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CITATION: R. v. Dunn, 2013 ONSC 137

COURT FILE NO.: 10-00145

DATE: 20130114

ONTARIO

SUPERIOR COURT OF JUSTICE

BETWEEN:

HER MAJESTY THE QUEEN

– and –

FRANK A. DUNN, DOUGLAS C.
BEATTY AND MICHAEL J. GOLLOGLY

Defendants

)
)
) *Robert Hubbard, Amanda Rubaszek &*
) *David Friesen, for the Crown*
)
)
) *David M. Porter, John Dent, Sarit Batner,*
) *Harry Underwood & Andrew Matheson, for*
) *the Defendant, Frank A. Dunn,*
)
) *Gregory Lafontaine & Lori Anne Thomas,*
) *for the Defendant, Douglas C. Beatty*
)
) *Sharon Lavine & Robin McKechney, for the*
) *Defendant, Michael J. Gollogly*
)
) **HEARD:** January 12, 16, 17, 18, 19, 20, 30,
) 31, February 1, 2, 3, 6, 7, 8, 9, 13, 14, 15, 16,
) 17, 21, 22, 27, 28, 29, March 5, 6, 26, 27, 28,
) April 2, 3, 4, 5, 10, 11, 17, 18, 30, May 1, 2,
) 3, 10, 14, 22, 23, 24, 28, 29, June 4, 5, 12,
) 13, 14, 19, 20, 21, 22, 25 & 26, September
) 27, 28, October 2, 3, 2012

MARROCCO J.:

[1] The defendants are charged with two counts of fraud.

[2] The first count alleges that, between January 1, 2000 and April 28, 2004, the three accused did, by deceit falsehood or other fraudulent means, defraud the public by deliberately misrepresenting the financial results of Nortel Networks Corporation.

[3] The second alleges that, between January 1, 2000 and April 28, 2004, the three accused did, by deceit falsehood or other fraudulent means, defraud Nortel Networks Corporation by deliberately misrepresenting the financial results of Nortel Networks Corporation.

[4] In both counts, it is alleged that the extent of the fraud exceeded \$5,000.

[5] For the sake of completeness, I make two observations: first, the events captured by this indictment concern matters which occurred between 2000 and 2004. Nortel did not commence *Companies Creditors Arrangement Act* proceedings until January 14, 2009. The evidence in this proceeding did not describe events linked to the commencement of those proceedings. Second, Nortel Networks Corporation's shares traded publicly on the New York and Toronto Stock Exchanges. It ceased trading publicly on January 14, 2009.

NORTEL'S CIRCUMSTANCES DURING THE TIME-FRAME OF THIS INDICTMENT

[6] All allegations of criminal conduct are made within a factual fabric or context. A true appreciation of the nature of the alleged criminal conduct is impossible without a description of that fabric or context.

[7] Part of the factual context for this matter is set out in Exhibit 251D. Exhibit 251D was received in evidence as a business record of Deloitte & Touche.

[8] Nortel Networks Corporation ("Nortel") was in the business of providing data, wireless and optical networking products and services to telecommunications carriers and enterprise customers around the world. Between 1998 and 2001, Nortel Networks Corporation and its predecessor, Nortel Networks Limited, undertook a total of twenty-two acquisitions for an aggregate purchase price of \$29 billion. These acquisitions were undertaken during a period of both strong economic growth in 1999 and 2000 and rapid infrastructure build-out by the telecommunications industry.

[9] By 2001, the telecommunications industry began to experience a slowdown attributed to excess capacity created as a result of the build-out, the consolidation of service providers within the industry and lower capital spending by industry participants. As a result, there was a dramatic and significant reduction in the demand for Nortel's products and services.

[10] In response to the industry and economic downturn in 2001, Nortel attempted to streamline its operations. Nortel reduced its overall workforce from approximately 94,002 to

approximately 52,000 and incurred severance and termination charges in excess of \$3.3 billion. Nortel discontinued aspects of its operations and divested itself of investments. Nortel recorded a write down of \$12.4 billion for goodwill and other intangible assets in the quarter ending June 30, 2001.

[11] In 2002, Nortel reduced its workforce to 37,000 as at December 31, 2002. Nortel experienced a write down of its goodwill in its Optical business of approximately \$595 million and, on December 13, 2002, Nortel pledged substantially all of its assets in favor of certain lenders.

[12] Nortel experienced net income losses of \$197 million in 1999, \$2.9 billion in 2000, \$27.4 billion in 2001 and \$3.6 billion in 2002.

[13] The equity of Nortel's shareholders shrank from \$28.7 billion in 2000 to \$1.9 billion in 2002.

[14] The circumstances had become so dire at Nortel that, when a quarterly result was announced, the auditors had to take a view of the next twelve months from the date of the quarterly report and opine on the likelihood of Nortel continuing as a going concern.

[15] Nortel Networks was publicly-traded on the New York Stock Exchange. The New York Stock Exchange ran on Nortel equipment. Nortel's decline was so severe that the closing share price for the company's common shares in September 2002 fell below the minimum for continual listing on the New York Stock Exchange. The Chairman of Nortel's Board was advised that Nortel might be de-listed although, in fact, this did not occur.

[16] The compelling but rather sterile economic reality described above was put into more human terms by Mr. Bruce Richmond, who testified as a Crown witness. During the time-frame of the indictment, Mr. Richmond was the Vice-Chair and Deputy Chief Executive of Deloitte & Touche LLP (Canada). He is a chartered accountant; he is a Fellow of the Institute of Chartered Accountants since 1997, a designation conferred on approximately 2% of the Institute's members.

[17] During the time-frame set out in the indictment, Mr. Richmond was responsible for overall management of Deloitte's clients across the entire Deloitte organization, which comprised sixty-seven offices with \$1.4 billion in revenues.

[18] Mr. Richmond was professionally associated with Nortel through Deloitte & Touche from the late 1970's.

[19] Through the time-frame described in the indictment, Mr. Richmond served as the Deloitte & Touche Senior Advisory Partner to Nortel. Specifically, Mr. Richmond had been the Senior Advisory Partner at Nortel since 1992. In addition to Nortel, Mr. Richmond also served as the Advisory Partner to approximately a dozen of Canada's major corporations.

[20] I accept Mr. Richmond's entire evidence in this matter without qualification.

[21] As Advisory Partner, Mr. Richmond had two primary responsibilities; first, to interface with the directors, particularly members of the Audit Committee, as well as the CEO and the CFO; second, to be a sounding board for the Deloitte partners conducting Nortel audits and reviews.

[22] Mr. Richmond attended virtually all Audit Committee meetings.

[23] Mr. Richmond described Nortel as a major client in the same category as Canadian banks and other major Canadian corporations. Mr. Richmond indicated that approximately twenty companies in Canada would be described as major clients.

[24] Mr. Richmond described Nortel's situation during the time period set out in the indictment as follows: "Nortel was descending down a very slippery path at a very fast rate... The notion of where the bottom was going to be was not understood at that point in time by anybody... One day a client existed the next day it was out of business... The team was clearly on red alert in terms of what they were facing... ..endeavoring to the best of our collective ability, and I'm talking Nortel folk and I'm talking Deloitte folk, to put your arms around a situation that frankly, having had 20 years in the profession and having been the lead client guy and the senior client service guy for the largest firms in the country, this was a situation that we had never seen before".

[25] Later on in his evidence, Mr. Richmond said: "in the years 2001, 2002, the company was fighting for its very survival..."

[26] Mr. Richmond indicated that the free-fall that Nortel was experiencing resulted in a situation where Nortel could be comfortable with the value of an asset on one day and next day be convinced that the asset was severely diminished in value.

[27] As a result of that situation, Nortel's Audit Committee and Board of Directors were in Mr. Richmond's words: "focused like a laser beam in terms of ensuring from their perspective in the discharge of their responsibilities that the Corporation was doing whatever was required to ensure that they had identified and appropriately quantified provisioning in connection with any exposure of the Corporation".

[28] Nortel's Audit Committee and Board of Directors had succeeded in communicating this concern about providing for every risk to senior management and the field.

[29] Nortel's first re-statement re-stated more than \$900 million in excess accrued liabilities into previously-published Nortel financial statements. I am satisfied that one of the underlying reasons for the presence of these excess accrued liability balances was the determination of Nortel's Audit Committee, auditors, senior management and field staff to provide for every risk and, thereby, avoid unpleasant surprises.

THE LAW OF FRAUD AS IT APPLIES TO THE ALLEGATIONS AGAINST THE ACCUSED IN THIS CASE

[30] It is the Crown's position that the accused told lies and that the lies put investors at risk of economic deprivation. It is also the Crown's position that the accused told lies which put Nortel itself at risk of economic deprivation. The lies, according to the indictment, are found in the deliberate misrepresentation of Nortel Networks Corporation's financial results.

[31] The offence of fraud is set out in the *Criminal Code*, RSC 1985, C. C-46 s. 380 in the following terms:

380. (1) Every one who, by deceit, falsehood or other fraudulent means, whether or not it is a false pretense within the meaning of this Act, defrauds the public or any person, whether ascertained or not, of any property, money or valuable security or any service,

(a) is guilty of an indictable offence and liable to a term of imprisonment not exceeding 10 years, where the subject matter of the offence is a testamentary instrument or the value of the subject matter of the offence exceeds \$5000.

[32] At the outset of the trial, the Crown provided the court with a factum setting out the general principles of the law of fraud, as well as helpful references to s. 397(1)(a) of the *Criminal Code*. That factum was quite helpful and I have attempted to apply those principles in this case.

[33] In *R. v. Zlatic* (1993), 79 C.C.C. (3d) 466 (S.C.C.) at para. 26, the court stated that the *actus reus* of fraud will be established by proof of: (i) the prohibited act, be it an act of deceit, a falsehood or some other fraudulent means; and (ii) deprivation caused by the prohibited act, which may consist in actual loss or the placing of the victim's pecuniary interests at risk.

[34] The court, in *R. v. Zlatic*, at para. 26, held that the *mens rea* for fraud was established by proof of: (i) subjective knowledge of the prohibited act; and, (ii) subjective knowledge that the prohibited act could have as a consequence the deprivation of another (which deprivation may consist in knowledge that the victim's pecuniary interests are put at risk).

[35] Finally, the court stated that, where proof of these two elements was established, the accused was guilty if he or she actually intended the prohibited consequence or was reckless concerning the consequences (see: *R. v. Zlatic (supra)*, at para. 27).

[36] In *R. v. Eizenga* 2011 ONCA 113 [2011] O.J. No. 524, at para. 81, the Court of Appeal emphasized that a subjective intent to mislead was not an essential element of fraud.

[37] In *R. v. Theroux* (1993), 79 C.C.C. (3d) 449, at paras. 16-17 (S.C.C.), McLachlin J. [as she then was] defined the *actus reus* for the offence of fraud as requiring two elements: a dishonest act and deprivation.

[38] McLachlin J. indicated that deprivation was established if it was proven that the dishonest act caused detriment, prejudice or risk of prejudice to the economic interests of the victim.

[39] In *R. v. Theroux*, McLachlin J. [as she then was] defined the *mens rea* requirement for the offence of fraud.

[40] McLachlin J. stated that the *mens rea* of fraud was established by proof of subjective awareness that one was undertaking the prohibited act, *i.e.* the deceit, falsehood or other dishonest act, and that the prohibited act could cause deprivation in the sense of depriving the proposed victim of property or putting the proposed victim's property at risk.

[41] McLachlin J. also stated that the fact that an accused person may have hoped that the deprivation would not take place or may have felt that there was nothing wrong with what he or she was doing was not a defence (see: *R v Theroux*, at para. 22).

[42] Later on, McLachlin J. stated, at para. 29: "the accused must have subjective awareness at the very least that his or her conduct will put the property or economic expectations of others at risk".

[43] This case deals with false financial results. Where the omission or misstatement complained of is not material to those financial results, it stands to reason that it will be difficult to prove that there was any risk of prejudice to the economic interests of the public.

[44] The public are not defined in the indictment in count one. Obviously, the public can be divided into different groups or segments. I am satisfied that a fair interpretation of the public in this case is the investing public.

[45] In count two, the victim is defined; namely, Nortel Networks Corporation.

[46] As indicated earlier, the Crown advances the proposition that, in this fraud case, the accused told lies. McLachlin J. specifically commented in *R. v. Theroux*, at para.29: "But in cases like the present one, where the accused tells a lie knowing that others will act on it and thereby puts their property at risk, the inference of subjective knowledge that the property of another would be at risk is clear".

[47] In *R. v. Drabinsky*, 2011 ONCA 582 [2011] O.J. No. 4022, one of the charges in the indictment was that the accused in that case had provided false financial information to persons who invested in an IPO. In that case, at para. 80, the Ontario Court of Appeal stated: "the Crown had to prove the appellants knew that the financial statements contained misrepresentations and that they were material to the decision to invest in the IPO".

[48] The matter before me is different; there is no IPO. In this case, the defendants are, in count one, facing a charge of defrauding the public by deliberately misrepresenting the financial results of Nortel Networks Corporation. Accordingly, if one applies the same conclusion that the Court of Appeal expressed in *R. v. Drabinsky*, *supra*, the conclusion in this case must be that the Crown has to prove that the accused knew that Nortel's financial statements contained misrepresentations that were material to the decision of a member of the investing public to buy, hold or sell Nortel publicly-traded securities.

[49] With respect to count two, the essence of the matter seems to be that the misrepresentation of Nortel's financial results created the economic risk that Nortel Networks Corporation would pay money to the defendants that ought not to be paid to them.

MATERIALITY

[50] In *R. v. Drabinsky*, at para. 83, the Court of Appeal commented on the notion of materiality. The court said that materiality in the context of that case was a fair inference from the nature of the misrepresentations, the documents in which they appeared and the context in which those documents were used.

[51] At paras. 81 & 82, the Court of Appeal, in *R. v. Drabinsky*, upheld the trial judge's decision that the misrepresentations in the financial statement relied on in support of the IPO were material to the decision to purchase shares through the IPO.

[52] The materiality of a misstatement or omission is, therefore, important. In its opening, as part of a Glossary of Terms, the Crown provided a definition of materiality. In the context of financial statements, an omission or misstatement is material according to this glossary if "the judgment of a reasonable person relying on the statements would have been changed or influenced by the inclusion or correction of the item".

[53] The Crown offered expert evidence on various aspects of the accounting issues of concern in this proceeding. This evidence was received on consent in the form of a written report from Asset Risk Advisory Inc. The Asset Risk Advisory Inc. Report was prepared by Mr. Robert Chambers, who is a lawyer, a chartered accountant, a certified fraud Examiner and a Fellow of the Institute of Chartered Accountants of Ontario.

[54] At paragraph 31 of his report, which was appended to his affidavit, Mr. Chambers made the following observation about materiality: "According to FASB, materiality is the quality of being important. The omission or misstatement of an item in a financial report is material if, in the light of surrounding circumstances, the magnitude of the item is such that it is probable that the judgment of a reasonable person relying upon the report would have been changed or influenced by the inclusion or correction of the item."

[55] Mr. Chambers referred the reader of his report to SEC Staff Accounting Bulletin 99 ("SAB 99") for guidance in determining materiality. SAB 99 was published in 1999 – the same year that Nortel's world began to unravel.

[56] In SAB 99, SEC made it clear that exclusive reliance on dollar thresholds cannot be used as a substitute for a full analysis of all relevant considerations when determining materiality.

[57] SAB 99 states that, among the considerations that may render material a quantitatively small misstatement of a financial statement item, are:

- Whether the misstatement arises from an item capable of precise measurement or whether it arises from an estimate and, if so, the degree of imprecision inherent in the estimate;

- Whether the misstatement masks a change in earnings or other trends;
- Whether the misstatement hides a failure to meet analysts' consensus expectations for the enterprise;
- Whether the misstatement changes a loss into income or vice versa;
- Whether the misstatement concerns a segment or other portion of the registrant's business that has been identified as playing a significant role in the registrant's operations or profitability;
- Whether the misstatement affects the registrant's compliance with regulatory requirements;
- Whether the misstatement affects the registrant's compliance with loan covenants or other contractual requirements;
- Whether the misstatement has the effect of increasing management's compensation – for example, by satisfying requirements for the award of bonuses or other forms of incentive compensation; and,
- Whether the misstatement involves concealment of an unlawful transaction.

[58] Apart from Mr. Chambers' general statements, no expert evidence concerning materiality was offered in this case. Representatives of Deloitte performed a materiality analysis, which was admitted as a business record and to which reference will be made.

[59] Count number one alleges a fraud upon the public. Nortel was publicly-traded. I am satisfied that the public in this case includes the investing public. Persons who own publicly-traded Nortel securities are included in the term "public". Persons who are thinking of purchasing publicly-traded Nortel securities are included in the term "public". I accept and intend to apply the notion of materiality that is described in Mr. Chambers' report. A misrepresented financial result is material if, in light of the surrounding circumstances, the magnitude of the item is such that it is probable that the judgment of a reasonable member of the investing public would have been changed or influenced by the correction of the item. The omission of a financial result is material if, in light of the surrounding circumstances, the magnitude of the item is such that it is probable that the judgment of a reasonable member of the investing public would have been changed or influenced by the disclosure of the item.

