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Ontario Court of Appeal Denies Leave to Appeal Nortel Allocation Decision

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On May 3, 2016, the Court of Appeal for Ontario released its decision (Leave Decision) denying leave to appeal from Justice Newbould's allocation of the proceeds of sale of the remains of the Nortel Networks group of companies (Allocation Decision).

The main points arising from the decision are as follows:

- The Court of Appeal finds no basis to interfere with Justice Newbould's decision that *pro rata* allocation does not constitute a "substantive consolidation".
- Justice Newbould considered relevant evidence and law, and there were no *prima facie* errors in his judgment.
- The importance of the case to the parties does not warrant leave to appeal absent an issue of broader importance to the profession.

The Leave Decision has implications for the ongoing international Nortel insolvency proceedings and is of broader interest for the Court of Appeal's detailed discussion of the test for leave to appeal in *Companies' Creditors Arrangement Act* (CCAA) cases.

For much of the 1990s, Nortel was a leading communications technology firm headquartered in Canada, but with subsidiaries and significant operations located around the world. Various Nortel entities filed for insolvency protection in Canada, the United States, the United Kingdom and various other jurisdictions, starting on January 14, 2009. By June of that year, the various entities decided to liquidate the group's remaining assets rather than attempt to restructure and continue the business in some form.

The insolvency proceedings for the Nortel entities located in Canada (Canadian Debtors) were administered by the Commercial List of the Ontario Superior Court; the Nortel entities in the United States (U.S. Debtors) were administered by the federal Bankruptcy Court in Delaware; and the Nortel entities in Europe, the Middle East and Africa (EMEA Debtors) were administered primarily by the English courts, with secondary proceedings in the various other countries in which EMEA Debtors were located.¹

The Canadian, U.S. and EMEA Debtors worked cooperatively to sell Nortel's remaining assets and after payment of various expenses, approximately US\$7.3 billion remained in a "lockbox", pending an agreement on how to allocate the funds among the various debtors. When no such agreement could be reached, the Ontario and Delaware courts agreed to conduct a unique joint trial to determine the issue. On May 12, 2015, Justice Newbould of the Ontario Superior Court of Justice and Judge Gross of the U.S. Bankruptcy Court for the District of Delaware simultaneously released separate decisions directing that the lockbox proceeds be allocated in proportion to each debtor's share of the Nortel group's debts. This allocation was, broadly speaking, favourable to the EMEA and Canadian Debtors.

After unsuccessfully seeking reconsideration of the Allocation Decision and its Delaware equivalent, the U.S. Debtors and various other parties with related interests pursued appeals in both jurisdictions. In Delaware, they appealed as of right to the federal District Court for Delaware. That appeal was argued on April 5, 2016 and is currently under reserve. In Ontario, leave to the Court of Appeal was sought under section 13 of the CCAA, leading to today's decision.

Leave to appeal in CCAA proceedings is granted only when there are serious and arguable grounds that are of real and significant interest to the parties and the legal profession. This test is rarely met. In considering whether to grant leave, the Court of Appeal considers four factors: (i) whether the proposed appeal is *prima facie* meritorious; (ii) whether the proposed appeal raises issues of significance to

the practice; (iii) whether the proposed appeal raises issues of significance in the proceeding; and (iv) whether the proposed appeal will unduly hinder the progress of the proceeding.

The bulk of the Leave Decision addressed the first factor. The U.S. Debtors advanced three grounds of appeal that, they argued, were *prima facie* meritorious. The Court of Appeal rejected each of those arguments.

First, the U.S. Debtors argued that Justice Newbould "substantively consolidated" (and thereby disregarded the separate legal existence of) the various Nortel estates and that he applied an inappropriately low threshold in doing so. The Court of Appeal disagreed, noting that Justice Newbould found that a *pro rata* allocation was not tantamount to substantive consolidation in the circumstances. The Court of Appeal held that there was no basis to interfere with that conclusion because it was supported by factual findings that Justice Newbould was entitled to make on the basis of the evidence before him. There was therefore no need for the Court of Appeal to consider the threshold for applying the substantive consolidation doctrine.

Second, the U.S. Debtors argued that Justice Newbould erred in finding that an agreement that was at the heart of the U.S. Debtors' allocation theory was not, in fact, intended to address the allocation of proceeds in an insolvency. Once again, the Court of Appeal held that there was no reason to intervene. The standard of appellate review with respect to matters of contractual interpretation is a deferential one, and the U.S. Debtors did not identify any reversible error of law or fact. The Court of Appeal also rejected the U.S. Debtors' complaint that Justice Newbould took an unduly narrow view of the "factual matrix" evidence (*i.e.*, evidence about the surrounding circumstances of the agreement), given that Justice Newbould reviewed that evidence in considerable detail.

Third, the Court of Appeal dismissed the U.S. Debtors' argument that they were denied procedural fairness and that the allocation decision was arbitrary. The U.S. Debtors were aware that a *pro rata* allocation was a possible outcome and strenuously opposed such an allocation. In this regard, the decision was not unfair to them. Nor was the allocation decision arbitrary simply because it did not give the U.S. Debtors credit in the *pro rata* allocation for certain guarantee claims made by U.S. bondholders. Justice Newbould carefully considered those claims and held that it would be "double counting" to account for them in the *pro rata* allocation.

The Court of Appeal dealt with the three other factors of the leave test in a fairly summary fashion. There were no issues of general importance to insolvency practice: the facts of the case were unique, the doctrine of substantive consolidation was not engaged and the principles of contractual interpretation did not require clarification. Although the allocation of the lockbox funds was a significant issue in the proceeding, the Court of Appeal held that this did not warrant granting leave to appeal on its own (since most appeals involve issues of importance to a proceeding). Finally, the Court of Appeal observed that the insolvency proceedings had already been ongoing for some time and that granting leave to appeal would be a "barrier to progress".

The Leave Decision, though perhaps more detailed than many leave to appeal decisions, applied the well-settled test for leave to appeal in the CCAA context to the unique facts of the Nortel insolvency. The Court of Appeal's emphasis on resolving the allocation proceedings expeditiously embodies the traditional appellate deference to CCAA proceedings, which typically take place in real time and are not well-suited to lengthy appellate review.

¹Davies acts as co-counsel to the EMEA Debtors in Canada, along with Lax O'Sullivan Lissus Gottlieb LLP. Herbert Smith Freehills LLP and Debevoise & Plimpton LLP act as United Kingdom co-counsel to the EMEA Debtors, and Hughes Hubbard & Reed LLP act as United States counsel to the EMEA Debtors.

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