Nortel

A global sales process for a global restructuring

Gavin Davies, Kate Carlile, Stephen Gale, John Whiteoak and **Bruno Basuyaux** of **Herbert Smith LLP** analyse how Nortel dealt with its insolvency to maximise return to creditors.

Illustration: Getty Images

Nortel, one of the world's largest telecommunications groups, filed for insolvency protection in Canada, the US and the UK on 14 January 2009. Since that time, the group has been focused on trying to realise value for creditors by disposing of its business in a number of separate cross-border disposals.

Both the multi-jurisdictional insolvency filings and the cross-border disposals have been extraordinarily complex and required a large degree of co-operation among the three insolvent estates (in Canada, the US and the Europe, Middle East and Africa region (EMEA)) and also with creditors.

This co-operation has been the most important factor in maximising the return to creditors. Despite their competing interests, the three estates quickly agreed that all creditors would be best served if they worked together to focus on realising value through a co-ordinated disposal of the business units.

This article examines the Nortel group insolvency which consisted of a four-stage process:

- Filing for insolvency protection.
- Carrying out the M&A strategy of realising value for creditors.
- Allocation of M&A proceeds among the estates.

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had coupon payments totalling $107 million due on convertible notes issued by NNC. Nortel management concluded that a comprehensive business and financial restructuring was required which could only be accomplished through a formal insolvency process. Therefore, the decision was ultimately taken in North America to file for insolvency protection before the coupon payment date.

North American filings

On 14 January 2009, NNC and certain of its Canadian subsidiaries applied for protection under the Canadian Companies' Creditors Arrangements Act (CCAA) (*see box "North American insolvency regimes"*). Concurrently, Nortel Networks Inc and certain US subsidiaries filed under Chapter 11 of the US Bankruptcy Code (Chapter 11).

Given the integrated nature of the Nortel group, it was considered necessary for the Canadian and US proceedings to be as co-ordinated as possible. Accordingly, the Canadian filing entities applied for the Canadian proceedings to be recognised as foreign main proceedings under Chapter 15 of the US Bankruptcy Code while the US filing entities applied for the Chapter 11 proceedings to be recognised in Canada as foreign proceedings.

North American insolvency regimes

Key features of the Canadian Companies' Creditors Arrangement Act are as follows:

- The goal is to allow a debtor to continue to operate its business while formulating a plan of arrangement and compromise. The court may order a stay against the debtor while it attempts to restructure its business.

- There is no prescribed form for such plans. They will be the result of negotiations between the debtor and its creditors.

- The debtor remains in control of its affairs, subject to the scrutiny of the court and its appointed officer, the monitor. The monitor reports to the court on the debtor's financial and operational position. It is also the debtor's foreign representative in the US Chapter 15 proceedings (*see "North American filings" in the main text*).

Key features of Chapter 11 of the US Bankruptcy Code are as follows:

- The goal is to provide the debtor with an opportunity to marshal its assets, reconcile its debts and formulate a plan of reorganisation.

- The debtor's management remains in control and manages the company for the interests of its stakeholders, including creditors who are represented by a creditors' committee. The debtor may continue to enter into ordinary course transactions but transactions outside the ordinary course require court approval.

- Proceedings may result in a standalone reorganisation of the debtor, a section 363 auction of its assets and/or the liquidation of the debtor (*see "North American filings" in the main text*).

- An automatic stay is imposed preventing the debtor's creditors from asserting or otherwise pursuing pre-filing claims.

Each group of entities proposed that the relevant court adopt a cross-border insolvency protocol to ensure that both proceedings were managed effectively. This protocol provided, among other things, for court hearings to be held concurrently and linked up via video networking.

The Nortel entities in the Caribbean and Latin America region and Asia Pacific (APAC) region have not filed for insolvency protection. However, directors in those regions are continuously monitoring their entity's financial position to ensure that this remains an appropriate decision.

EMEA filings

The view in EMEA was that the North American filings would cause an unavoidable impairment of the operations of the EMEA entities. The highly-integrated nature of the Nortel group meant that customer and supplier confidence in Nortel would be severely affected by the North American filings. The group would not be able to continue its internal trading arrangements and any global restructuring solution (for example, a sale of the business units) would be very difficult to achieve with only the North American side of the business under insolvency protection.

Additionally, there was the risk of losing control of individual entities if local insolvency proceedings were commenced by directors or creditors. Most (but not all, for reasons discussed below) of the EMEA entities therefore also applied for insolvency protection under the EU Insolvency Regulation (*1346/2000*) (the Regulation) and the UK's Insolvency Act 1986 (1986 Act) on 14 January 2009. It was the largest and most complex administration filing of its kind.

EMEA CONSIDERATIONS

In order to prepare for the English law administration proceedings, the directors of the EMEA entities had several considerations to deal with:

Corporate governance

The board composition of the EMEA entities had to be addressed before any filing. The Nortel group was run on a global and regional basis with operational divisions made along business units within the EMEA region. Each individual legal entity had its own board

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of the Regulation which had the effect of suspending the six-month period and enables a continuation of trading until shortly before the disposal of the business.

The second issue was resolved through very close co-operation with the local French court and the French office holders in order to comply with all compulsory provisions of French law in a manner and timing which had to fit with the overall deal process (*see "Ongoing trading" below*).

ONGOING TRADING

Immediately after filing, the key focus of Nortel, the Canadian court-appointed monitor (the monitor) and the joint administrators was to continue trading on a "business as usual" basis as much as possible while they determined what would be the best method of maximising the return to creditors.

Global co-operation

All three estates (Canada, US and EMEA) quickly came to the view that a co-ordinated series of global sales of each business unit was the best option.