SAB 99 and Mr. Dunn, Mr. Beatty and Mr. Gollogly

[60] Mr. Gollogly was aware of SAB 99. Mr. Gollogly sent a memo to selected Nortel employees dealing with SAB 99 on March 3, 2003. His memo attached SAB 99 itself. Mr. Gollogly made a presentation to Nortel's Audit Committee on April 23, 2003, in which he explained the concept of materiality. Mr. Beatty and Mr. Dunn were normally in attendance at Audit Committee meetings.

[61] I am satisfied that Mr. Dunn and Mr. Beatty were present when Mr. Gollogly made this presentation to the Audit Committee.

[62] Mr. Beatty was aware of SAB 99. On April 19, 2003, Mr. Beatty sent an e-mail to Mr. Gollogly which stated: “would you please email me the charts (if possible) for SAB 99 that speak to the need to disclose, particularly if management comp’n is achieved etc. – probably useful to have the SAB 99 text as well for Monday a.m.”

[63] Mr. Dunn was Nortel’s CEO during the time with which we are concerned. Prior to that, he was Nortel’s CFO and, prior to that, he was Nortel’s Corporate Controller.

[64] Mr. Dunn, Mr. Beatty and Mr. Gollogly were senior officers of a corporation publicly-traded on the New York Stock Exchange with annual revenues of approximately \$10 billion per year during the time frame of the indictment.

[65] I am satisfied that Mr. Dunn, Mr. Beatty and Mr. Gollogly were aware of the specifics of SAB 99, the importance of determining whether items of financial information were materially important and, finally, the importance of making the appropriate disclosure to the public.

THE PRESUMPTION OF INNOCENCE, REASONABLE DOUBT, R. V. W.(D.), [1991] 1 S.C.R. 742

[66] I have instructed myself on the presumption of innocence, the burden of proof and reasonable doubt. In a criminal case, the accused is presumed to be innocent unless and until the Crown has proved his/her guilt beyond a reasonable doubt. It is not the responsibility of any accused under our law to establish or to demonstrate or to prove his innocence. If the Crown should fail to prove guilt in respect of a particular crime beyond a reasonable doubt, then the accused is not guilty of that crime. To put the matter somewhat differently, in order to find an accused guilty of a particular offence, the Crown must prove each and every one of the essential elements of that offence beyond a reasonable doubt. If I should entertain a reasonable doubt about the proof of one or more of those essential elements, then I must find the accused not guilty of that offence.

[67] A reasonable doubt is not a far-fetched or frivolous doubt. It is not some fanciful doubt. It is not a doubt based upon sympathy or prejudice. Rather, it is an honest and fair doubt based on reason and common sense. It is doubt that logically arises from the evidence or lack of evidence. It is not enough that I believe that Mr. Dunn, Mr. Beatty or Mr. Gollogly is probably or likely guilty of count one or count two of this indictment. In those circumstances, I must find any or all of them not guilty because Crown counsel has failed to satisfy me of guilt beyond a reasonable doubt. Proof of probable guilt or likely guilt is not proof of guilt beyond a reasonable doubt. I should also remember, however, that it is virtually impossible to prove anything with absolute certainty. Crown counsel is not required to do so. Absolute certainty is a standard of proof that is impossibly high.

[68] If, based on all the evidence, I am sure that Mr. Dunn, Mr. Beatty or Mr. Gollogly committed the offence described in either count one or count two in the indictment, I should find Mr. Dunn, Mr. Beatty or Mr. Gollogly guilty of such offence since I would have been satisfied of

guilt beyond a reasonable doubt. If, at the end of the case based on all the evidence, I am not sure that Mr. Dunn, Mr. Beatty or Mr. Gollogly committed either count one or count two in this indictment, I should find Mr. Dunn, Mr. Beatty or Mr. Gollogly not guilty of such offence. If, after a full consideration of all the evidence admissible against any one of defendants, there remains in my mind a reasonable doubt concerning the guilt of such defendant, then the Crown has failed to meet the standard of proof which the law requires, the presumption of innocence prevails and it is my duty to acquit. On the other hand, if, after a full and careful consideration of all the evidence, I am left with no reasonable doubt concerning the guilt of Mr. Dunn or Mr. Beatty or Mr. Gollogly on either or both counts in the indictment, the presumption of innocence has been displaced and it is my duty to convict.

[69] Reasonable doubt applies to issues of credibility. I am not required to firmly believe or disbelieve any witness or set of witnesses. I must ask myself whether, on the basis of the evidence which I do accept, I am convinced beyond a reasonable doubt by that evidence of the guilt of one or more of the accused (see: R. v. W.(D.), [1991] 1 S.C.R. 742, at para. 28).

BUSINESS RECORDS

[70] During the course of this trial, the Crown and the defence tendered hundreds of documents. These documents were received as business records. As such, they are capable of proving the facts contained within them. However, I am not bound to accept the business records as proof of facts contained within them.

SHOULD THE EVIDENCE OF SOME OF THE NORTEL AND DELOITTE'S EMPLOYEES BE VIEWED WITH CAUTION?

[71] The Crown indicated that several of the witnesses listed in the Appendix to its submissions were accomplices. The Crown indicated that these witnesses sought to minimize their involvement or distance themselves from wrongdoing and that this took the form of acquiescing quickly with defence suggestions on cross-examination.

[72] Leading questions were asked on cross-examination and it is correct that, on many occasions, witnesses accepted the suggestions contained in those questions.

[73] At the same time, the Crown submits that there was strong confirmatory evidence of aspects of the testimony of these witnesses in the documents which were tendered. The witnesses in respect of whom the Crown urges caution played a role, according to the Crown, in the planning, analysis and use of accrued liability balances to meet earnings targets. Without the co-operation of these witnesses, the Crown submits the three accused would not have been able to shift Nortel from a profit to a loss in Q4 02 (the fourth quarter of 2002) and engineer profits in Q1 03, Q2 03 and Q3 03 (the first quarter of 2003 etc.).

[74] This is perhaps an appropriate place to observe that there is nothing about the background of any of these witnesses which makes them inherently "unsavory". The evidence has disclosed that regulatory proceedings against the defendants are in abeyance pending the outcome of this matter. The evidence has not disclosed that any of the witnesses listed in the Crown's Appendix

are facing criminal charges themselves. There is no suggestion in the evidence that any of these witnesses are the subject of outstanding regulatory proceedings.

[75] The Crown submits that there was a long-standing culture of Conservatism at Nortel and many of the witnesses who are chartered accountants or certified management accountants had to know that accrued liability balances therefore existed and were being used to meet earnings targets. The Crown submits that compliant employees assisted the accused in misrepresenting the financial results of Nortel Networks Corporation.

[76] I am satisfied that, during the time-frame of the indictment, there was at Nortel a culture of Conservatism, in the accounting sense of that term. I am satisfied that this culture existed for in excess of twenty years. It has to be remembered, however, that, until 1999, the SEC and the Ontario Securities Commission had not prohibited the practice of releasing accrued liability balances to bridge the gap between a company's actual performance and a previously announced financial target. Coincidentally, it was in the same year, 1999, that Nortel began experiencing significant losses.

[77] Finally, one has to remember that Nortel's culture concerning the recording of accrued liability balances was slow to change because for fiscal 2000, 2001 2002 Nortel reported losses in the billions and, as a result, the Board of Directors, Nortel's auditors and its senior management were preoccupied with survival.

[78] The accused called no defence. All of the witnesses who testified were called by the Crown.

[79] The ten witnesses listed in the Crown's Appendix gave evidence which was capable of both inculcating and exculpating the accused. As well, this is not a case in which it is relatively straightforward to delineate evidence which implicates any one or all of the accused in either of the offences set out in the indictment.

[80] With respect to those portions of the evidence which, in my view, are exculpatory, the question is whether such evidence alone or in combination with other evidence leaves me with a reasonable doubt (see: *R. v. Rowe*, 2011 ONCA 753, 2011 OJ No. 5382 (Ont. CA), at para. 42).

[81] With respect to those portions of the evidence which implicate the accused, I have to decide whether the credit of these witnesses is such that I should caution myself about accepting, in the absence of confirmatory evidence, testimony from them which implicates any one or more of the three accused.

[82] As indicated earlier, the Crown suggested that these witnesses were accomplices and that their evidence implicating the accused should be viewed with caution in the absence of confirmatory evidence.

[83] I propose now to consider a few highlights of the testimony of the witnesses named by the Crown.

[84] Mr. Brian Harrison was, during the time-frame of the indictment, the Vice-President of Performance Management and, later, when the position of Vice-President Performance

Management was eliminated, Nortel's Director of Financial Planning and Analysis. Mr. Harrison was directly involved in the process of soliciting accruals during Q4 02. It is the Crown's view that he actively assisted in changing a Q4 02 pro forma gain before taxes into a loss before taxes. Mr. Harrison was a CMA or certified management accountant during the time-frame of the indictment. He no longer has that designation for reasons which were not disclosed. He was interviewed many times by different police forces and regulatory authorities. At one point, he was told that he was a target of the investigation into the matters described in this indictment. Prior to actually testifying, he was told by the police and the Crown that he was no longer considered a target of the investigation into these matters.

[85] In my view, I should exercise some caution before accepting unconfirmed evidence from Mr. Harrison which I think implicates any of the accused in this matter

[86] Linda Mezon, Nortel's Assistant Corporate Controller for a portion of the time-frame described in this indictment, indicated she was not aware of the fact that there was a point in time in Q4 02 when Mr. Harrison's Outlook (forecast) suggested positive pro forma earnings before taxes of \$73 million. Ms. Mezon also played a central role in the JDS offset in the fourth quarter of 2002 (Q4 02). While I will discuss this in more detail later, it is sufficient to say that the JDS offset resulted in expenses being reduced to reflect a reduction in revenue at a late point in Nortel's close of the books for Q4 02.

[87] Even if I were to disbelieve Ms. Mezon concerning what she knew about Nortel's preliminary pro forma earnings before taxes during the early part of the Q4 02 close, this would not make her a witness, whose testimony implicating any or all of the accused, should be viewed with caution in the absence of confirmatory evidence. It simply means that she knew something which she claimed not to know. While this could affect her credibility, it does not make her a *Vetrovec* witness (see: *R. v. Winmill* (1999), 131 C.C.C. (3d) 380 (Ont. C.A.), at para. 113). Similarly, her participation in the JDS offset does not make her a witness whose evidence implicating the accused ought to be viewed with caution unless confirmed by other evidence. It simply means that, with the knowledge and consent of her superiors and Nortel's auditors, she accepted an entry to offset the loss of revenue caused by the accounting for the JDS transaction. This conduct does not make her a witness whose evidence implicating the accused I should be cautious about accepting in the absence of confirmatory evidence.

[88] Helen Verity was the Director of Consolidations for Nortel from 2001 – 2003. She received Outlooks or forecasts during the Q4 02 close process. Her handwriting is on some of them. Ms. Verity testified that she was not aware of the skepticism which greeted Mr. Harrison's assertion that Nortel's pro forma earnings before taxes were positive in Q4 02. While this may be a credibility issue as far as Ms. Verity's concerned, it does not make her a *Vetrovec* witness (see: *R. v. Winmill, supra*, at para. 113).

[89] Mr. Crosson was a long-standing Nortel employee who, during the material time, was the Vice-President of Global Operations. Mr. Ken Crosson, despite the fact that he was satisfied with the original financial results he submitted to Nortel headquarters in Brampton during the Q4 02 close, came up with additional accrued liability balances upon request. These additional balances resulted in increases in expenses and a corresponding decrease in earnings. This clearly assisted

Mr. Harrison, who was canvassing for accrued liability expenses/liabilities which, by definition, would decrease earnings.

[90] Mr. Crosson, in my view, was responding to requests from his superiors, but I am not satisfied that he responded in an inappropriate way. He indicated in his estimation there was some flexibility concerning excess and obsolete accrued liability balances relating to inventory. While his responses arguably were not entirely consistent with United States Generally Accepted Accounting Principles (“US GAAP”) and while that may be a concern for securities regulators, the accrual balances which he agreed to increase could be changed without distorting Nortel’s underlying financial reality.

[91] I am not satisfied that Mr. Crosson’s conduct changes his character as a witness such that I ought to be cautious, in the absence of confirmatory evidence, about accepting inculpatory evidence from him.

[92] Mr. Glenn Morita was the Director of Finance for the Europe Middle East Asia Region during the time-frame of the indictment. Mr. Morita was also satisfied with his original financial results submitted to Nortel headquarters in Brampton during the Q4 02 close but, nevertheless, located additional accrued liability balances upon request from Mr. Harrison. The fact that Mr. Morita provided additional accrued liability balances which he thought were genuine does not change Mr. Morita’s character as a witness such that, in the absence of confirmatory evidence, caution should be exercised before accepting evidence from him implicating any or all of the accused.

[93] Mr. Jim Kinney was, during the time-frame in the indictment, Vice-President Finance of Wireless, which was a business unit within Nortel. Mr. Kinney and his group worked very hard to meet their Q4 02 target. Despite this, Mr. Kinney submitted additional accrued liability balances that moved him off target in Q4 02. He testified that he was not concerned because he had been requested by his superiors to find additional accruals and that is what he did.

[94] I do not find that Mr. Kinney’s behavior in this regard changes his character as a witness and that I should, therefore, be cautious in the absence of confirmatory evidence about accepting evidence from him implicating any or all of the accused.

[95] Ms. Karen Sledge was the U.S. Controller during the Q4 02 close. She became Assistant Corporate Controller in 2003 where she remained until 2005. When she was Assistant Corporate Controller Ms. Sledge reported to Mr. Gollogly until he was suspended in March 2004. Ms. Sledge changed the Fringe accrued liability balance as a result of repeated calls from Mr. Gollogly and others. Ms. Sledge was not comfortable with making this change and mentioned it to the representatives of the Wilmer Cutler Pickering law firm. Wilmer Cutler Pickering, about one year later, were conducting, at the request of Nortel’s Audit Committee, an independent review of the circumstances leading to Nortel’s re-statement of previously-published financial results. Her conduct does not change her character as a witness such that I should, in the absence of confirmatory evidence, exercise caution before accepting inculpatory evidence from her.

A FEW BASIC ACCOUNTING PRINCIPLES

[96] Mr. Robert Chambers, the Crown's expert, provided some basic accounting principles in his report.

[97] A general principle underlying US GAAP is that expenses are to be matched with revenues as long as it is reasonable to do so. When work or a product makes its contribution to revenue, expenses associated with that work or product are recognized even if those expenses cannot be known with precision. This matching principle is applied through accrual accounting. In such a situation, the accrued expenses are estimated.

[98] An accrued expense is an expense that has been incurred but not yet paid. An accrued liability is an obligation disclosed on the balance sheet that is not yet payable.

[99] Recording an accrued expense reduces income on the profit and loss statement and, simultaneously, results in the recording of an accrued liability on the balance sheet.

[100] Once the accrued liability is recorded on the balance sheet of a publicly-traded corporation like Nortel, the corporation is required to assess that accrued liability balance at the end of each financial quarter to determine whether something has occurred within that quarter which requires a change (*i.e.*, an increase or decrease) in the estimate of the liability.

[101] If an event has occurred within that quarter which requires a change in the estimate of the accrued liability balance, then the accrued liability balance should be either increased or decreased in that quarter. This is sometimes referred to as a "change in estimate".

[102] If an accrued liability balance is increased as a result of the change in estimate, earnings are negatively affected.

[103] If an accrued liability balance is decreased as a result of a change in estimate, earnings are positively affected.

[104] In Nortel speak, the event which required a change in the estimate of the accrued liability balance was called a triggering event or a trigger. Put simply, trigger was a word used to denote an event or some other situation that drove a change in an accrued liability balance.

[105] When the accrued expense becomes certain and is paid, the earnings of the corporation can be favorably affected. The following example, borrowed and slightly-amended from the Crown's expert evidence, illustrates this.

[106] Assume that, as a result of a contract into which it has entered, a publicly-traded corporation is involved in litigation at the close of its fiscal year ending December 31, 2002 and assume that an unfavorable outcome is probable. Management does not know the exact amount it will have to pay, but its reasonable estimate is that the judgment against it will be for not less than \$3 million and not more than \$9 million. If no amount within that range appears to be a better estimate than any other, Financial Accounting Standards No. 5 ("FAS 5") requires that an expense of \$3 million be recorded at December 31, 2002, *i.e.*, the expense estimate at the lowest end of the estimated range of appropriate exposures.

[107] Recording this expense on the profit and loss statement will have a \$3 million negative impact on earnings for the period ending December 31, 2002. Recording this accrued expense also results in an accrued liability of \$3 million being recorded on the balance sheet.

[108] In the example above, if the company thought that \$4 million was the best estimate of its liability, then it would record \$4 million as an expense/liability despite the fact that it was not at the lowest end of the range of appropriate liabilities. It is only when no amount within the acceptable range is a better estimate than any other that the lowest amount in the range must be chosen.

