

Regulatory intervention report

issued under s89 of the Pensions Act 2004 in relation to Nortel Networks UK Pension Plan

September 2017

The Pensions
Regulator

Background

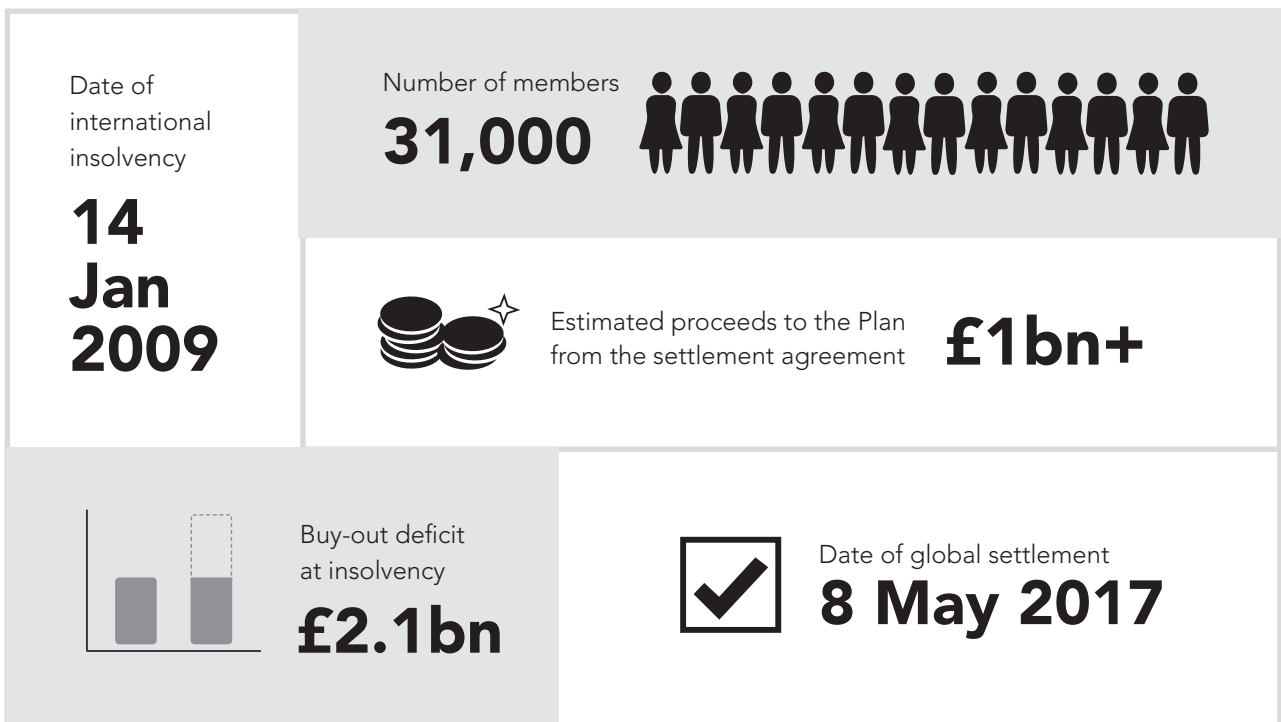
Nortel was a large telecommunications and data networking manufacturing group, operating mainly in Canada, the US, and the Europe, Middle East and Africa (EMEA) region. The hub of Nortel's operations in EMEA was Nortel Networks (UK) Limited (NNUK), the principal employer of the Nortel Networks UK Pension Plan (the Plan).

In January 2009, following a period of difficult trading conditions, the group's main worldwide operating companies entered insolvency proceedings in their local jurisdictions. This included NNUK, which remains in administration.

From 2009 to 2011, the group's major business lines were sold and its intellectual property portfolio was auctioned, raising around US \$7.3 billion. Until recently, this has remained in an escrow account (known as the lockbox) while multi-party negotiations, litigation and mediation attempts have taken place over several years in an effort to agree how to share the proceeds across the group. These attempts to reach agreement have finally resulted in a global settlement, which should result in a series of payments to the Plan totalling over £1 billion.

The Plan has approximately 31,000 members, and on NNUK's insolvency the cost of securing members' benefits in full was estimated to be £2.1 billion. This made it one of the largest creditors in the global Nortel group. The Plan has been in an assessment period with the Pension Protection Fund (PPF) since January 2009.

