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Honourable Ted Menzies
Parliamentary Secretary to the Minister of Finance
House of Commons
Ottawa, Ontario, K1A 0G5
MenziT@parl.gc.ca

Dear Honourable Ted Menzies:

I am writing again today on the subject of federal bankruptcy laws and why the Federal Government needs to make an urgent amendment of the Bankruptcy and Insolvency Act (BIA) to give preferred status to pension, health and long term disability plan deficits and unpaid severance above the unsecured creditors. You wrote me on June 29, 2009 and I sent you my first reply on June 29, 2009, which contained my financial analysis concluding that preferred status for the employment related claims would raise the cost of debt by only about 0.05% to 0.26% per annum.

I have now done more research on the subject, this time focussing upon debt owners having access to credit default swaps (CDS) to insure their loss upon corporate restructuring or bankruptcy. I have reached disturbing conclusions that the relatively new CDS market is causing an increase in bankruptcy protection filings and bankruptcies, because the bond owners who also own CDS contracts need to have a credit event in order to trigger the CDS cash settlement auction process. A fully hedged bond owner would rather realize upon the full value of his investment by collecting upon his CDS hedge rather than take the uncertain value of new securities offered in an out-of-court restructuring plan. The incentive for advocating bankruptcy court filings is high from the bond owner who bought more CDS coverage than the amount of bonds owned, since he can make more money on the CDS contract cash settlement than he loses on the underlying bonds. Also, as we see in the Nortel case, there is money to be made from the bankruptcy court filing even on a perfectly hedged bond position, because the CDS cash settlement occurs when the bankruptcy court filing is announced and the bond price is at its lowest price. Then the hedged bond owners with locked in lower cost bases after their CDS cash settlement make profit when the final liquidation amount is much higher due to the impact of business sales or positive restructuring actions for the ongoing concern. My new independent research report can be found at the following web address:

Bond Owners Use Credit Default Swaps to Gain, While Pensioners, Disabled and Terminated Employees Told to Share the Pain: Preferred Status in Bankruptcy for Pension, Health and Long Term Disability Deficits and Severance

<http://ismymoneysafe.org/pdf/NortelCreditDefaultSwapsandBIAPreferredStatus08042009.pdf>

My first analysis on the impact of the BIA amendment of preferred status on the cost of debt was part of the following independent research report that I published on July 6, 2009.

Interventions to Protect Nortel's Canada Estate for Canadians

<http://ismymoneysafe.org/pdf/InterventionstoProtectNortel'sCanadaEstateforCanadiansJuly6,2009.pdf>

I concluded in my first research report that the social benefits of preferred status far outweighed the impact on the cost and availability of debt and economic growth. In this second research report, I conclude that the impact of the change on the cost of debt is even less than I thought due to bond owners having access to insurance for their credit defaults in the CDS market. **Even the most right wing capitalist, who does not subscribe to the concept of social policy and the equitable principle of putting people first, cannot argue that the current BIA offers balance between the Canadian pensioners, long term disabled and terminated employees without access to insurance and the bond owners with access to insurance.**

When one takes into account the prospects for the Nortel Canada estate having a much higher loss or compromise, at say, close to -\$0.90 compared to -\$0.60 for the US estate, the difference in bankruptcy outcomes between the Nortel Canadian pensioners, long term disabled and terminated employees and the U.S. hedged bond owners with a profit of \$0.28 is flagrantly abusive and crass.

In Canada, there are 17,500 Nortel pensioners with expected income loss of -28%; 410 long term disabled employees with expected income loss of -90% and up to 1000 expected terminated employees losing -90% of their severance. The Canadian pensioners, long term disabled and terminated employees, who are the primary creditors in the Canada estate, are seriously disadvantaged relative to the other creditor groups in the Nortel Global estate: the Nortel hedged bond owners are making an estimated profit of +28%; the majority of Nortel U.S. and U.K. pensioners are covered by robust public pension insurance plans; and the U.S. and U.K./EMEA unhedged and unsecured creditors are expected to have much higher recoveries due to their considerable power being used to deplete the Canada estate to date and to extract a considerable proportion of the pending cash proceeds from sale of the businesses.

Canada needs to make an emergency amendment of the BIA to provide "Preferred Status" to the claims of pensioners, long term disabled and severed employees. Canada also needs to set conditions on the approval of the foreign purchases of Nortel's businesses as authorized under the Investment Canada Act for allocation of sale proceeds to the Nortel Canadian pension, health and long term disability plans and a severance fund. These conditions are to ensure that the Canada estate has adequate cash available to pay these Canadian employment-related claims.

The employment related claims getting preferred status over the unsecured bond owners in the BIA is necessary to restore integrity to the BIA process and to give balance between different unsecured creditors that was intended to be there. With BIA preferred status and the setting of conditions for the allocation of sale proceeds under the Investment Canada Act, Canadian pension, health and long term disability plan deficits and unpaid severance claims have a shot at being paid in full, just like the bond owners have had the opportunity to be immunized from loss in bankruptcies by buying CDS hedging contracts.

Sincerely,

Diane Urquhart

CC: Honourable Tony Clement, Minister of Industry
Honourable James Flaherty, Minister of Finance
Honourable Stockwell Day, Minister of International Trade