[109] Assume, for simplicity's sake, that the company settles the litigation for \$2 million in the third quarter of 2003 and pays the plaintiff in that quarter. At the end of the third quarter of 2003, the company should eliminate the accrued liability of \$3 million. \$2 million of the liability was used to pay the plaintiff so the remaining balance is \$1 million. This remaining \$1 million excess is removed from the balance sheet and \$1 million is recorded on the profit and loss statement as a positive impact on earnings. This is sometimes referred to as a "releasing" the accrued liability balance to the profit and loss statement or "releasing the accrual" or a "releasing the \$1million". Sometimes it is referred to as "reversing the accrual".

[110] In some of the documentation received in evidence, accrued liabilities were referred to as "provisions". Setting up accrued expense/liability was sometimes referred to as "provisioning".

[111] There is a timing issue in the example. US GAAP, specifically SEC Bulletin 14, requires the elimination of the accrued liability and the recording of the \$1 million positive impact on earnings in the quarter when the event precipitating the conversion of the liability occurred. In this example, it is the third quarter of 2003 because the precipitating event is the settlement of the litigation.

[112] In the example, if the accrued liability balance was not adjusted in the third quarter of 2003, then an "error" has occurred. In the third quarter 2003, accrued liability balances would be \$3 million greater than they should be and earnings would be \$1 million lower than they should be.

[113] An accrued liability can be falsely stated on the balance sheet if any one of three things happens:

- first, if, contrary to US GAAP, the liability is fictitious;
- second, if, contrary to US GAAP, an artificially-high number is used to estimate the liability when it is first set up;
- third, if an event occurs within a quarter which calls for a change (*i.e.*, an increase or decrease) in the estimate of the accrued liability and, contrary to US GAAP, a change in estimate does not occur. From that point on, accrued liabilities will be either overstated or understated on the balance sheet.

[114] When there are excess accrued liability balances on the balance sheet, an opportunity is created to tailor earnings by arbitrarily “releasing the accrual” to positively impact earnings in the quarter where you want to increase earnings. The motive for tailoring earnings is often to meet a previously-publicized financial target. Such behavior is contrary to US GAAP. The financial results in the tailored quarter are misrepresented. Whether the misrepresentation is material is a separate consideration.

[115] Returning to the example, if the corporation did not release the \$1 million in Q3 02 but, instead, left it on the balance sheet for a rainy day, the corporation would be said to have a “cookie jar” of \$1 million on its balance sheet.

[116] A corporation can also tailor earnings by lowering them if, contrary to US GAAP, it creates an accrued expense/liability which is completely false or artificially high. The false or artificially-high expense negatively affects earnings and results in earnings being misrepresented on the corporation’s profit and loss statement. Recording the false or artificially-high expense automatically results in the recording of a false or artificially-high accrued liability. When this happens, the corporation’s financial results are misrepresented. Whether the misrepresentation is material is a separate consideration.

[117] Finally, a corporation has to account for impairment of its assets even if there is uncertainty concerning the recognition of revenue or the incurring of an expense and uncertainty concerning how much money is involved.

[118] The Financial Accounting Standards Board issued the Statement of Financial Accounting Standards No. 5 (“FAS 5”) in March 1975 to assist in accounting for uncertainties related to the occurrence of future events, commonly known as accounting for contingencies.

[119] Nortel was required to record an expense related to a material contingency if information available prior to the issuance of its financial statements indicated that it was probable that an asset had been impaired or a liability had been incurred at the date of the financial statements and the amount of the impairment or loss could be reasonably estimated. The evidence established that, during Nortel’s decline, assets thought secure became impaired overnight. The evidence established that great uncertainty existed in 2001 and 2002 concerning the extent to which Nortel’s assets had become impaired.

More generally

[120] First, when estimating and recording accrued expenses/liabilities, considerable discretion is accorded to management and, correspondingly, considerable judgment is required.

[121] Second, Mr. Richmond testified that, while the basic concepts of accrual accounting were straightforward, their application could be quite complex. He testified that, between 2000 and 2005, the operating mechanics of accrual accounting did not change, the regulatory environment changed. To this, I would add sometimes reasonable differ; sometimes interpretations and applications of basic principles change.

Considerations concerning the set-up and use of accrued expenses/liabilities

[122] Mr. Richmond explained that there are two considerations. The first is ensuring that your provisioning for expenses is appropriate at any point in time; that is, that you had identified every risk for which you should provide. The second consideration requires, if necessary, reducing accrued liability balances should they turn out, at any point in time, to be overstated.

[123] It was Mr. Richmond's view that there had been a practice in corporate Canada and corporate America in the late 1990s to prepare financial statements in a professional, thorough and comprehensive way, but also in a way that made sure there was flexibility in the accrued liability levels of the corporation so that, at the end of a quarter if a CEO found himself slightly short of the market's expectations of profitability, he or she might release accrued liabilities from the balance sheet and, thereby, positively impact earnings in order to meet the corporation's publicly-stated targets.

[124] Mr. Richmond commented that this practice was ended by the SEC and the Ontario Securities Commission in 1999. The result of the change, according to Mr. Richmond, was that it was still permitted to provision in a prudent way, but not appropriate after the results of the corporation had been determined to go in and use "magic" to change numbers arbitrarily to comply with previously-publicized targets.

[125] Mr. Richmond described this change in 1999 as "a huge deal". Mr. Richmond gave examples of corporations such as Microsoft, which had experienced difficulty with regulators because they failed to appreciate this change in the environment.

NORTEL SPECIFIC CIRCUMSTANCES

Deloitte's historical relationship with Nortel

[126] The scope of Deloitte's involvement with Nortel is an important part of the context of this matter. It is difficult to get a full appreciation of the total number of Deloitte & Touche partners and associates who worked on the Nortel file. Mr. Richmond indicated that younger partners, managers and senior accountants worked on the Nortel file full-time. In terms of billings, Nortel was a major client of Deloitte.

[127] Evidence in this proceeding indicated that external auditing fees for 2003 were approved by the Nortel Audit Committee in the amount of \$19 million.

[128] Some Deloitte's auditors including the lead audit partner had their offices in Brampton at Nortel headquarters.

[129] Deloitte had been Nortel's auditors for approximately one hundred years.

[130] I am satisfied that Nortel was a significant Deloitte & Touche client. I am satisfied that Deloitte & Touche were embedded in one form or another in all aspects of Nortel's operations. The evidence is replete with communications between Nortel staff and Deloitte staff. Many of the witnesses testified that, when Deloitte asked for information, it was provided. This assertion is amply borne out by the documentary record.

Target setting and Nortel's culture

[131] Mr. Peter Dans testified in this matter. Mr. Dans worked at Nortel from 1990 to 2007. Mr. Dans served in a strategic planning role from 2001 to 2003. Specifically, Mr. Dans was assigned to the Global Planning and Reporting Group.

[132] Mr. Dans has a degree in engineering. He has an MBA; he is also a CMA – that is, a certified management accountant.

[133] Mr. Dans described the setting of targets. He testified that Nortel, whose fiscal year was the calendar year, started working on its budget in August. In August 2003, Mr. Dans prepared budgets and potential targets for each of the business units for fiscal 2004. The initial targets came from the Global Planning and Reporting Group. They produced a target for revenue and profitability which was essentially in the form of a profit and loss statement. Mr. Dans then reviewed these initial targets with the accused Douglas Beatty and it was Mr. Dans' understanding that Mr. Beatty reviewed the target with the accused Frank Dunn.

[134] The targets were sent to the Presidents and financial Vice-Presidents of the various business units so that they could provide their view on achieving their proposed target.

[135] Mr. Dunn and the Presidents of the business units would hold a final meeting and set the budget targets for the year.

[136] Mr. Dans further testified that there were times during the year when targets were updated. Mr. Dans indicated that Mr. Dunn and Mr. Beatty set what were called "stretch targets". This was a target that would be harder to achieve. It might be as much as 5% better than the budget. While Mr. Dans only had direct knowledge of this process for the fiscal year 2003, it was his impression that the target setting process employed in 2003 had not changed from earlier years.

[137] Hitting the target was an important part of Nortel's culture. Mr. Kinney offered the observation that one negotiated targets which allowed one to succeed rather than fail.

[138] Mr. Gollogly described the attitude at Nortel in an e-mail, dated July 31, 2003: "... General approach is to sandbag good news and close hard to the forecast".

[139] E-mails were received as business records in this trial.

[140] Mr. Glenn Morita is a chartered accountant. He was the Director of Finance for the Europe Middle East Asia Region. Mr. Morita similarly expressed himself in an e-mail to a colleague, dated January 8, 2004. Mr. Morita testified and confirmed the implication in his e-mail.

[141] The inference I draw is that the Nortel business units made a very determined effort to meet their targets.

The employment of Mr. Dunn, Mr. Beatty and Mr. Gollogly at Nortel

[142] Mr. Richmond and other witnesses were able to provide some history and context to the employment at Nortel of all three accused. This evidence could not be elicited from the accused because they did not testify.

Mr. Frank Dunn

[143] Specifically, Mr. Richmond testified that Mr. Dunn, a certified management accountant by training, joined Nortel out of university. Mr. Richmond, although aware of Mr. Dunn, only began to deal with him when Mr. Dunn became Corporate Controller (1992-1993). When Mr. Dunn was Nortel's Controller, Mr. Richmond met with him both individually and at Audit Committee meetings.

[144] Mr. Richmond indicated that, after Mr. Dunn became Nortel's CFO, their dealings became more frequent. Mr. Richmond was present at Audit Committee meetings when Mr. Dunn, as CFO, made presentations and commented on issues.

[145] Mr. Richmond pointed out that, when Mr. Dunn was the CFO of Nortel, he was the CFO of a corporation with the largest capitalization value of any corporation in Canada.

[146] Mr. Dunn became the CEO of Nortel in the fall of 2001. Mr. Richmond continued to deal with Mr. Dunn after that time.

[147] Mr. Richmond testified that Mr. Dunn was technically competent as far as accounting skills were concerned. Mr. Brian Harrison indicated that Mr. Dunn was knowledgeable concerning accounting principles. Mr. Harrison also testified that Mr. Dunn was very interested in details; he described him as detail-oriented. In a similar vein, Ms. Helen Verity, a chartered accountant herself, testified that she worked with Mr. Dunn and Mr. Beatty at different times during her career at Nortel. Ms. Verity described Mr. Dunn as "a very smart man" with a good grasp of accounting principles. Mr. Ken Crosson testified that he had known Mr. Dunn for twenty-five years at Nortel and offered the opinion that Mr. Dunn was "very familiar with numbers, very efficient with numbers. Understood -- he -- he understood numbers". Mr. Crosson also indicated that, on the occasions when he and Mr. Dunn discussed accounting issues, Mr. Dunn was able to "understand it completely".

[148] I accept the assessments of Mr. Dunn offered by Mr. Richmond, Mr. Harrison, Ms. Verity and Mr. Crosson. They had years to observe Mr. Dunn and their evidence in this regard did not appear to be contentious.

[149] Mr. Lynton R. Wilson also testified. Mr. Wilson was the Chairman, President and CEO of BCE Inc. and, as a result, joined the Board of Nortel in 1991. Mr. Wilson was a member of the Board of Directors throughout the period described in the indictment. He was the Chair of the Board of Directors of Nortel for most of the period set out in the indictment. Mr. Wilson was, therefore, personally familiar with the period described in the indictment.

[150] Mr. Wilson is an Officer of the Order of Canada and a Companion of the Order of the Business Hall Of Fame. During his career, Mr. Wilson served as CEO and as a director of a number of major Canadian corporations.

[151] I accept Mr. Wilson's evidence without qualification.

[152] Mr. Wilson became the Chair of Nortel's Board in 2001. He testified that Mr. Dunn was asked to take on the role of CEO at Nortel in the fall of 2001 at a difficult time. At that time with reference to Nortel, Mr. Wilson stated, "the ship was listing pretty badly..."

[153] It was Mr. Wilson's opinion that it was a credit to Mr. Dunn's leadership that he was able "to keep the ship afloat" after he became CEO in 2001.

Mr. Douglas Beatty

[154] The evidence established that Mr. Beatty was a C.A., who became the CFO of Nortel on July 17, 2002. Thus, Mr. Beatty's first quarter as CFO was Q3 2002. Prior to being CFO, Mr. Beatty was the Corporate Controller. Mr. Beatty succeeded Mr. Dunn as Corporate Controller.

[155] Mr. Richmond testified that he felt it was part of his responsibility to assess Mr. Beatty's ability to be CFO. Mr. Richmond indicated that it never occurred to him to suggest to the Chair of the Board or the Chair of the Audit Committee that Mr. Beatty did not possess the technical and other expertise to carry out his responsibilities. To the contrary, Mr. Richmond testified that he recommended Mr. Beatty to the Board for the position of CFO.

[156] Mr. Brian Harrison testified and I accept his evidence that Mr. Beatty was knowledgeable concerning accounting principles. Ms. Helen Verity also confirmed that Mr. Beatty was "a good accountant". Mr. Ken Crosson testified that he was in contact with Mr. Beatty on at least a weekly basis. He testified that Mr. Beatty was a very knowledgeable and efficient accountant.

[157] I accept the evidence of Mr. Richmond, Mr. Harrison, Ms. Verity and Mr. Crosson concerning Mr. Beatty's background and accounting acumen.

Mr. Michael Gollogly

[158] The evidence established that Mr. Gollogly is a C.A., who became Nortel's Corporate Controller on July 25, 2002, eight days after Mr. Beatty became CFO. July 25 was in the third quarter of 2002. The fourth quarter of 2002 (October 1-December 31) figured quite prominently in the evidence in this case.

[159] At an earlier point in his career, Mr. Gollogly had been Nortel's Assistant Controller (the late 1990s). He moved from Assistant Controller to senior executive positions with Nortel in France, Asia and England and then returned to the Brampton head office in July 2002 as Controller.

[160] Quite significantly, immediately upon assuming his position, Mr. Gollogly made a better understanding of Nortel's Balance Sheet a priority for him and his staff.

[161] Exhibit 42 TT demonstrates that, in January 2003, Mr. Gollogly began Balance Sheet Reviews for all units and statutory entities within Nortel.

[162] Mr. Richmond was of the view that Mr. Gollogly was technically competent as far as his accounting skills were concerned. Mr. Harrison and Ms. Verity both indicated that Mr. Gollogly was knowledgeable concerning accounting principles.

[163] In addition, Mr. Gollogly prepared draft letters and made presentations to the Audit Committee of Nortel staff which demonstrated that he was quite knowledgeable concerning accounting principles of interest in this proceeding.

[164] I accept Mr. Richmond's, and Ms. Verity's assessment of Mr. Gollogly's accounting ability.

Mr. Dunn, Mr. Beatty and Mr. Gollogly

[165] The three defendants were, from Q3 02 (the 3rd quarter of 2002), the three senior managers of the Corporation.

[166] I am satisfied that all three of the defendants were knowledgeable and experienced accountants who had the principal responsibility for Nortel's financial statements and records.

[167] I am satisfied that they were, by reason of their training, their access to forecasts and their long association with Nortel, interested in and well-acquainted with all aspects of Nortel's financial affairs.

[168] I am satisfied that all three accused were aware of financial information which materially affected Nortel's financial results.

Nortel was a complex corporate organization

[169] Nortel, itself, is part of the fabric in context of this case. Because we are dealing with the consolidated financial statements, there is a tendency to think of Nortel as a single entity. This is not precise.

[170] Mr. Richmond testified that Nortel operated in at least sixty countries in the world. He stated that the organizational chart included dozens of separate entities operating in geographies all over the world. He pointed out that, every time you had a subsidiary Nortel Corporation, generally speaking, you had to conduct an audit.

[171] Mr. Richmond described Nortel as a large, complex organization with a large and complex audit-processing team. He estimated that there were hundreds of people involved in Nortel auditing.

[172] This fact is important because it means that the financial information which the Regions were forwarding to corporate headquarters each quarter was financial information which had been produced by entities which, themselves, had been audited.

[173] Mr. Donald Hathway was Deloitte's Lead Audit Partner on the Nortel audit commencing in the spring of 2003. He was the DeLoitte person in charge of the conduct of the actual audit. Mr. Hathway stated that Nortel had a matrix organization. He said that responsibility for particular General Ledger accounts was divided between geographic entities and line of business entities. He said that responsibility for particular accounts was not always clear because of the complicated nature of the organization. Mr. Hathway testified that there were financial decisions made at the business level which were not controlled by Regional Controllers and for which Regional Controllers would have no responsibility.

[174] Mr. James Kinney testified. Mr. Kinney is a Certified Management Accountant. He started at Nortel in 1980 and continued there until 2004. From August 2002, he was the Vice-President Finance for the Wireless Business Group. Mr. Kinney indicated that, from a business perspective, Nortel was divided by both Business Lines and Regions. Mr. Kinney also indicated that the Business Lines, in turn, were divided by technologies and products. The products were also divided by Regions. Each Line of Business had a President; each Region had a President. Each Line of Business had Vice-President Finance and each Region had Vice-President Finance.