The strategy for preserving the ordinary course of business by global co-operation included:

- Retention of senior management to undertake global roles in continuing management and running the sales process, notwithstanding the appointment of the monitor and the joint administrators.
- Retention of key employees to allow trading to continue on a business as usual basis, although, of course, subject, in the case of EMEA, to the overall supervision of the joint administrators.
- Weekly meetings between the three estates to monitor and develop strategy in relation to the sales processes and potential reorganisation.
- Providing information to employees in a consistent and co-ordinated manner.
- Agreeing a consistent approach to dealing with global suppliers that took into account the requirements of the different insolvency regimes.

Intra-group trading and funding

To allow each entity to continue to trade post-filing, the Nortel group needed to ensure the continuation of its complex internal purchasing system and transfer pricing arrangements.

The main agreement governing these arrangements was the Group Supplier Protocol Agreement. This agreement, effective from 14 January 2009, enabled EMEA to continue to trade with the US and Canada in the ordinary course on the basis that goods and services provided post-filing would be paid for in full.

Supplemental funding agreements were entered into with the APAC entities, also with the objective of ensuring the continuation of business as usual.

Third party dealings

Under English administration law, any debts or liabilities arising under a contract entered into after administration has begun will be treated as administration expenses and given priority over unsecured creditor claims (*paragraph 99(4), Schedule B1, 1986 Act*). In continuing to trade on a business as usual basis, the joint administrators had therefore to strike a balance between allowing the business to contract on "standard" terms in order to retain customers, and minimising the extent of administration expenses.

They did so by devising a contracting guide for the business which set out the terms on which joint administrators were prepared to contract with customers and suppliers. Broadly, these terms sought to minimise any warranties or indemnities that the business gave to third parties as much as possible without deterring third parties from entering into contracts at all. Nortel staff dealt with third parties on this basis with support provided by the joint administrators when required.

M&A DISPOSALS

Although the disposals involved the sale of assets in many jurisdictions, each of the disposals was marketed and structured as a global asset sale, rather than individual local sales, to maximise value (*see box "Sales"*).

Each sale involved assets located in Canada, the US, EMEA and other jurisdictions, with most value lying in the intellectual property, goodwill and the customer base rather than in the fixed assets. Each sale also had to comply with relevant insolvency law in all these jurisdictions.

US sales

The sales were conducted using a US insolvency process under section 363(b) of the US Bankruptcy Code (section 363 auction) (*see box "North American insolvency regimes"*). A section 363 auction process, also known as a stalking horse auction process, is one of the ways in which a US debtor can sell assets in bankruptcy. The overriding condition is that the debtor needs to be able to demonstrate to the court that the deal is the highest and best possible. Each of the disposals therefore followed broadly the same two-stage auction process:

- A stalking horse bidder was selected following a fairly customary competitive M&A auction process. Definitive agreements were negotiated and executed in each process, conditional on the outcome of the section 363 auction and providing certain protections to the stalking horse bidder if it lost the auction (namely, a break fee and expense reimbursement).
- A competitive live auction was conducted, regulated by bidding procedures that are agreed with the stalking horse bidder and approved by the US Bankruptcy Court. The bidding procedures allow any interested party who meets the stated criteria to undertake a period of due diligence and submit bids. Any bids submitted were considered with a view to determining if they were higher and

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nadian and the rest of the world assets (governed by New York law) and the other for the EMEA assets (governed by English law). Both agreements were inter-conditional, followed broadly the same structure, had the same commercial terms and were conditional on the section 363 auction.

The agreement for the EMEA assets, however, had some key differences that reflected the market position in the UK with regards to the sale of assets out of an administration. For example, in the EMEA agreement, there were significantly fewer buyer protections (such as business warranties or specific indemnities), assets were sold on an "as is where is" basis and post-completion covenants were kept to a minimum. (*See also feature article "Buyer beware: buying the business of an insolvent company", www.practicallaw.com/6-500-4537.*)

Transitional services agreement (TSA). Each deal also included a TSA and other ancillary agreements usually found in an asset deal (*see feature article "Transitional services agreements: a cornerstone of modern M&A", this issue*). In the case of the TSA, a usual structure was not appropriate because of the intention to wind up the selling entities (in particular, the EMEA entities) in a shorter time frame than that for which buyers would usually require transitional services. A new company was therefore established specifically for the purpose of providing transitional services for each of the disposed business units for the required time period.

Inter-estate issues

In every disposal, the three estates worked together closely to bring the deal to consummation. Representatives from Canada, the US and EMEA attended all negotiations. Each group (namely, the North American estates and the EMEA estate) was given the opportunity to review the other's draft documentation. To the extent that there were any conflicts between the two, these were (as much as possible) resolved before negotiations with the bidders.

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If the creditors were unhappy with the terms of any executed document, they had the right to object to the US bankruptcy court granting its approval to the process, and so it was important that the creditors were satisfied with the process. They were, therefore, also given the opportunity to review and comment on the deal documentation.

Inter-estate co-operation was also documented by way of a side agreement for each deal. As well as agreeing to co-operate in closing the transaction, the estates agreed that the proceeds would be dealt with pursuant to a "locked box" arrangement whereby all proceeds are placed into an escrow account pending agreement between them (or failing agreement, determination) as to how the proceeds should be allocated. The locked box structure was adopted to prevent inter-estate disagreements over allocation of proceeds from delaying closing on any of the disposals.

In addition, the estates agreed that any deal costs (other than where those costs were incurred by some misconduct of a particular entity) should be shared in accordance with any final allocation by "top slicing" them from the escrow funds in advance of any distribution.

Current position

At the current time, the bulk of the disposals have been completed and the proceeds deposited into escrow pending agreement between the estates (or, failing agreement, determination) of an appropriate allocation among them.

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