generated.

UK and French interaction

The second interesting subject matter of the Nortel saga is the interaction between UK main and French secondary insolvency proceedings.

Initially, in January 2009, the NNSA's UK joint administrators wanted to avoid the opening of secondary proceedings in France in order to include the assets of NNSA, located in France, into the global auction process.

However, in May 2009, UK joint administrators were confronted with the challenge to coordinate laying off 500 employees working in the R&D department near Versailles in the context of main insolvency proceedings governed by UK law. This was an impossible mission and the UK joint administrators filed for the opening of secondary proceedings in order to benefit from French insolvency law and the intervention of the French employee insurance fund, the AGS, that would bear the redundancy costs. In addition, prior to the opening of proceedings, the liquidity that was generated by the ongoing business of NNSA in France was centralised with RBS in London.

A protocol between the practitioners of the main and secondary proceedings was designed and concluded to solve all pending problems. The UK joint administrators agreed to transfer back to France all liquidities. The French liquidator agreed to assume all administration expenses incurred by the main proceedings with respect to the ongoing activities of NNSA in France before the opening of secondary proceedings, as well as those incurred by the joint administrators representing the interests of the French secondary proceedings of NNSA in the

framework of the global auction process in the US.

The French liquidator settled the claims of NNSA's employees providing for the payment of an extraordinary indemnity claim of €100.000 in favour of each employee. The settlement agreement contained a waterfall for the payment of privileged workers' claims, administration expenses and the other unsecured claims.

Main or secondary proceedings?

Following the US auction proceedings, the question arose as to whether the claim of NNSA against JP Morgan, as holder of the lockbox, belonged to the main or secondary proceedings. Under the rules of EIR, such claim was part of the main proceedings, since the debtor of the claim was located in the US, outside the territory of the secondary proceedings. However, the French employees took the position that, at the date of the opening of secondary proceedings, all assets of NNSA were located in France. Any subsequent transfer of assets to another State should therefore be irrelevant. The question also occurred as to whether the Court of Versailles had jurisdiction to determine the assets belonging to the secondary proceedings. The joint administrators pleaded that the courts of the main proceedings had exclusive jurisdiction.

The Court of Versailles referred these questions to the European Court of Justice (**ECJ**) which handed down its decision on 11 June 2015. The ECJ confirmed the (non-exclusive) jurisdiction of the Court of Versailles and held that the picture of the assets belonging to the secondary proceedings must be taken at the date of the opening of proceedings. Any subsequent transfer to another State should be disregarded. The question as to whether NNSA's share in the IP rights, that were subject to a Canadian trust, were located in France at the date of the opening of secondary proceedings, as suggested in the opinion of the Avocat General, was not decided by the ECJ, which referred this question back to the Commercial Court of Versailles.

This lawsuit was finally settled thanks to the intervention of the conflict administrator, who was appointed within the main proceedings. The practitioner of the secondary proceedings adopted a very pragmatic approach, considering that its pro-rata share of the lockbox under the settlement was sufficient to close the proceedings with an excess of cash. Indeed, secondary proceedings were just closed, and the French liquidator transferred a liquidation bonus of more than €20 million to the main proceedings.

What are the lessons to be learned?

First, the determination of the scope of the assets and liabilities of secondary proceedings could give rise to rather complex questions. Recital 46 of the recast EIR 2015/848 prohibits any abusive transfer, by the insolvency practitioner of the main proceedings, of assets located in a Member State, where an establishment is located, with the purpose of frustrating the interests of subsequently opened secondary proceedings. Hence, this recital supplements the ECJ ruling in Nortel pursuant to which the scope of assets shall be determined at the date of the opening of secondary proceedings.

Indeed, and in particular in the case of centralised cash pooling, if the opening of secondary proceedings is likely to occur, the office holders of main proceedings should not transfer any assets of the establishment, before the opening of secondary proceedings, to another Member State, outside the ordinary course of business. Protocols among insolvency practitioners of main and secondary proceedings are best designed to resolve this topic and settlements have proven more efficient than lengthy litigations.

The comparison of the efficiency of French liquidation proceedings versus UK insolvency proceedings provided an unexpected outcome. French liquidation proceedings have the reputation of being quite lengthy and inefficient. The Nortel case proved quite the contrary. The NNSA secondary proceedings have been handled by the French liquidator in a pragmatic cost-efficient manner. The rulings handed down by the Commercial Court of Versailles were a model of efficiency and predictability. The amount of all fees and costs were reasonable. Conversely, while English law proved very efficient in valuing the assets during the first stage of the Nortel case, the distribution phase turned out to be lengthy, rigid and extremely costly. ■

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