[175] Mr. Kinney testified that the Regions were also responsible for the contractual liabilities that went with the customer. Contractual liabilities were 40% of Nortel's total liabilities. Contracts would be understood by the responsible person in the Regional organization and would have been set-up through the Regional organization. Knowledge about the documentation of the contract and knowledge concerning the customer resided with individuals within the Regional organization.

[176] Finally, it was Mr. Kinney's view that ownership of the balance sheet resided in many sections of Nortel but, primarily, in the Regions. This aspect of Mr. Kinney's evidence was not contentious and I accept it.

[177] I am satisfied that Nortel's business organization worldwide was composed of dozens of separate corporations operating in geographies everywhere and that it was internally a complex entity.

THE FINANCIAL RESULTS OF NORTEL NETWORKS CORPORATION

[178] Because the essence of these charges is that the defendants deliberately misrepresented the financial results of Nortel Networks Corporation, it is necessary to make some comments about Nortel's financial results and Nortel's decisions to re-state some of those results.

[179] Nortel's fiscal year ended on December 31. Nortel reported its financial results in accordance with US GAAP and Canadian Generally Accepted Accounting Principles ("Canadian GAAP"). The primary financial statements were prepared in accordance with US GAAP.

[180] Mr. Robert Chambers, the Crown's expert on accounting matters, stated that US GAAP is the common set of United States accounting principles, standards and procedures that companies use to compile their financial statements. It is a combination of standards set by the Financial Accounting Standards Board Statements of Financial Accounting Standards, the Accounting Principles Board Opinions and Accounting Research Bulletins, the American Institute of

Certified Public Accountants Statement of Position, the Financial Accounting Standards Board Emerging Issue Task Force, SEC Staff Accounting Bulletins, as well as other rules of the SEC.

[181] Mr. Chambers indicated that there were thousands of standards set by these various standards-setting agencies.

[182] The evidence in the trial concerned compliance with US GAAP; compliance with Canadian GAAP was not an issue.

Nortel's Consolidation Close Process

[183] Nortel had an accelerated closing process, which meant that financial results had to be reported publicly within less than four weeks. It is the General Ledger which is being closed. Nortel reported quarterly so the closing process occurred quarterly. Nortel reported annual results so the General Ledger was closed annually.

[184] Ms. Helen Verity, the Director of Consolidations, indicated that the Consolidation Close meant that Nortel consolidated its results.

[185] Ms. Verity indicated that there were stages of consolidation. Each business unit closed its General Ledger. Ms. Verity referred to the Regional General Ledger as a sub-ledger. Sometimes, the sub-ledger was referred to as Advance 2. Each business unit may have had more than one entity for which it was responsible so each business unit had to consolidate those entries before it could close its sub-ledger. Mr. Morita testified that the sub-ledgers (Advance 2) had to close within three to five days of the end of the fiscal quarter.

[186] Backup for sub-ledger entries remained in the Regions. The Regions had their own management sign-off and they had their own auditors. The same was true for entries coming from Corporate Services.

[187] After Day 4, late entries that were not material would not be considered. Despite this rule, if one of Ms. Verity's counterparts from the Regions called and wanted to book a late entry, there would be a discussion about the entry. If the entry was a re-classification between the business units, she would refuse to book the entry. If an entry was significant, Ms. Verity would tell Ms. Mezon, who approved late entries, to expect it.

[188] Mr. Dans testified that an Outlook was prepared every time a consolidation took place and Mr. Dans pointed out that consolidations took place every day and sometimes more than once a day during the first days of a close as results came into corporate headquarters in Brampton Ontario. The Outlook prepared by Mr. Dans during the closing of the books was a snapshot of Nortel's financial results at that moment. The word "Outlook" denoted more than one document. One type of Outlook was a forecast. Forecasts were prepared throughout the quarter.

[189] After the sub-ledgers were closed, draft financial statements were produced according to the number of adjustments and entries which occurred. Mr. Dans indicated that the draft financial statements were available to the Controller and the CFO upon request.

[190] The corporate headquarters General Ledger was referred to as Advance 1. When the last entry was made into that General Ledger, numbers were final.

[191] Ms. Verity testified that management wanted to have a line of sight to the results earlier than waiting for the consolidated results and so, on Day 4 of the close, a draft of the results would be run. It is important to remember that the close process contemplates repeated drafts being produced after the sub-ledgers had been closed. Draft results can change due to entries from corporate headquarters. Mr. McMillan, Nortel's Director of Consolidations, indicated that, by Day Four or Day Five of the close process, corporate in Brampton would get their first complete view of the regional financial information. At this point, according to Mr. McMillan, they did not have a complete view from a corporate perspective.

[192] The evidence established that there were up to twenty draft financial statements produced over the close. Each draft statement was numbered.

[193] Results can change due to entries to the General Ledger from corporate headquarters or late entries from the Regions. Corporate headquarters was not subject to the same deadlines as the Regions.

[194] There were two headquarters units which submitted entries to the General Ledger. These units were called Corporate and Non-op. Corporate was a consolidation of the various corporate functions such as real estate, human resources etc.; Non-op was a catchall – a collection of everything that was left over.

[195] Releases of accrued liability balances to the profit and loss statement from Corporate and Non-op could be entered in the General Ledger after the Regions had closed their sub-ledgers.

[196] The Assistant Corporate Controller, Linda Mezon, advised whether an entry from the Regions was appropriate for the General Ledger. Ms. Mezon would advise Helen Verity that an entry was appropriate and Ms. Verity would sign the entry so that it could be recorded in the General Ledger.

[197] Ms. Verity testified that she was responsible for managing the time-lines associated with the close process. Ms. Verity testified that there was a well-established close schedule. It was distributed by e-mail prior to the close and one of her responsibilities was to hold people accountable to that schedule. It was her responsibility to work with Nortel people to resolve timing issues.

[198] Ms. Verity was responsible for resolving posting issues that arose during the close process; she reviewed profit and loss statements and balance sheets; she prepared binders and provided information to the Investor Relations Group within Nortel.

[199] Ms. Verity indicated that an entry was significant if it was significant to the profit and loss statement or the balance sheet. An entry was significant if it was not a "net to zero" or a re-classification entry. This distinction was made because dealing with such items would slow down the close process. At the same time, management cared about trying to get things right and so the compromise was that after Day 4 of the close, entries that changed the consolidated results

for external reporting purposes or changed the profit and loss statement would be processed. Ms. Mezon said even small items which met those criteria could be processed.

[200] Ms. Verity indicated that Fringe was the last entry of the close because, if you made another entry to the General Ledger, it might affect the Fringe. Typically, when all entries had been finalized, the business units released any Fringe accrued liabilities to the profit and loss statement.

[201] The binders for which Ms. Verity was responsible contained a consolidation package which was an XL-based profit and loss statement and balance sheet.

[202] The consolidation package was available to everyone at head office in her group; it was available to the auditors and it was available to Linda Mezon, the Assistant Corporate Controller.

[203] There was a Frank Dunn binder which was prepared for the purpose of giving Mr. Dunn a summary of the close. Douglas Beatty and Michael Gollogly and the Assistant Controller and several others received copies of this binder.

[204] Mr. McMillan indicated that the executive package binder included financial statements prepared by Corporate Consolidations and detailed schedules.

[205] The external auditors, according to Ms. Verity, had access to all of the close process material, including the Frank Dunn binder. Mr. Dans indicated that Deloitte & Touche had special access to and a special binder for late entries. The Late Journal Entry Binder contained a copy of the late entries and a copy of the backup for those entries. Deloitte and Touche received regular profit and loss statement updates during the close process.

[206] Ms. Verity indicated that there were regularly-scheduled update meetings during the close; there was also a Controller's meeting and a CFO meeting. At the Controller's meeting, there would be a discussion of entries outside the close process which remained outstanding. At the CFO meeting, the results were discussed with the CFO.

Excess accrued liabilities & Nortel's policy of Conservatism

[207] Nortel had a long-standing corporate policy concerning estimates of liabilities. Nortel Corporate Policy 300.33 provided that any anticipated decline in the value of Nortel assets and any anticipated liabilities must be provided for in accordance with the accounting concept of Conservatism.

[208] On February 27, 2003, following a review of Nortel's accounting policies including Corporate Policy 300.33, Deloitte & Touche reported to the Audit Committee that they considered Policy 300.33 to be an appropriate accounting policy.

[209] Mr. Chambers discussed Conservatism.

[210] The accounting concept of Conservatism is a characteristic of financial accounting. It is referenced in paragraph 17 of Accounting Principles Board Statement No. 4, as follows: "Conservatism. Frequently assets and liabilities are measured in the context of significant

uncertainties historically; managers, investors, and accountants have generally preferred that possible errors in measurement be in the direction of understatement rather than overstatement of net income and net assets. This has led to the convention of Conservatism...”

[211] It is also referenced in paragraph 35 of Accounting Principles Board Statement No. 4, as follows: “Conservatism. The uncertainties that surround the preparation of financial statements are reflected in a general tendency toward early recognition of unfavorable events and minimization of the amount of net assets and net income”.

[212] As indicated earlier, the Financial Accounting Standards Board issued Financial Accounting Standard 5 (FAS 5), which provides that where there is a range of accrued liabilities and no estimate within the range is better than any other, the lowest estimate in the range must be used. Significantly, paragraph 84 of provides that FAS 5 is not inconsistent with the accounting concept of Conservatism.

[213] Mr. Richmond testified that Nortel had, for twenty years prior to the events described in the indictment, a Conservative accounting culture within the context of the rules.

[214] Mr. Richmond stated that because of the precipitous descent that Nortel went through, those in the field took it upon themselves to identify as many risks as they could and to put an estimate of those risks at the conservative end of the range.

[215] Mr. Richmond elaborated that, when an organization is experiencing the “free fall” that Nortel was experiencing, a customer that one day might appear sound may very well be in financial peril the next day. As a result, Mr. Richmond stated that it was his experience at Nortel that, in preparing Nortel’s financial statements, there was an overarching desire by the directors and the executive management team to ensure that they did the best job possible to prepare the financial statements to adequately account for risks.

[216] Mr. Richmond testified that Nortel was operating in an atmosphere of doubt about the value of its assets and the operative principle was “if in doubt provide for it”.

[217] It struck Mr. Richmond as reasonable and unsurprising that Nortel employees and Deloitte professional staff defaulted to a position that was at the conservative end of the range when recording an accrued expense and liability estimating a particular risk. Mr. Richmond testified that this was something he personally embraced and that it was appropriate in Nortel’s set of circumstances “to provide at the reasonably hard end of that conservative range”. He also testified that the identification of the range involved considerable judgment.

[218] More generally, Mr. Richmond said that the essential concern was whether Nortel would stabilize before it hit the ground.

[219] Mr. Richmond indicated that the critical issue, during the time period described in the indictment, was “making sure that you have the cash to operate the enterprise”. Mr. Richmond indicated that cash was a critical issue in terms of everything Nortel did. I infer from this that Nortel’s cash position was material to its financial results.

[220] There was no suggestion in the evidence that Nortel's financial results misrepresented its cash reserves, its cash flow generally or its cash flow in its various business units.

[221] Mr. Richmond stated that the data, upon which risk management decisions were made, changed very rapidly and, therefore, management's estimates quantifying risk went up and down.

[222] Mr. Richmond indicated that the Audit Committee's preference was for Nortel to be at the conservative end of the acceptable range of risk. He described making sure that adequate provisions had been taken against the risk that assets had lost their value as an overarching paramount focus of Deloitte and Nortel in 2001 and 2002. According to Mr. Richmond, management and Deloitte's were both told by the Audit Committee concerning the corporation's exposure to risks to "make sure there are no surprises".

[223] Mr. Wilson, the Chair of the Board of Nortel, gave similar evidence. He referred specifically to a briefing the Board received in January 2003 concerning an accrued expense/liability of \$50 million taken in respect of a claim by a company known as 360 Networks. Mr. Wilson did not recall the details of the briefing concerning the taking of the provision, but he recalled that Mr. Cleghorn, the Chair of the Audit Committee during the time period of the indictment, asked at the Board meeting if \$50 million was sufficient because the claim against Nortel was for \$100 million.

[224] Similar evidence was provided by Mr. Cleghorn. Prior to serving as Chair of the Nortel Audit Committee, Mr. Cleghorn was the Chairman and CEO and a Director of the Royal Bank of Canada. He was also Chairman of the Board of the Canadian Pacific Railway until 2012. He, like Mr. Richmond, is a Fellow of the Institute of Chartered Accountants of Ontario.

[225] I accept Mr. Cleghorn's evidence without qualification.

[226] Mr. Cleghorn described participating at the Audit Committee meeting in 2001 where Nortel management advised that it was necessary to write off \$19 billion. Mr. Cleghorn testified that his first thought when he heard this was "did they get it all?" Mr. Cleghorn testified that, during the period described in the indictment, the auditors were regularly asked if they were satisfied with management's estimates of liabilities.

[227] Mr. Gollogly expressed a somewhat similar view in an e-mail, dated October 13, 2003. In this e-mail, Mr. Gollogly proposed a draft for the Note to the Financial Statements explaining why it was necessary for Nortel to re-state earlier financial statements. While Mr. Gollogly's proposed draft was not used, I note that he attributed the overstatement of accruals and the failure to draw down accruals in the correct fiscal period to "the high level of Conservatism used to identify Nortel Networks financial exposure during our period of realignment and our significant workforce reductions..."

[228] A more extreme view was articulated by Mr. Michael McMillan in his evidence. Mr. McMillan joined Nortel in 1997. Mr. McMillan had an M.B.A. from the University of Manitoba. During the timeframe of the indictment Mr. McMillan was Nortel's Director of Consolidations. It was Mr. McMillan's evidence that accrued liabilities were booked on a worst-case scenario

basis rather than a best estimate basis. Mr. Peter Dans, to whom reference will be made later, testified that he was aware of accruals being booked on a conservative basis “which may have been the worst-case scenario sometimes”.

[229] During the time period described in the indictment, Nortel lost billions. I do not find it unusual that sensible people confronted with that reality would think that the worst-case scenario was the best estimate of the risks to Nortel’s assets. I also do not find it unusual that sensible people confronted with Nortel’s reality would be slow to decrease accrued liabilities already on the balance sheet.

[230] I am satisfied that throughout the time period described in the indictment accrued liabilities at Nortel were estimated at the high-end of the range of estimates and sometimes on a worst-case scenario basis. According to the evidence a risk can be provided for on a worst-case scenario basis provided that it is the judgment of the person estimating the risk that the worst-case scenario is the best estimate of that risk.

[231] One of the risks created by Nortel’s situation was that excess accrued liability balances would find their way onto Nortel’s balance sheet. This reality created a possibility of using accrued liability balances to meet financial targets. Exhibit 5, tab 242 provides an example of how ingrained this problem was by 2004. This document is an e-mail string. Mr. Glenn Morita, one of the authors of some of the e-mails in the string, in an e-mail, dated January 8, 2004, wrote: “sounds like you Aussies are like squirrels (not sure if you have them Down Under) secretly storing your nuts for a rainy day”. Mr. Morita testified that he was frustrated when he sent the e-mail because his Australian counterpart was covering an expense with the release of an accrued liability balance. Mr. Morita said he was frustrated because Nortel had just gone through a Comprehensive Balance Sheet Review and his Region, which included Australia, thought that it had cleaned up the problem, but it turned out that they had not. There are other references in emails to digging up “opportunities” and having “flexibility”.

[232] Nortel’s Conservatism concerning the recording of accrued liabilities and expenses was likely in effect for twenty years. It was ingrained in Nortel’s culture.

[233] This policy of Conservatism was memorialized in Nortel Corporate Policy number 300.33. This policy had been reviewed by Deloitte in 2003 and found to be an appropriate corporate accounting policy. This policy, which had become a Nortel cultural norm, resulted in the excess accrued liability balances found on Nortel’s consolidated balance sheet during the Comprehensive Balance Sheet Review in 2003.

The accused knew there were excess liabilities on the balance sheet

[234] I am satisfied beyond a reasonable doubt that all three accused, by virtue of their long experience with Nortel and their positions of responsibility, well-understood how the men and women in the field were implementing Nortel’s policy of Conservatism.

[235] I am satisfied, based on the evidence adduced at this trial, that none of the accused initiated this policy.

[236] I am satisfied beyond a reasonable doubt that they knew that the policy of Conservatism had created excess accrued liabilities and, therefore, they knew that these excess liabilities could be released to assist in meeting financial targets.

[237] I also find that the enormous losses suffered by Nortel in these years created a situation in which senior management, Nortel's Board of directors and Nortel's auditors were quite reasonably concentrating on doing all things necessary to make sure that Nortel had sufficient cash reserves to survive and continue in business. I am satisfied that non cash impacting excess accrued liabilities on the balance sheet were not a priority.