Illustrated summary



Regulatory action

Following NNUK's insolvency, we began an investigation to determine whether there were grounds to issue Financial Support Directions (FSDs) requiring other Nortel group companies to provide financial support for the Plan.¹ After an intensive investigation, we issued Warning Notices to various group entities in January 2010 and a hearing in front of The Pensions Regulator's Determinations Panel (the Panel) took place in June 2010.

The Panel decided that FSDs should be issued to the parent company of the Nortel group in Canada, and to various operating companies in the US and the EMEA region. The Panel took into account the fact that the group was highly integrated, and operated on the basis of business lines rather than by reference to individual legal entities. The Panel also found that NNUK had played a key role running Nortel's activities in EMEA. This benefited the whole Nortel Group thanks to NNUK providing much of the infrastructure and management functions necessary for EMEA's operations. NNUK was also one of the group's principle research and development centres, and had made significant intercompany loans to other group companies.²

The EMEA companies referred the Panel's decision to issue FSDs against them to the Upper Tribunal. The FSD proceedings were then adjourned while other matters were being resolved, both in the UK and in North America.

In the UK, the administrators of the companies in EMEA and the administrators of certain companies in the Lehman Brothers group³ launched a joint court action in November 2010, seeking confirmation of the legal status of an FSD when issued against an insolvent company. The case was eventually heard by the UK Supreme Court. In July 2013, it ruled that an FSD is effective against insolvent companies, and that liabilities under it rank as provable debts,⁴ a welcome decision which removed considerable uncertainty in the pensions and insolvency industries at the time.

In the US, a court had ruled that UK regulatory action against the group's US respondent companies would breach the creditor protection provisions of Chapter 11. However, the trustee subsequently made claims against the US companies based on what might have been recovered by the Plan under regulatory action. As a result of this, the US group companies that the Panel had decided should provide financial support to the Plan agreed to pay \$37.5 million to the trustee.

1
As prescribed by Section 43 of the Pensions Act 2004.

2
The Panel's reasoning can be viewed at www.tpr.gov.uk/nortel-notice.

3
TPR was also pursuing FSDs on behalf of the Lehman Brothers Pension Scheme at the time following the insolvency of that scheme's sponsoring employer.

4
For further information please see the 'Nortel Lehman' Supreme Court Judgment, dated 24 July 2013, at <http://bit.ly/SCJudg>.

In Canada, the claims brought in the UK were also held by the Canadian court to be in breach of the creditor protection provisions in the Canadian bankruptcy proceedings. Nevertheless, the court decided that the Plan's trustee and the PPF could pursue a claim for the support they would have been able to establish under the UK regulatory action.

The trustee and the PPF ultimately pursued a number of claims in the Canadian insolvency court in 2014. While the court did not agree with the arguments submitted by the trustee based on the FSD case, it did allow a claim in respect of a guarantee provided by one of the group's Canadian respondent companies to the Plan.

There were also coordinated court proceedings in the US and Canada in 2014 to determine the allocation of the proceeds held in the lockbox account.

In May 2015, the judges of the respective courts in the US and Canada jointly concluded that the money in the lockbox should, in principle, be allocated between the individual companies in the Nortel Group pro rata to their respective creditor claims. This meant that NNUK received a share of the lockbox proceeds that reflected its liabilities to the Plan. This had the effect of significantly improving the Plan's recoveries from NNUK's administration which was, in effect, consistent with the outcome sought in our 2010 Warning Notices. Certain parties in the US and Canada appealed these decisions, but these appeals were withdrawn as a condition of the global settlement agreement which became legally effective on 8 May 2017.

The settlement

At the time of the global settlement we agreed to cease our anti-avoidance action. We concluded, in conjunction with the Plan's trustee and the PPF, that the settlement agreement meant that it would not be reasonable to pursue FSDs against any entity in the group.

Our agreement to terminate our anti-avoidance action was subject to (i) the settlement agreement becoming legally effective and (ii) certain of the potential EMEA FSD respondent companies undergoing company voluntary arrangements (CVAs)⁵ on a basis that would make certain concessions benefiting NNUK and, indirectly, the Plan.

⁵
A CVA is an insolvency process under Part 1 of the Insolvency Act 1986 by which a company can compromise or reschedule some or all of its unsecured debts. It is generally used to allow companies an opportunity to trade out of their financial difficulties.