[238] I am satisfied, on the evidence, that Mr. Gollogly, virtually from the time he took over as Corporate Controller, turned his attention to Nortel's balance sheet. I am also satisfied, on the evidence, that neither Mr. Dunn nor Mr. Beatty, his immediate superiors, did anything to impede his efforts.

Unsupported and excessive accrued liabilities on the balance sheet

[239] The evidence persuades me that accruals were present on Nortel's consolidated balance sheet which could not be supported by documentation. However, I decline to draw the inference that these accruals never existed. It seems more logical to me that the downsizing of Nortel, which involved the closing of offices, the selling of real estate and, undoubtedly, the storage of documents, created a situation in which supporting documentation for some of Nortel's accrued liability balances could not be located. Further, the loss of employees (two out of every three worldwide) created a situation in which the institutional memory concerning the unsupported accruals no longer existed within the company. I am satisfied that these were the reasons why unsupported accrued liabilities were present on Nortel's consolidated balance sheet.

[240] Also, the evidence does establish and, I so find, that excessive accrued liabilities existed because accrued liabilities were not released when they should have been and because accrued liabilities were not adjusted when they should have been.

[241] Mr. Dunn and Mr. Beatty took part in the analyst calls which generated a 2002 Accrued Liability Report by Ms. Susan Shaw. Ms. Shaw, a chartered accountant in Nortel's Corporate Consolidations Group, reported to Mr. Gollogly. Ms. Shaw advised both Mr. Gollogly and Mr. Harrison that there were unsupported liabilities on Nortel's balance sheet.

[242] I am satisfied that all three accused knew that there were unsupported and excessive accrued liabilities on Nortel's balance sheet.

Nortel's Pro Forma earnings calculations

[243] The evidence disclosed that securities regulators encouraged Nortel and other publicly-listed companies to refrain from reporting non-GAAP measures commencing Q1 2003 (Q1 03). Prior to Q1 2003, Nortel had reported "pro forma" financial results.

[244] As a result of this regulatory change in attitude, as of fiscal 2003, pro forma earnings calculations at Nortel became an internal measure only. This meant that, commencing in Q1 03, Nortel no longer published pro forma financial results.

[245] Pro forma financial results were calculated using a formula generated internally at Nortel. This formula changed from year-to-year. The 2002 pro forma formula was not the same as the formula used in 2003.

[246] Despite this change, certain Nortel bonus plans, which are important for our purposes, continued to be triggered by Nortel's 2002 formula for calculating pro forma earnings.

[247] The pro forma calculation of earnings differed from the calculation of earnings according to US GAAP. The pro forma formula for calculating earnings excluded items, including significant cost items, which were included in US GAAP earnings calculations. The items excluded were non-operational in nature. For example, pro forma earnings calculations excluded gains from buying back bonds. According to Mr. Harrison, the items included in pro forma earnings calculations were, themselves, calculated in accordance with US GAAP. Mr. Harrison's evidence in this regard was not questioned and I accept this aspect of his evidence.

[248] For the sake of completeness, the method of calculating pro forma earnings that was used in 2002 excluded charges which were included in the 2003 method of calculating pro forma earnings. In other words, the 2002 formula resulted in higher pro forma earnings.

[249] The difference between pro forma earnings calculations and US GAAP earnings calculations was also referenced in a glossary of terms filed in this proceeding which contained a definition of "pro forma". The definition provided, in part, that pro forma financial statements consisted of information which Nortel management believed was meaningful to investors.

[250] Nortel published Q4 02 pro forma financial results in its January 24, 2003 press release announcing financial results for Q4 02. Nortel did not publish pro forma financial statements for Q4 02.

[251] In 2003, Nortel did not publish pro forma earnings calculations at all.

Pro Forma earnings and Bonus Thresholds

[252] Mr. Cleghorn testified that, in the summer of 2002, Nortel employees were being approached by the competition. By this time, many employees at Nortel had been laid off or fired, sales were declining and the auditors considered Nortel to be a high-risk audit. Employees with stock options found that the options were worthless. In an effort to prevent valuable employees from leaving the company, Mr. Cleghorn testified that the Board adopted a Return to Profitability Bonus Plan.

[253] The Return to Profitability Bonus Plan was announced in November 2002. It provided eligible employees with a special bonus if Nortel achieved profitability for any quarter in the period from Q4 2002 through to and including Q4 2003.

[254] Profitability for the purpose of this bonus plan was based on pro forma earnings from continuing operations; it also included an accrual for the cost of the bonus in such period. In other words, there had to be sufficient pro forma earnings before taxes from operations to pay for the bonus. Senior executives would be paid in three tranches.

[255] Pro forma earnings (loss) before taxes was an internal Nortel calculation and metric. This meant that Nortel could change the calculation and this happened in 2003. The Board of Directors, however, in a minute from the 2:50 p.m. Board meeting of April 24, 2003, decided that, for greater certainty concerning the bonus calculations, Nortel's 2002 formula for calculating pro forma earnings before taxes would continue to be used for the purpose of calculating whether the Return to Profitability Bonus and the Restricted Stock Unit Bonus were earned. This is significant because it meant that, although Nortel changed the way in which it calculated pro forma earnings in 2003, this change did not affect the pro forma calculation of earnings for the purpose of determining whether Restricted Stock Unit and Return to Profitability Bonus targets had been met.

[256] Entitlement to bonuses is an issue in this trial. The bonus payment issue was not made simpler by the fact that Mr. Dans, who did the bonus calculations, erroneously used Nortel's 2003 pro forma income formula in some of his calculations. Mr. Dans agreed that profitability was more easily achieved under the 2002 formula than the 2003 formula.

NORTEL'S RE-STATEMENT OF PREVIOUSLY-PUBLISHED FINANCIAL STATEMENTS

[257] The evidence established that Nortel, on two occasions, restated financial statements which it had previously published.

[258] Neither restatement affected Nortel's cash position. Nortel's cash position was critical to its survival.

[259] Mr. Chambers, the Crown's expert, explained in his report when a restatement of previously-published financial information is necessary. Mr. Chambers indicated that, if a misstatement has occurred in a publicly-traded corporation's published financial results, a restatement of the prior year's financial statements is required if the misstatement is material in the prior year or if a correction in the current year, *i.e.*, when the misstatement is discovered, materially overstates or understates earnings in the current year.

[260] Mr. Chambers also offered expert evidence on the reasons why financial statements are restated. Mr. Chambers stated in his report that Restatements occur because the earlier financial statements contain errors:

- due to the misapplication of US GAAP;
- mathematical mistakes;
- incorrect facts;
- fraud due to the manipulation of accounting records, misrepresentation, or the intentional misapplication of US GAAP;
- changes in accounting principles; and,

- stock splits.

[261] Mr. Chambers stated that the majority of Restatements are attributable to internal company errors.

[262] Mr. Hathway, the lead auditor for Deloitte on the Nortel file in 2003, explained when it is necessary to restate prior published financial results so that accrued liability balances can be re-profiled to the appropriate financial periods when they should have been released to the profit and loss statement.

[263] Mr. Hathway testified that, where there is an error in the financial statements due to an overstatement of accrued liabilities, there are two choices:

- if the overstatement of an accrued liability balance is not material to either the balance sheet or the profit and loss statement in the current quarter or the quarter in which it should have been released, then it can be, with the appropriate disclosure, released to the profit and loss statement in the quarter in which the error is discovered; and,
- if the overstatement is material to the results in the quarter in which the error is discovered or to the results in the quarter in which it should have been released to the profit and loss statement, then there must be a Restatement of the earlier financial statements to push the excess accrued liability balance back to the period when it should have been released.

[264] Mr. Richmond testified that Restatements in both Canada and the United States are infrequent. He said that for an organization to restate a previously-published financial result is not something that is well-embraced by the organization. Mr. Richmond's evidence is consistent with evidence heard in the trial to the effect that Mr. Beatty told Mr. Cleghorn that a restatement was never a good idea.

The First restatement

A short chronology

[265] Nortel's first decision to restate financial statements for 2000, 2001, 2002, Q1 2003 and Q2 2003 was announced on October 23, 2003.

[266] This restatement essentially restated excessive accrued balances on Nortel's balance sheet back to the quarters when they should have been released to the profit and loss statement.

[267] The restated financial statements resulting from the first Restatement were released to the public on December 23, 2003 approximately two months after the announcement of the first Restatement.

Who was Responsible

[268] Ms. Sledge, indicated that she personally dealt with both Douglas Beatty and Michael Gollogly in connection with the first Restatement and that, from her perspective, both Douglas Beatty and Michael Gollogly were in charge of the first Restatement. Ms. Sledge's evidence in this regard is consistent with the positions held by Douglas Beatty and Michael Gollogly during the first Restatement; namely CFO and Controller. I accept this portion of Ms. Sledge's evidence; although I am satisfied Ms. Sledge, a certified public accountant and Nortel's Assistant Corporate Controller from 2003-2005, also had a major role in the first restatement.

Nortel Restatements are complex

[269] Mr. Michael McMillan testified that, due to the significant number of corporate entities involved worldwide, the restatement process was complex. I accept Mr. McMillan's evidence that the restatement process for Nortel was a complex one.

How the Restatements came about

[270] Mr. Richmond described the situation at Nortel when consideration was being given for the first time to restating financial statements from earlier periods. The immediate cause of this discussion was the release to the profit and loss statement in Q2 03 (the second quarter of 2003) of approximately \$142 million in accrued liabilities which could no longer be supported. The release of this \$142 million would have had a positive effect on earnings. These balances had been released during preparation of one of the preliminary drafts of Nortel's Q2 03 financial statements during the Q2 03 close process described earlier.

[271] Mr. Gollogly made Mr. Hathaway, Deloitte's lead Nortel audit partner, specifically aware of the \$142 million and asked Mr. Hathaway for Deloitte's view. Mr. Hathaway objected to the release of these balances, with the result that the release of these balances was reversed in the next preliminary draft of the financial statements and the \$142 million in accrued liability balances was returned to Nortel's balance sheet where they always been.

[272] No profit and loss statement containing the \$142 million was ever published.

[273] It was Mr. Richmond's evidence that Mr. Dunn maintained that the \$142 million was the total number of unsupported liabilities on Nortel's consolidated balance sheet. It was Mr. Dunn's view that the \$142 million should remain released to the profit and loss statement of Q2 03 and that there should be appropriate disclosure of this fact in the press release publishing Nortel's Q2 03 financial results. Mr. Dunn maintained that his view should be respected because not only was he the CEO, but he had been, prior to that, Nortel's CFO and Corporate Controller.

[274] This is perhaps an appropriate time to observe the obvious. Mr. Dunn was spectacularly wrong; the first restatement identified in excess of \$900 million of accrued liabilities that could no longer remain on Nortel's consolidated balance sheet.

[275] Mr. Richmond indicated that Mr. Dunn also resisted the idea of a comprehensive balance sheet review due to the workload demands it would place on a group of busy people. This

observation attributed to Mr. Dunn seems reasonable to me because, by this time in 2003, Nortel's employees had been reduced by two-thirds.

[276] Mr. Richmond indicated that, if Mr. Dunn had been correct, the restatement might have been as simple as booking the \$142 million back into 2002 because, in 2002, Nortel suffered total losses of \$3.7 billion. Thus, the effect of restating the \$142 million into 2002 would only have been to reduce that loss to \$3.5 billion approximately, which would have been an immaterial change to Nortel's financial statements for 2002.

[277] Mr. Richmond indicated that it was Deloitte's position that Nortel had to comprehensively review its balance sheet so that the true extent of the accrued liability problem would be known and that, only when that had occurred, could consideration be given to the correct accounting treatment of the \$142 million in unsupported accrued liability balances that everyone already knew was on Nortel's consolidated balance sheet.

[278] Mr. Richmond indicated that it was Deloitte's view that it was appropriate to "park" the \$142 million on the balance sheet until the comprehensive review of the balance sheet was completed. It was Mr. Richmond's view and Deloitte's view that leaving the \$142 million on Nortel's balance sheet did not misrepresent Nortel's financial results. Mr. Richmond explained that Nortel had more than \$5 billion in liabilities on its balance sheet in Q2 03 and that, in Deloitte's view, the \$142 million was not material to that total. Mr. Chambers, the Crown's expert, offered no opinion to the contrary.

[279] I accept Mr. Richmond's evidence in this regard and I agree with his conclusion.

[280] Mr. Richmond further explained that Nortel's profit and loss statement for Q2 03 revealed that it was, at long last, at break-even and that, therefore, the release of the \$142 million to the profit and loss statement in Q2 03 would have been material to that statement and, therefore, could not be permitted.

[281] I agree with this conclusion as well.

[282] Finally, Mr. Richmond pointed out that Deloitte's was not satisfied that the \$142 million represented the entire extent of the problem.

[283] Mr. Richmond indicated that this discussion between Deloitte and Mr. Dunn went on for a period of time.

[284] Nortel's second-quarter concluded on June 30, 2003. Mr. Richmond indicated that, sometime in the first two weeks of July 2003, he had a meeting with Mr. Dunn which resolved the matter as follows:

- The \$142 million in accrued liabilities, released to the profit and loss statement in Q2 03 and returned to Nortel's balance sheet after Deloitte's objected, would remain on Nortel's balance sheet;
- Nortel would comprehensively review its balance sheet;

- The fact that a comprehensive balance sheet review was taking place would be disclosed in Nortel's public financial filings for Q2 03. Mr. Richmond did not suggest that this aspect of the discussion was contentious.

The Comprehensive Balance Sheet Review

[285] Ms. Karen Sledge testified that she participated in the Comprehensive Balance Sheet Review which began at the end of July 2003. During this process, she was part of the team reviewing all of the different accounts from the different regions and business units. She said, as the balance sheet review proceeded, it became clear that there was more and more on the balance sheet that needed to be corrected. She said that the numbers were increasing every time they looked at the accounts.

[286] It was Ms. Sledge's evidence that, at some point during the Balance Sheet Review process, those involved realized that there would need to be a restatement of prior years' financial results. Her evidence in this regard is also consistent with Mr. Richmond's evidence that, as the Comprehensive Balance Sheet Review progressed, the quantum of excess accrued liabilities increased. Mr. Richmond indicated that, as a practical matter, the error with respect to accrued liabilities was so large that a Restatement was inevitable.

[287] I accept this aspect of Ms. Sledge's evidence.

[288] Mr. McMillan testified that there was a timing sensitivity associated with the first Restatement. Specifically, he said that all of the people involved in the restatement wanted to make sure that it was completed within the normal reporting lines so that the appropriate filings with the SEC and the Ontario Securities Commission would not be delayed. Mr. McMillan said that the need to report in a timely manner made the first Restatement a demanding exercise.

[289] It was Mr. McMillan's view that "at the end of it I felt that we had done a good job of it and we had managed it within the timeframe". Mr. McMillan also indicated that he was quite surprised that it was necessary to restate Nortel's earlier financial results a second time. I accept Mr. McMillan's evidence concerning timeliness.

[290] Mr. Richmond also testified that there was pressure to complete the Comprehensive Balance Sheet Review in a timely manner. Mr. Richmond indicated that there was an agreement among the Board, senior management and Deloitte to complete the review "as rapidly as was humanly possible".

[291] It was Mr. McMillan's view that the Comprehensive Balance Sheet Review and first Restatement was driven by Karen Sledge and Michael Gollogly. He said that these were the two people to whom he regularly reported. McMillan's evidence is not contentious and I accept it. Ms. Sledge work was obviously satisfactory; she remained in Nortel's employ until 2010.

[292] Mr. Peter Dans testified that there was a "focus on getting the Restatement correct and there was, you know, high level of review that was going to be associated with that to try and ensure that the Restatement was done correctly".

[293] Mr. Richmond said that it was his observation, as the balance sheet review progressed, that “there were some really tired folk, both at Nortel and our firm in terms of trying to make that happen”.

[294] Mr. Richmond indicated that the Comprehensive Balance Sheet Review exercise was so intense that, at one point, he spoke to the Chairman of the Audit Committee and suggested that Nortel should provide an opportunity for those Nortel and Deloitte employees and partners involved in the Comprehensive Balance Sheet Review to enjoy a long weekend.

[295] The time pressure was so intense that Mr. Gollogly wrote in his diary “get it done versus get it right” which was a play on the theme for the restatement which was “do it once and do it right”.

[296] Mr. Hathway recounted being present when Mr. Gollogly suggested to Mr. Dunn that the restatement might not be finished in time for Nortel’s next public filing; Mr. Hathway indicated that Mr. Dunn was adamant that a delay was unacceptable.

[297] Mr. Richmond indicated that, in his view, the Deloitte Nortel engagement team, led by Don Hathway and John Cawthorne, was as close to workaholics as he had ever seen; he said their behaviour was matched by the individuals working for Mr. Gollogly.

[298] Ms. Karen Sledge testified that she remembered one evening where she, Mr. Hathway and Mr. Gollogly were up the entire night resolving balance sheet review issues affecting Nortel’s operations in Asia.

[299] Mr. Hathway was interviewed by the R.C.M.P. in connection with this matter on November 14, 2005. By this time, he was well-aware of the results of the Wilmer Cutler Pickering independent inquiry on behalf of the Audit Committee concerning the causes of the need to restate Nortel’s previously-published financial statements. By this time, Mr. Dunn, Mr. Beatty and Mr. Gollogly had been accused of wrongdoing in that report and, as a result, fired for cause.

[300] During the course of that interview, Mr. Hathway was asked by Sgt. Bone if he felt a conscientious effort had been made during the first balance sheet review. Mr. Hathway said he thought the Nortel side had done a conscientious job. When asked why he thought that, he said “the extent of the work they did, the amount of documentation they tried to go back and find, they did, seemed to me they made a real effort to get behind these items and find out what the real story was, when we asked questions about it, if we were not satisfied with what they gave us initially we would tell them to follow up and it seemed to me they were making a real concerted effort to get you know to respond to our questions and to get the answers...”

[301] Mr. Hathway confirmed that his answers in the R.C.M.P. interview reflected his thinking, not only at the time of the Comprehensive Balance Sheet Review, but also at the time of his RCMP interview in November 2005.

[302] During the course of the R.C.M.P. interview, Mr. Hathway recounted a conversation with Mr. Gollogly at the time when it became clear that there would be a restatement. Apparently, Mr. Gollogly asked Mr. Hathway if he, that is Mr. Gollogly, should resign. Mr. Gollogly thought he

should resign because he was the Corporate Controller and should accept responsibility for the fact that the Audit Committee found it necessary to restate previously-published financial results. Mr. Hathway told Mr. Gollogly that he did not think he should resign. When asked during the R.C.M.P. interview why he gave Mr. Gollogly that advice, Mr. Hathway said, “my view was Mike was trying to get the numbers right...” Mr. Hathway was asked during his interview if his opinion had changed and he said, “I am not sure my opinion’s changed”.

Was the Comprehensive Balance Sheet Review Comprehensive?

[303] The Crown suggested all three accused misinformed the public by saying that the first restatement represented a comprehensive review engaged in for the purpose of correcting past accounting errors.

[304] The Crown maintains that the first restatement was not comprehensive. The Crown suggested that the scope of the first restatement was too narrow.

[305] The Crown suggested that, because Nortel and Deloitte staff worked so hard, the first restatement was under-resourced.

[306] The Crown submits that the first restatement understated the extent of the errors on the balance sheet and argues this is demonstrated by the fact that there was a second restatement.

[307] Mr. Wilson, whose evidence I accept, testified that the impact of the restatement of \$900 million in accrued liability balances identified during the Comprehensive Balance Sheet Review was favorable to shareholders. The \$900 million represented expenses on the balance sheet that did not have to be recognized. Shareholders’ equity was increased by \$900 million.

[308] Mr. Wilson described the first restatement as a restatement of over-providing; amounts were brought back which added to the shareholders investment in the company.

[309] The Crown has never suggested that the \$900 million in accrued liability balances ought not to have been restated.

[310] I accept the evidence of Mr. Richmond, Ms. Sledge, Mr. McMillan and others attesting to the effort that went into the first restatement. No witness testified or suggested that Mr. Beatty or Mr. Gollogly interfered with the first restatement. Mr. Hathway remained convinced, after the release of the Wilmer Cutler Pickering Review and after the investigation into this matter had begun, that “Mike was trying to get the numbers right”.

[311] I propose to separately consider why there was a second restatement and the inferences to be drawn from that restatement.

[312] I am satisfied the Comprehensive Balance Sheet Review was, in a word, comprehensive.

[313] I am not satisfied that the scope of the first Comprehensive Balance Sheet Review (a review of all accrued liability balances in excess of \$100,000 and a review of all accrued liability balances released to the profit and loss statement equal to or in excess of \$2 million) was too narrow in scope.

[314] It became apparent in the late summer that a restatement would likely be necessary. The scope of the Comprehensive Balance Sheet Review was approved by Nortel's auditors and Nortel's Audit Committee. Nortel's Audit Committee and auditors knew that the decision to restate earlier published financial statements would attract regulatory interest. It was to satisfy regulators that Nortel's Audit Committee hired Wilmer Cutler Pickering to conduct an independent review of the circumstances leading to the decision to restate. I am satisfied that, without the benefit of hindsight, Nortel's auditors and Nortel's Audit Committee thought that these parameters were reasonable.

[315] I am not satisfied that the first restatement was under-resourced. Deloitte was free to add staff as they saw fit. Mr. Richmond did not hesitate to recommend that Nortel staff and Deloitte staff be compelled to take a long weekend. I have no doubt he would have recommended that Nortel find additional staff for the Comprehensive Balance Sheet Review if it had come to his attention that the project, which he had insisted upon, was being compromised because it was under-resourced on the Nortel side. The Comprehensive Balance Sheet Review did, in fact, reveal that approximately \$900 million in accrued liability balances needed to be restated.

[316] I am not satisfied that the original balance sheet review was too narrow in scope

[317] I am satisfied that there was intense pressure to complete the Comprehensive Balance Sheet Review as quickly as possible. I do not attribute this imperative to the accused alone. I accept the evidence of Mr. Richmond that there was an agreement among the Board, senior management and Deloitte that the Comprehensive Balance Sheet Review should be completed "as rapidly as was humanly possible". I am satisfied that this imperative existed because Nortel wanted to put the balance sheet review and a restatement, if there was indeed going to be one, behind them as quickly as possible and because the accused and Nortel's Audit Committee wanted to make their appropriate filings with the SEC and the Ontario Securities Commission within normal reporting lines.

[318] I am not satisfied, on the evidence, including the evidence specifically referred to, that the first restatement was not comprehensive because timelines were short.

[319] I am not persuaded that any or all of the three accused insisted upon an unreasonably short timeline in an effort to make certain that the first restatement failed to uncover the true extent of the accrued liability problem on Nortel's balance sheet.

[320] I attach no importance to the fact that Mr. Beatty told Mr. Cleghorn, the chair of the Audit Committee, that he, that is Mr. Beatty, viewed a restatement as a last resort or that a restatement was a last resort. Mr. Beatty's statement proves that his attitude toward a restatement was consistent with what Mr. Richmond described as the attitude of corporations generally.

[321] The restatement of these accrued liability balances had no cash impact on Nortel's cash reserves. Maintaining sufficient cash reserves to keep Nortel functioning was the most pressing responsibility of Nortel senior management, Audit Committee and Board of Directors. In fact, neither the first restatement nor the second restatement had an effect on Nortel's critically important cash reserves.

[322] Mr. Richmond testified that Nortel lost \$3.5 billion in 2000, \$27 billion in 2001 and \$3.7 billion in 2002. It was his view that the \$900 million in excess accrued liability balances was not material to Nortel's financial statements in those years. Mr. Chambers did not offer a contrary opinion.

[323] Mr. Chambers did not offer any opinion concerning the comprehensive balance sheet review or the first restatement.

[324] I am not satisfied beyond a reasonable doubt that Nortel's original financial statements for 2000, 2001, 2002, Q1 03 and Q2 03 were materially misstated. I am not satisfied that Nortel's original financial statements for those fiscal years materially misrepresented Nortel's financial results. I am not satisfied beyond a reasonable doubt that Nortel's financial statements published after the first restatement materially misrepresented Nortel's financial results.

[325] I am satisfied that Nortel's original financial statements for the years 2000, 2001, 2002, Q1 03 and Q2 03 properly reflected Nortel's financial reality.

The results of the second restatement

[326] The Crown relied upon the fact of and results from the second restatement as proof that the first restatement was not comprehensive.

[327] Mr. Richmond indicated that, when it became clear in October 1993 that there were \$900 million in excess accrued liability balances to be restated, he suggested that the directors retain independent attorneys to review the circumstances which led to both the recording of excess accrued liability balances on Nortel's consolidated balance sheet and the decision to restate previously-published financial statements for fiscal 2000, 2001, 2002, Q1 2003 and Q2 2003.

[328] The independent attorneys chosen were from the U.S. firm of Wilmer Cutler Pickering.

[329] The Summary of Findings and Recommended Measures resulting from the WCP Review ("WCP Summary") was received in evidence for contextual purposes and not as proof of the facts or conclusions contained within it.

[330] The WCP Summary is contextual in the sense that it affected conduct which was the subject of evidence in these proceedings. For example, it precipitated the decision by the Board of Directors to restate for a second time. It also precipitated the decision by the Board of Directors to terminate all three defendants for cause. Finally, Mr. Hathway repeatedly asserted during his testimony that Deloitte's attitude toward Nortel would have been different had Deloitte known about the matters disclosed in the WCP Summary.

[331] The WCP Summary recorded the conclusion that the defendants and other persons employed in the former finance management of Nortel carried out accounting practices relating to the recording and release of provisions that were not in compliance with US GAAP in at least Q3 2002 and Q4 2002 and Q1 2003 and Q2 2003.

[332] The WCP Summary concluded that the dollar value of the individual provisions recorded and released was relatively small and that the aggregate value of the provisions made the

difference between a profit and a reported loss on a pro forma basis in Q4 2002 and the difference between a loss and a reported profit on a pro forma basis in Q1 2003 and Q2 2003.

[333] Nortel did not publish pro forma results in Q1 03 or Q2 03.

[334] The WCP Summary concluded that these practices were undertaken to meet internally imposed pro forma earnings targets.

[335] The WCP Summary concluded that the conduct in question caused Nortel to pay bonuses to all employees and senior management under bonus plans tied to pro forma profitability.

[336] The WCP Summary recorded that the work of Nortel's external auditor, Deloitte & Touche LLP, was not examined, although several current and former audit partners were interviewed.

[337] With respect to the Q3 2003 and Q4 2003, the WCP Summary concluded that no evidence emerged to suggest an attempt to release provisions strategically in those quarters. However, given the significant volume of accrued liability balance releases in those quarters, it recommended a review of releases down to a low threshold.

[338] In addition, the WCP Summary recorded a series of recommendations intended to prevent a recurrence of the conduct uncovered by the WCP Review.

[339] I do not wish to imply that I disagree with the Wilmer Cutler Pickering conclusions. I have no opinion about their conclusions. Forming an opinion about their conclusions would confuse my task with theirs, fail to take into account differences in the evidence we considered and fail to take into account my standard of proof and whatever standard they used. Wilmer Cutler Pickering was answering a question: what were the facts and circumstances leading to the need to restate Nortel's previously-published financial statements for the relevant periods (*i.e.*, 2000, 2001, 2002, Q1 03 & Q2 03)? I am trying to determine beyond a reasonable doubt whether Nortel's financial results were deliberately misrepresented during the time-frame of the indictment.

[340] Mr. Richmond stated that, on or about March 5, 2004, he found out that Wilmer Cutler Pickering intended to recommend that Nortel restate its prior financial results yet again. Mr. Richmond briefed the Chairman of the Board and the Chairman of the Audit Committee. Mr. Richmond's briefing led to a March 10, 2004 Board meeting attended by representatives of the Wilmer Cutler Pickering firm and, following the Board meeting, a press release, dated March 10, 2004.

[341] The March 10, 2004 press release announced that Nortel Networks would delay filing its 2003 annual reports. The press release indicated that Nortel was re-examining the establishment, timing of, support for and release to income of certain accrued liabilities in prior periods. The press release indicated that Nortel suspected that it would have to revise both its previously announced consolidated results for the fiscal year ending December 31, 2003 and its consolidated results for one or more earlier quarterly periods.

[342] Mr. Richmond testified that, when Nortel publicly-stated that it was going from the first Restatement to a Second Restatement, the level of interest in its affairs was intense. He stated that everyone from the Ontario Securities Commission to the SEC was looking over the collective shoulder of Nortel and Deloitte. He said that there was a mandate to get the Second Restatement right in an environment where there was significant litigation going on in the marketplace. He described it as a “high-stakes game”.

[343] Mr. Hathway indicated that the parameters for the second restatement were chosen as a result of the findings of the Wilmer Cutler Pickering independent review. He testified that the Wilmer Cutler Pickering Review revealed information which suggested that aspects of the prior accounting were not correct and raised the potential of earnings management. It was Mr. Hathway’s view that these findings eroded confidence in senior management and resulted in a second restatement.

[344] Mr. Hathway accepted the Wilmer Cutler Pickering conclusions and, based on those conclusions, testified that the first restatement was not comprehensive. As indicated earlier, I do not accept Mr. Hathway’s conclusion.

[345] I am satisfied that, once the Audit Committee received the Wilmer Cutler Pickering Review, it was necessary in response to that information to restate for a second time.

[346] The evidence established that this second review of Nortel’s previously-published financial results considered issues related to revenue recognition, as well as the release of accrued liability balances. Thus, it not only dealt directly with Nortel’s consolidated balance sheets, but also directly with the revenue side of its consolidated profit and loss statements.

[347] The thresholds for the first and second restatement were not the same. The first restatement reviewed all accrued liability balances in excess of \$100,000; the second restatement reviewed all accrued liability balances in excess of \$10,000. The first restatement reviewed all releases of accrued liability balances to income in excess of \$2 million; the second restatement reviewed all releases of accrued liability balances to income in excess of \$100,000.

[348] The Second Restatement of Nortel’s previously-published financial results was released January 11, 2005.

[349] A press release, dated January 11, 2005, announced the restatement of Nortel’s consolidated financial results for the fiscal years ended December 31, 2001 and 2002. It also released a revision of Nortel’s previously-announced results for the 2003 fiscal year.

[350] The various press releases were admitted into evidence as business records. The press releases were also attached to Nortel’s filings with the SEC. SEC filings were received as business records.

[351] The January 11, 2005 press release announced that the restated financial results reflected substantial revenue adjustments. The adjustments in revenue, according to the press release, had to be made because there had been accounting errors in Nortel’s previously-released consolidated financial results related to revenue recognition. The press release announced that

Wilmer Cutler Pickering would be conducting a further independent review of the circumstances that led to the erroneous recognition of revenue.

[352] The causes of the substantial revenue recognition adjustments reflected in the Second Restatement were not developed in the evidence offered in this case.

[353] This aspect of the January 11, 2005 press release is consistent with the evidence of Ms. Karen Sledge, whose evidence in this regard I accept, that the first Restatement focused primarily on the accrued liabilities on the balance sheet, while the Second Restatement had a much broader scope.

[354] The Crown's expert, Mr. Chambers, indicated that, as a general rule, expenses are to be matched with revenues as long as it is reasonable to do so. Accordingly, the logical inference is that, if revenues are re-profiled or restated from one financial quarter to another, the expenses associated with earning those revenues will be similarly re-profiled or restated.

[355] The first restatement was published December 23, 2003; the second restatement was announced March 10, 2004. The reason for the proximity of these two announcements was disclosed in the evidence.

[356] Mr. Richmond recommended to the Board that it not file the restated financial statements until Wilmer Cutler Pickering had completed their independent review. Mr. Richmond testified that there was no legal or regulatory requirement to file the restated financial statements on or about December 23, 2003. It was Mr. Richmond's view that, now that the first restatement was completed, the restated financial statements could be put to one side until Wilmer Cutler Pickering provided their advice, which was expected by mid-February 2004.

[357] The Board, for its own reasons, decided to publish the restated financial statements without waiting. Mr. Richmond conferred with the Wilmer Cutler Pickering firm, who advised that, at that point in December 2003, they knew of no reason why the restated financial statements could not be published. Accordingly, the statements were published.

[358] A short time later, Wilmer Cutler Pickering advised, among other things, that the accused had engaged in earnings management and that there should be a review of Nortel's previously-published financial results.

[359] Neither the first or second restatement affected Nortel's critically-important cash reserves. The Wilmer Cutler Pickering review did not suggest that Nortel's cash reserves had been misrepresented in Nortel's original financial statements or in the first restatement of those financial statements.

[360] The first restatement of previously published financial results differed from the 2nd restatement because the thresholds for the 2nd restatement were lower and because the 2nd restatement considered errors in revenue recognition as well as accrued liabilities.

Inferences concerning Nortel's restated financial results for Q1 03 and Q2 03

[361] During Q1 03, Nortel's financial results were affected by the release of \$361 million in accrued liability balances to income. These releases affected Nortel's balance sheet and profit and loss statement for Q1 03. The first restatement restated \$111 million of these balances. The second restatement restated a further \$106 million of these balances.

[362] During Q2 03, Nortel's financial results were affected by the release of \$372 million in accrued liability balances to income. These releases affected Nortel's balance sheet and profit and loss statement for Q2 03. The first restatement restated \$105 million of these balances. The second restatement restated a further \$105 million of these balances.

[363] The Crown submits that this indicates that the original Q1 03 and Q2 03 releases were not in the "normal course" and that, therefore, Nortel's financial results were misrepresented in the original financial statements and the first restatement of those financial statements. The Crown argued that the effect of the two restatements was to demonstrate that approximately 2/3 of the accrued liability balances released during Q1 03 and Q2 03 were wrongly released in those periods. The Crown submits that this supports its argument that the Comprehensive Balance Sheet Review was misrepresented as comprehensive and that the resulting financial statements misrepresented Nortel's financial results.