A court judgment in May 2017 gave effect to the settlement agreement, and in mid-June the final CVAs were approved for the relevant EMEA respondents, so the two conditions set out above have now been met. The lockbox has now been opened and the Plan has received its first payment through NNUK. It is expected that once the EMEA CVAs are concluded, the final amounts due to these companies will be paid by the end of 2018.

Working closely with the Plan's trustee, the PPF and NNUK's administrators, we have taken part in four separate mediation processes in North America since 2010, which attempted to reach a consensual settlement of the allocation issue. Throughout these processes our focus was on securing a fair result for the Plan's members. We were supportive of mediation as this could potentially have brought about a quicker and less costly resolution than drawn-out litigation, which would erode the value of assets available to creditors through mounting administration fees and legal costs. The settlement agreement developed from the last of these processes, which started in October 2015.

Outcome

We are pleased with the final outcome for the Plan and believe that the principle reached through the joint allocation judgments in May 2015 was equivalent to the result sought by our case team in 2010. The settlement puts an end to the lengthy delays that resulted from the complex and hugely expensive mediation and litigation processes in North America, and will finally end the period of distressing uncertainty for the Plan's members.

The trustee estimates that the Plan should receive aggregate payments in excess of £1 billion as a result of the settlement agreement. The trustee expects that the outcome for the Plan will enable members' benefits to be bought out at above PPF levels of benefits, but this is a complex task that will take several months to conclude. In the meantime, the Plan remains in PPF assessment and members will continue to receive their pensions in accordance with the PPF's rules.

This case has secured an important precedent that FSDs can be issued against insolvent companies, which could potentially benefit thousands of pension scheme members in years to come. We believe that the pursuit of the FSDs in all three jurisdictions was an influential factor in highlighting the impact of the Nortel group's collapse on the Plan's members and added weight to the Plan's claims in the worldwide insolvency process. The insolvency of the group resulted in unprecedentedly complex litigation, and we are pleased that our decision in 2010 to use our anti-avoidance powers has contributed to the good outcome for the Plan's members.

Our approach

We are determined to help protect members of UK defined benefit pension schemes by using our anti-avoidance powers where appropriate, even where complex and lengthy proceedings conducted across multiple jurisdictions are involved. This case also shows our willingness to work with all parties in order to reach a positive, fair, negotiated outcome for pension scheme members.

We will continue to take a commercial and pragmatic view in pursuing the use of our powers, and remain committed to achieving a positive outcome for members.

Timeline of events

January 2009: Insolvency of Nortel group and NNUK, start of TPR's anti-avoidance investigation

January 2010: Warning Notices issued

June 2010: Determinations Panel hearing

July 2010: EMEA targets refer Determinations Panel decision to Upper Tribunal

November 2010: Joint application by administrators of NNUK and Lehman Brothers entities to High Court re status of FSD in insolvency. Upper Tribunal referral stayed. High Court judgment supported TPR's position but was appealed to the Court of Appeal. First mediation process in US.

April 2011: Second mediation process in US

July 2011: FSD status challenge heard by Court of Appeal which agreed with TPR's position but the judgment was then appealed to the Supreme Court

January 2013: Third mediation process in Canada

July 2013: Supreme Court judgment re status of FSD confirming that an FSD should rank as a provable debt in insolvency

January-September 2014: Co-ordinated joint hearings in US and Canada re allocation claims

May 2015: Judgments of joint hearings issued simultaneously by US and Canadian courts but then appealed (or leave sought to appeal them)

October 2015: Fourth mediation process starts in US

April 2016: Hearings in US of appeals against joint allocation judgments. Global settlement discussions continue

October 2016: Global Settlement Agreement paperwork signed by all parties. FSDs against EMEA respondents permanently stayed before Upper Tribunal

May 2017: Settlement agreement becomes legally effective

June 2017: Final CVAs in respect of EMEA FSD respondents approved

July 2017: First distribution received by the Plan

The regulator's consideration and approach to individual cases is informed by the specific circumstances presented by a case, not all of which are referred to or set out in this summary report.

This summary report must be read in conjunction with the relevant legislation. It does not provide a definitive interpretation of the law. The exercise of the regulator's powers in any particular case will depend upon the relevant facts and the outcome set out in this report may not be appropriate in other cases. This statement should not be read as limiting the regulator's discretion in any particular case to take such action as is appropriate. Employers and other parties should, where appropriate, seek legal advice on the facts of their particular case.

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Nortel Networks UK Pension Plan

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