[364] In my view, this is an incomplete interpretation of the restatement process. The restatement process had the effect of restating releases of accrued liability balances in two directions:

- releases of accrued liability balances to income came out of the profit and loss statements for Q1 03 and Q2 03 into which they had erroneously been released. These releases were restated to the profit and loss statements for the quarters into which they should have been released;
- releases of accrued liability balances came into the profit and loss statements for Q1 03 and Q2 03, if those quarters were the quarters into which those balances should have been released.

[365] The Crown's interpretation only takes into account the accrued liability balances removed from income and, as a result, is incomplete.

[366] One of the late entry accruals provided by Mr. Morita, the PRC securitization release, was restated from Q4 02 to Q1 03. Although a small amount, \$1.8 million, it is an example of a release that was restated into Q1 03. The fact that this release into Q1 03 was randomly reflected in the evidence illustrates that it is reasonable to conclude that other releases were restated into Q1 03. The evidence does not permit an analysis of the net effect on a quarter-by-quarter basis of the restating of accrued liability balances.

[367] Mr. Chambers did not offer the opinion that this "one way analysis" was valid.

[368] The reason for releasing specific balances undermines the suggestion that the 3 accused are responsible for the Q1 03 and Q2 03 balances that were restated.

[369] The evidence demonstrated that at least one release was restated out of Q1 03 because Deloitte disagreed with itself. An example of this seemingly odd conclusion is the Genuity release (\$23 million) which is discussed elsewhere in these reasons.

[370] The PWC accrued liability release (\$19 million), also discussed elsewhere, was restated out of Q1 03 on the basis of the legal opinion which was produced in April 2004 after the accused had been dismissed from their positions.

[371] The fact that the results of the first restatement were tested undermines that portion of the argument which suggests that the first restatement misrepresented Nortel's financial results.

[372] Mr. Dans testified that he was involved with Deloitte when they performed a trending analysis to validate the results of the first restatement. He stated that each of the leadership categories presented to Deloitte & Touche the results of the restatement and explained the trends that resulted from the restatement to validate those trends from a business perspective. He described it as a "validation exercise."

[373] No evidence suggested that this trending analysis indicated that the results of the first restatement could not be validated from a business perspective. No evidence suggested Mr Dans was mistaken about the validation exercise. The trending analysis was not produced. I accept this aspect of Mr. Dans' evidence.

[374] The restatement of individual accrued liability balances occurred for a variety of reasons. It is not safe to generalize. The specifics of each restated balance have to be looked at in order to see what inferences they support. The first restatement was validated. No expert offered an opinion concerning the Comprehensive Balance Sheet Review and the first restatement.

[375] As indicated earlier, I am satisfied that the first restatement of previously published financial results differed from the 2nd restatement because the thresholds for the 2nd restatement were lower and because the 2nd restatement considered errors in revenue recognition as well as accrued liabilities.

[376] I am not satisfied, by the evidence, that the first restatement of accrued liability balances released in Q1 03 and Q2 03 demonstrates that the 3 accused misrepresented Nortel's original financial results. I am not satisfied, by the evidence, that the 2nd restatement of accrued liability balances demonstrates that the 3 accused misrepresented Nortel's financial results as first restated.

Q4 02-THE 4TH QUARTER OF 2002

[377] Q4 02 was the subject of considerable evidence. The Crown argued that the accused attempted to manage earnings in Q4 02 and, in so doing, deliberately turned a pro forma profit into a pro forma loss.

[378] The Crown submitted that the solicitation of late accrued expenses/liabilities wrongly converted a pro forma gain before taxes into a pro forma loss before taxes in Q4 02.

[379] Mr. Harrison described how his solicitation of late entry accrued expenses and liabilities for fiscal Q4 02 came about.

[380] As indicated earlier, after the business unit sub-ledgers had been closed and the business unit financial results submitted to corporate headquarters, Mr. Harrison frequently prepared an Outlook document to give management a hint of the consolidated financial results. This Outlook document was a snapshot of the results from the general ledger.

[381] At a daily status update meeting, Mr. Harrison shared his latest Outlook snapshot. Mr. Harrison also commented on what entries were still to be made.

[382] Typically, the Assistant Corporate Controller, Linda Mezon, the Controller, Michael Gologly, Mr. Harrison and someone from his staff would be in attendance.

[383] Mr. Harrison identified one of these snapshots, dated January 6, 2003, which indicated that Nortel's pro forma gain before taxes was \$73 million. Mr. Harrison testified that, when he announced this result at the January 6 status meeting, there was surprise. He testified that showing a profit in Q4 02 seemed out of context. He described the feeling at the meeting was that the result did not make sense.

[384] Skepticism concerning Mr. Harrison's calculation of a pro forma gain before taxes of \$73 million was justified. Nortel's pro forma income calculations excluded gains on the buyback of bonds. Mr. Harrison erroneously included \$59 million in gains from one such bond transaction in his January 6 Outlook calculations. Mr. Harrison had overstated Nortel's pro forma net gain before taxes by this amount.

[385] Mr. Harrison corrected his error two days later. By this time, Mr. Harrison had solicited the late entry accrued expenses/liabilities of which the Crown now complains.

[386] Mr. Harrison testified that, as a result of the skepticism concerning his calculation, he agreed to make calls to senior finance individuals in each of the business units and the Regions to see if they had accrued expenses/liabilities which they had failed to record.

[387] Mr. Harrison had no clear recollection of any particular person asking him to make these calls; he said the idea that he would do that came from the meeting. Mr. Harrison testified he had never before made a call of this nature.

[388] Mr. Harrison testified that he made these phone calls and told each of the individuals to whom he spoke that Nortel's results were very favorable and asked each of the individuals if they had any accrued expenses they needed to cover.

[389] Mr. Harrison's calls resulted in the various business units booking approximately \$176 million worth of accrued expenses/liabilities.

[390] Mr. Harrison created a list of the individual accrued expenses which he had solicited and testified that \$137 million of this total came from Non-op which Mr. Harrison stated was under the "purview of the Controller". Mr. Harrison, elsewhere on the same list, indicated that \$126

million in additional accrued expenses came from Non-op. The reason for this discrepancy is not clear.

[391] Two days later, January 8, 2003, Mr. Harrison's Outlook, or snapshot at the daily status meeting, suggested that Nortel was going to have a pro forma loss before taxes of \$73 million, rather than a pro forma gain of \$73 million.

[392] Mr. Harrison indicated that, if he had not made the calls, the \$176 million in accrued expenses would not have been booked and that Nortel's pro forma and US GAAP results would have not reflected the \$176 million in negative impacts represented by the late entry accrued expenses/liabilities.

[393] Mr. Harrison confirmed that if, the Q4 2002 results had reflected a pro forma gain before taxes, most of Nortel's employees would have been entitled to all or part of a Return to Profitability Bonus.

[394] The payment of this bonus in Q4 2002 was awkward from Nortel's point of view because, in Q4 2002, Nortel experienced a loss calculated according to US GAAP of \$248 million. This result had to be publicly reported. Bonus payments were payable if net pro forma income was positive after allowing for the cost of the bonus. The bonus was payable regardless of the fact that there was a US GAAP loss.

[395] The awkwardness, to which I refer results from the fact that Nortel would have publicly reported a US GAAP loss and, at the same time, publicly reported that it was paying its employees a bonus. The evidence disclosed that it was well-known that other publicly-traded corporations had been criticized for precisely this behavior.

[396] The three accused representing Nortel senior management were motivated to avoid such a situation.

[397] Additional accrued expenses/liabilities which were all that Mr. Harrison was soliciting would have a negative impact on pro forma earnings. Sufficient additional accrued expenses/liabilities could, therefore, turn a pro forma gain before taxes into a pro forma loss before taxes. If Nortel reported a pro forma loss before taxes in its press release announcing Q4 02 financial results, then no bonus would be payable.

[398] Reporting a pro forma loss before taxes in Q4 02 was expected. Mr. Dunn had publicly predicted pro forma gains before taxes in Q2 03 or the second quarter of 2003.

[399] Mr. Beatty had expressed himself to Mr. Harrison on a related issue. In a conversation in Q3 02 or the third quarter of 2002, according to Mr. Harrison, Mr. Beatty stated that "The Street" would not reward Nortel for only one quarter of positive earnings. Mr. Harrison said that he understood the objective was constant positive results.

[400] It is not contrary to the criminal law to attempt to manage the affairs of a corporation to achieve a financial target. The question is whether, in attempting to achieve the targeted result, those responsible for preparation of the corporation's financial results cause the financial statements to misrepresent the corporation's financial results.

[401] Accordingly, the question becomes did the late entry accrued expenses/liabilities cause a misrepresentation of Nortel's financial results?

[402] Before considering the additional accrued liability balances which resulted from Mr. Harrison's solicitation, I propose to discuss the participation of Mr. Dunn, Mr. Beatty and Mr. Gollogly in the solicitation of additional accrued expenses.

The participation of Mr. Dunn and Mr. Beatty

[403] Nortel was a multibillion-dollar year business, international in scope and publicly- traded. It was also financially at risk. When Nortel announced a quarterly result, the auditors had to take a view of the next twelve months from the date of the quarterly report and opine on whether Nortel would be able to continue in business as a going concern.

[404] It is not logical and I decline to draw the inference that matters affecting Nortel's pro forma and US GAAP earnings escaped the attention of Nortel's CFO and CEO. Both Mr. Dunn and Mr. Beatty were accomplished accountants. Mr. Dunn, in particular, was described as very intelligent with a mind for detail. The evidence disclosed that on a trip to China, as one would expect, he made arrangements to be kept informed of the final 2002 financial results. Mr Dunn told Mr. Wilson that Nortel was profitable on operations in Q4 02 but the quarter was going to be negative due to accruals including 360 Networks.

[405] Exhibit 1, tab 30 was received as a business record. It is, therefore, capable of proving the facts contained in it. One of the facts contained in the business record is that Mr. Beatty discussed with Mr. Dunn the \$30 million increase in Optical's excess and obsolete inventory accrued liability balance. The increase in this balance came about as a result of Mr. Harrison's solicitation of additional accrued expenses. Thus, the evidence is that Mr. Dunn was informed by Mr. Beatty of Optical's response to Mr. Harrison's communication.

[406] Nortel's Board of Directors decided to pay a Return to Profitability Bonus based on Nortel's 2002 formula for calculating pro forma gains (losses) before taxes. The bonus was created, in part, at Mr. Dunn suggestion because Nortel's competitors were attempting to hire away Nortel employees. It stands to reason that conclusions concerning whether the bonus was payable or not would be brought to Mr. Dunn's attention.

[407] Mr. Beatty, as Nortel's CFO, would obviously be preoccupied with Nortel's financial results.

[408] Mr. Gollogly was Nortel's Controller. Mr. Gollogly was at the meeting on January 6, 2003 when Mr. Harrison announced that his calculations indicated that Nortel was pro forma positive by \$73 million at that point in time. It was at the same meeting that it was decided that Mr. Harrison would call around and solicit late entries.

[409] I am satisfied that all three accused knew that Mr. Harrison was soliciting additional late entry accrued expenses/liabilities for fiscal Q4 02.

The specific late entry accrued expenses/liabilities solicited by Mr. Harrison

The solicitation of late entries from Karen Sledge

Late entry Fringe and Vacation accrued liability balances

[410] Karen Sledge offered some testimony concerning the solicitation of additional accrued expenses in connection with Fringe and Vacation benefits during the close of the books for Q4 02.

[411] Ms. Sledge is a CPA, which is the American designation which corresponds to our C.A. In Q4 2002, Ms. Sledge was responsible for accrued liability balances for vacations, holidays and termination benefits. Ms. Sledge indicated that she took on this responsibility in 2002, which was also the first year that she had U.S. Controller responsibilities.

Fringe Benefit Accrued Liability Balances

[412] In September or October 2002, Ms. Sledge and her team made a forecast that they did not have enough expenses accrued to cover medical costs in the U.S. throughout the fourth quarter of 2002.

[413] Ms. Sledge indicated that an additional \$13 million should be added to the Fringe accrued liability balance. This was done in October 2002. This increase in the accrued liability balance negatively affected Nortel's Q4 02 results by \$13 million.

[414] This conclusion was based on a review of medical costs associated with recently-terminated employees which demonstrated that recently-terminated employees took greater advantage of medical benefits than active employees. Apparently, terminated employees in 2002 spent approximately 141% of active employees' expenditures. Terminations in 2002 were 6% higher than originally estimated. Medical costs rose between 18 and 20% in 2002, resulting in significantly higher prescription drug costs.

[415] On December 20, 2002, only two months after the original forecast, Ms. Sledge's staff indicated that they had overestimated this accrued liability balance by \$7.3 million. This meant that, on December 20, 2002, Ms. Sledge and her team thought that a release to the profit and loss statement in the amount of \$7.3 million would reduce the Fringe accrued liability balance to the appropriate level. This meant that the \$7.3 million would positively affect Nortel's Q4 02 results by \$7.3 million.

[416] On January 3, 2003, two weeks later, Ms. Sledge advanced a new position, namely that the Fringe accrued liability balance should be reduced by \$37 million. This meant that the Fringe accrued liability balance had been overestimated by \$37 million. This meant that Q4 02 results would be positively affected by \$37 million. A journal entry recording this \$37 million reduction was made on January 4, 2003.

[417] Ms. Sledge received two or three telephone calls from Mr. Gollogly on January 5 or 6, 2003, as well as a call from Mary Cross, her immediate supervisor, expressing concern about the \$37 million release.

[418] According to Ms. Sledge, Mr. Gollogly asked her to take a look at her decision to release this \$37 million and Ms. Sledge initially responded that she thought the decision to release the accrued liability was correct. Ms. Sledge indicated that Mr. Gollogly became more emphatic about the need for her to reconsider the release with each call.

[419] Ms. Sledge said that she then increased the Fringe accrued liability balance by \$11 million. A journal entry recording this \$11 million increase was made on January 13, 2003. This, in effect, reduced the \$37 million positive impact on earnings by \$11 million. Ms. Sledge testified that, without these calls, she would not have increased the Fringe accrued liability balance.

[420] Ms. Sledge based her decision to increase the Fringe accrued liability balance by \$11 million on invoices that had been incurred but not yet received from medical institutions. A trending analysis was done on these invoices and this analysis indicated the invoices would ultimately come in higher than expected.

[421] Ms. Sledge said that she asked her own team to consider whether the \$11 million increase was justified. Their verification of the increase was communicated to Ms. Sledge on January 13, 2003. Accordingly, the Fringe accrued liability balance was adjusted upwards by \$11 million at that time.

[422] Ms. Sledge indicated that she then asked her staff to determine why their initial forecast had suggested a \$13 million increase in the Fringe accrued liability balance was necessary and then their subsequent forecast recommended a \$37 million reduction in the accrued liability balance. Ms. Sledge's staff discovered a \$19 million double counting error was, in part, responsible. In addition, Ms. Sledge's staff discovered that four months of employee severance notifications and their corresponding medical expenses had been overlooked in their original calculations.

[423] It is clear from Exhibit 58A, tab 8 that Deloitte & Touche audited Ms. Sledge's decision to increase the Fringe accrual by \$11 million. It appears that Deloitte did this on January 17, 2003. Deloitte concluded that the Fringe accrued liability balance should be increased, but only by \$8.7 million and a downward adjustment of \$2.3 million, representing the difference between \$11 million and \$8.7 million, was made in Q1 03.

[424] Nortel published its Q4 02 results on January 23, 2003.

[425] Ms. Sledge testified that the accrual increase was restated during the Second Restatement. Deloitte restated the \$11 million increase because the increase was "not based on sufficient and/or appropriate evidence to support the accrual".

Vacation Expenses

[426] Ms. Sledge testified that she was also responsible for accrued liability balances for vacation expenses. She said that, after she had submitted her figures, she was asked by her supervisor, Mary Cross, and by Mr. Gollogly if she had any other accrued expenses/liabilities to record in Q4 02.

[427] Ms. Sledge knew that there had been a \$9 million release of vacation accrued liability balances to the profit and loss statement. Ms. Sledge reversed the release of this \$9 million to the profit and loss statement. She did so by increasing the percentage factor that Nortel used in establishing vacation liability. Specifically, she increased the percentage factor from 75% to 85%.

[428] Ms. Sledge's increase in the percentage factor used in establishing vacation liability and the supporting documentation were specifically brought to the attention of Deloitte & Touche.

[429] In an e-mail to Deloitte explaining the decision, Ms. Sledge that prior to 1998, the U.S. had used 100% as a vacation factor and Canada 75%. In September 1998, after a survey of North American employers to determine the average vacation days on hand, a decision was made to use 75% as a factor across North America. Due to unusual circumstances at Nortel in 2002, which Ms. Sledge partially identified as layoffs, management churn and employees not taking time off out of fear that they would be laid off, the consensus was reached that Nortel North American employees had not taken vacation and, therefore, a factor of 85% factor was more appropriate than 75%.

[430] Ms. Sledge indicated in her e-mail that a North American survey and analysis was scheduled for June-July 2003 and that further adjustments could be made upon receipt of the survey results and analysis.

[431] The North American survey was conducted in May 2003, which suggested a range of percentages varying from 77% to 89%.

[432] The \$9 million increase in the vacation accrued liability balance was restated in the second restatement. The reason given for restating this \$9 million increase was that the results of the survey were not available at the end of Q4 02.

[433] The restatement set the appropriate percentage at 85% for Q2 03 and Q3 03, which was the period when the study was available. The restatement set the appropriate percentage factor at 77% for Q4 03.

Soliciting accrued expenses in Asia

[434] Glenn Morita joined Nortel in 1997 and became a chartered accountant in 1998. Commencing in 2000, he was stationed in what Nortel termed the Asia Region. His title was Director of Finance.

[435] Asia Region was very large; it included China, India, Pakistan, Australia, New Zealand, Taiwan and Japan.

[436] When Mr. Morita first arrived in Asia Region, he reported to Mr. Gollogly. Mr. Morita knew Mr. Gollogly prior to being stationed in Asia because both of them were stationed in Brampton for a time.

[437] While in Asia Region, Mr. Morita was responsible for end of year, budgeting, forecasting and financial reporting. Mr. Morita said that he was also responsible for passing information along to the Corporate Consolidation Group in Brampton headed by Mr. Harrison.

[438] Mr. Morita indicated that, during the quarterly close of the general ledger, it was his responsibility to make sure that partial almost complete deals were properly documented so that Asia Region could book the revenues and the appropriate expenses associated with those revenues. Mr. Morita also indicated that, sometimes, it was possible to proceed more quickly with part of a project and, thereby, trigger a release of an accrued liability balance to income.

[439] During the course of his cross-examination, Mr. Morita indicated that accrued expenses booked in Asia were not readily visible in North America, with the result that Corporate in Brampton depended upon Asia Region to tell them about potential accrued liability releases to the profit and loss statement.

[440] Mr. Morita indicated that he had received a request to look for potential accrued expenses/liabilities that had been missed at the original close of the Asia Region sub-ledger. Mr. Morita said the request came from Mr. Gollogly and his team. He recalled the request specifically as being one to survey the Region and all the Regional Financial Primes for risk areas that they might want to cover off.

[441] Mr. Morita said that he spent the day making calls around the Region asking if there were accrued expenses/liabilities which people wanted to book to the general ledger.

[442] Mr. Morita pointed out that, at the time he was making these calls in January, the books in Asia Region had already been closed and Asia Region had already submitted its final Q4 02 figures to corporate headquarters in Brampton.

[443] Mr. Morita booked three additional items totaling \$4.8 million. He said that these were not large items; they were not material at the corporate consolidations level. Mr. Morita indicated that because he was sending these three items so late in the process, he thought the entries would be refused because they were not material to the results. Mr. Morita testified that he sent the information along to demonstrate that he had cooperated with the request from Mr. Gollogly and his team. He indicated that he had no backup for these accruals when he sent them along. Backup was obtained later.

[444] The \$4.8 million in accrued expenses was, in fact, booked to the General Ledger on January 8, 2003. Mr. Morita agreed on cross-examination with the suggestion that he viewed this process as an opportunity to make things more accurate; to go back and to double-check for opportunities to cover off risk.

[445] It appears that one of these items (the PRC securitization release) was restated from the Q4 02 profit and loss statement to the Q1 2003 profit and loss statement. The reason for this restatement appears to be that it was part of a Securitization Review.

[446] Mr. Morita indicated that the \$4.8 million in additional accrued expenses, which he submitted, were given to him by his contacts in the various countries. He indicated that the three accrued expenses which he submitted were genuine and verifiable. Mr. Morita indicated that he

went through each expense with the individual submitting the expense. It was his view that, if he had not booked these accrued expenses in Q4 02, they would have been booked in a subsequent quarter. Mr. Morita was firm that he would not have engaged in this process if he thought he was doing something wrong or incorrect.

[447] Mr. Morita indicated that, from his perspective, whether it was proper to set-up an accrued expense or release an accrued liability balance to the profit and loss statement depended upon whether the set-up or release could be justified.

[448] Mr. Morita indicated that, from his perspective, while it was not proper to release accrued expenses to the profit and loss statement to meet targets, the appropriate release of accrued liabilities to the profit and loss statement could, in fact, assist in meeting targets.

The solicitation of additional accruals from Ken Crosson

Excess and obsolete inventory

[449] Mr. Crosson joined Nortel in 1975 after obtaining an MBA from York University. From 2000 to 2003, he was the Vice-President of Global Operation; he was located in Raleigh, North Carolina. Mr. Crosson had between twelve and seventeen people reporting to him. Mr. Crosson reported to the accused Douglas Beatty. He was terminated by Nortel in 2003 for matters apparently unrelated to this case.

[450] Global Operations was a single supply chain that supplied product to various lines of business. Mr. Crosson was responsible for the financial management of the supply chain in the manufacturing of Nortel's products. Mr. Crosson was responsible for efficiently managing inventory; this was one of his two prime responsibilities.

[451] Mr. Crosson indicated that gross inventory was valued at \$2 billion and that there was an accrued liability balance for inventory for \$1 billion approximately. In Mr. Crosson's words, half the inventory "was provided for". The risk with respect inventory was that it was excess or obsolete; *i.e.*, not sold within the appropriate period of time or unusable.

[452] Mr. Crosson pointed out that excess inventory on the books of Nortel's contract manufacturers was, in many cases, Nortel's responsibility and had to be provided for. According to Mr. Crosson, determining who was responsible for what was a contentious matter among Nortel and its contract manufacturers. Finally, Mr. Crosson indicated that the Optical business unit had an inventory problem. Specifically, Optical's exposure on account of excess and obsolete inventory was more than \$500 million or approximately ½ of the total accrued liability balance on account of excess and obsolete inventory.

[453] The precise amount of the inventory accrued liability balance was determined by an algorithm or formula. Obsolete inventory was not usable and so the accrued liability for it was 100% of its value on Nortel's books. Excess inventory was inventory calculated on a percentage basis based on whether the inventory was six-months-old, nine-months-old or one-year-old. The algorithm made these calculations.

[454] Mr. Crosson testified that determining the level of excess inventory involved judgment and forecasting. Forecasting is important because, if orders do not come in and revenues are not as anticipated, then there will be a calculation suggesting that excess inventory is greater than originally anticipated and the accrued liability balance for excess inventory will have to be increased. Optical was particularly vulnerable in this regard.

[455] The accrued liability balance for excess and obsolete inventory was also affected by various attempts to dispose of the inventory. For example, Nortel approached manufacturers of similar items and offered its excess or obsolete inventory to them at a significant discount. Mr. Crosson testified that Deloitte & Touche took an active interest in auditing these excess or obsolete inventory mitigation programs.

[456] Mr. Crosson indicated that the Optical business unit had not reached “the bottom” and so there was always the risk that the accrued liability balance on account of Optical’s inventory was not sufficient. Specifically, the possibility was that, when the algorithm was applied to Optical’s inventory, it would indicate that the accrued liability balance for Optical’s inventory must increase.

[457] Mr. Crosson indicated that running the algorithm for all of Nortel’s inventory required time; specifically, it required you to input the age of the inventory and then run the algorithm. It was not something that could be done instantaneously. Accordingly, a decision was reached in late 2002 to postpone re-evaluating the inventory and focus on disposing of it.

[458] Mr. Crosson indicated that he submitted his financial information for Q4 02 on time that is by January 5, 2003. Mr. Crosson indicated that he was satisfied that his financial information was accurate. Mr. Crosson indicated that, prior to submitting his financial information, he gave consideration to increasing the accrued liability balance on account of excess and obsolete inventory by \$50 million. His evidence in this regard is confirmed by an Outlook outlining a potential \$50 million increase in the accrued liability balance for excess and obsolete inventory, dated December 19, 2002.

[459] Mr. Crosson ultimately decided not to make this adjustment to the excess and obsolete inventory balance in Q4 02.

[460] Mr. Crosson testified that he received a telephone call from Brian Harrison on January 6 or 7, 2003 asking him if he could justify increasing his inventory accrued liability balance. Specifically, the request was, if required, could Mr. Crosson justify increasing his inventory accrued liability balance for Optical by \$30-\$35 million. Mr. Crosson indicated that he had never before received such a communication. Mr. Crosson indicated to Mr. Harrison that, based on Optical’s history and the fact that he did not see a bottom for Optical, such an increase could be justified.

[461] Mr. Crosson would not have increased the accrued liability balance for Optical’s inventory had he not received Mr. Harrison’s call.

[462] Increasing Optical’s accrued liability balance had the effect of reducing its income because it meant increasing Optical’s expenses on its profit and loss statement, thereby

negatively affecting Optical's net income. A similar effect would be felt on Nortel's consolidated profit and loss statement.

[463] Subsequent to agreeing to this increase, Mr. Crosson testified that he was then asked to agree to a reduction of this increase from \$35 million to \$30 million. Mr. Crosson indicated that he was unconcerned about the reduction.

[464] Mr. Crosson indicated that, after the reduction, the backup documentation was changed to support a \$30 million increase in the excess and obsolete inventory accrued liability balance rather than a \$35 million increase.

[465] Interestingly, one of the business records introduced was an e-mail from Mr. Beatty to Mr. Gollogly and others indicating that Mr. Dunn did not agree with the \$30 million increase in the accrued liability balance for Optical's inventory.

Use of Mr. Crosson's \$30 million as an offset

[466] The tale of Mr. Crosson's \$30 million increase in the excess and obsolete inventory accrued liability balance contained an unexpected twist.

The JDS Uniphase Corporation transactions

[467] Nortel purchased a plant from JDS Uniphase which was located in Switzerland and, as well, purchased related assets in New York State.

[468] The purchase price (\$2.8 billion) had two components – cash and Nortel shares. A portion of the Nortel shares (500,000 shares) amounted to future consideration for the purchase of these assets. Specifically, if Nortel purchased 16.9% of its component needs from JDS in the years 2001, 2002 and 2003, then Nortel would not have to issue 500,000 shares of its stock to JDS. In other words, this portion of the purchase price was deferred and could potentially amount to a purchase price discount.

[469] At the time of the transaction in 2001, advice was received from Deloitte & Touche concerning how this deferral of the purchase price should be treated in the years 2001, 2002 and 2003. Specifically, Deloitte's advice was that Nortel positively impact net income by approximately \$40 million per quarter. Nortel followed this advice. Each quarter, commencing immediately after the purchase, \$40 million in positive impacts to income was automatically posted to the General Ledger. Consistent with this decision \$40 million in positive impacts had been posted in Q4 02.

[470] On November 8, 2002, Nortel sold these assets to an arm's length company.

[471] Deloitte gave Nortel the opinion that the \$40 million in positive impacts to Q4 02 net income had to be reduced by \$25 million. Nortel accepted Deloitte's opinion.

[472] Due to the fact that the resolution of this matter was not straightforward, the decision to reduce the \$40 million positive impact for Q4 02 by \$25 million was not made until January 21, 2003. This was two days before Nortel intended to publish its Q4 02 results.

[473] Rather than revise Nortel's financial statements for Q4 02, a decision was made to find a fully offsetting entry. Specifically, the accrued liability balance for Optical's excess and obsolete inventory was reduced by \$25 million.

[474] From the Crown's perspective, the changes in the accrued liability balance for Optical's excess and obsolete inventory are suspicious in the extreme. First, Mr. Crosson increases the accrued liability balance for excess and obsolete inventory by \$35 million in response to Mr. Harrison's request. The \$35 million increase is reduced to \$30 million. Then it is reduced to \$5 million so that Nortel's financial statements will not have to be changed two days before they were to be published.

[475] Ms. Linda Mezon testified in these proceedings. Ms. Mezon joined Nortel in Brampton in May 2001 as Assistant Corporate Controller. At this point in time, Mr. Beatty was the Controller. She left Nortel in 2003.

[476] Ms. Mezon is both a CPA (the American equivalent of the Canadian CA) and a C.A. Ms. Mezon is also an MBA. She was a member for eight years of the Accounting Standards Board, which is responsible for setting accounting standards in Canada for public companies, private entities, not-for-profit organizations and government entities.

[477] Ms. Mezon testified that she had a good solid working knowledge of both Canadian and United States GAAP.

[478] Ms. Mezon indicated that, after the decision was made to reduce Nortel's revenue by \$25 million on January 21, she, Mr. Gollogly and Helen Verity had a conversation about finding an offset. The reason they were looking for an offset was because it was January 21, 2003 and the press release describing Nortel's financial results was due to be released on January 23, 2003. Finding an offset would mean that the financial statements which already been prepared would not have to be changed.

[479] Ms. Mezon indicated that it was not her job to find the actual offset and so she went home. The next morning she found out that the offset was a \$25 million reduction of Mr. Crosson's \$30 million increase in the excess and obsolete inventory accrued liability balance. Ms. Mezon testified that, as soon as she found out about this, she contacted Mr. Crosson and confirmed that he was content with the reduction.

[480] Ms. Mezon explained her own thinking which was quite helpful. She thought that the total accrued liability balance for excessive and obsolete inventory exceeded \$1 billion and so she asked herself whether the \$25 million reduction would materially misstate the balance sheet and she concluded that it would not. Ms. Mezon indicated that she knew that excessive and obsolete inventory had been discussed many times with Deloitte & Touche. She described excessive and obsolete inventory as "a very difficult area because in this business, you know the demand had ramped up very quickly, and the demand had fallen off very quickly, particularly, for instance, in Optical, which was—it was very difficult the forecast".

[481] She said that she concluded that the \$25 million reduction was not material. She said that, although she talked to Mr. Gollogly about the offset, she felt the decision was really her responsibility because she was the “GAAP expert”.

[482] Ms. Mezon testified that she made Deloitte & Touche specifically aware of the offset.

[483] Deloitte specifically reviewed the offset and concluded that the \$25 million release was a release associated with inventory classed as a deferred asset which had already been provided for. Accordingly, there was no impact on the inventory line in Nortel’s consolidated balance sheet from the \$25 million reduction. This conclusion is recorded in Exhibit 156; a Deloitte’s working paper, at Tickmark I. Deloitte’s working papers were admitted into evidence as business records. The author of this particular working paper was not called as a witness. No witness, including the Crown’s expert Mr. Robert Chambers, suggested this conclusion was wrong.

[484] As far as the offsetting entry is concerned, Ms. Mezon understood the transaction concerning which she was testifying and took responsibility for her decisions. The decision to reduce the excess and obsolete inventory balance to offset the unexpected revenue decline was reasonably taken. Mr. Crosson was consulted; it is true, only after the decision was taken. However, Mr. Crosson was consulted before Nortel’s financial statements for Q4 02 were finalized. The auditors were made aware of the downward adjustment and signed off on the financial statements for an “accounting reason” that was not challenged.

[485] There is one other aspect of this matter and that is the difficulty with drawing general conclusions about an item which has been restated.

[486] The Q4 02 accounting for this transaction was reviewed when Nortel sold these assets to an arm’s length purchaser. At a meeting of Nortel’s Audit Committee on January 9, 2003, Deloitte & Touche confirmed that they were of the opinion that the accounting advice which they gave in 2001 remained appropriate.

[487] During the second restatement, Deloitte changed its opinion concerning the treatment of the entire transaction.

[488] Deloitte’s new approach calculated that the deferral of the purchase price was worth approximately \$500 million. Accordingly, Deloitte decided that the appropriate accounting treatment was to reduce the purchase price by \$500 million. This reduction in the purchase price meant that \$319 million in positive revenue impacts, which had resulted from the \$40 million revenue entry in each quarter after the sale, had to be eliminated. As a result, revenue in 2001 and 2002 was collectively reduced by \$319 million as a result of Deloitte changing its mind. I infer from Mr. Chambers report that any expenses associated with earning this \$319 million would also have to be restated.

[489] Deloitte gave two opinions endorsing the accounting treatment of this transaction. The first opinion was given in 2001 and the second confirming opinion was given to the Audit Committee in 2003. In October 2004, during the second restatement, Deloitte changed its opinion, resulting in a reduction in Nortel revenues.

[490] The Crown argues that the accused, in restating previously-published financial statements, have admitted that accrued expenses/liabilities should not have been recorded in the quarters in which they were recorded, that they were not properly released in the quarters when they should have been released and that, therefore, Nortel's financial statements are not US GAAP compliant. The Crown argues that the fact that there was a restatement proves that Nortel's financial results were misrepresented from 2000 to May 2003 and the only question is whether the accused knew this when those results were published.

[491] It would be wrong to conclude in a criminal case such as this that the \$319 million reduction in revenue means that Nortel's original financial statements misstated its revenue in 2001 in 2002 by \$319 million. Describing the original JDS entries as false or wrong inaccurately characterizes what occurred and could easily lead to the false conclusion that something inappropriate happened when the original accounting was done. A consideration of the details of this transaction illustrates why it is impossible to draw the inference which the Crown urges from the fact that accounting entries are restated. The accounting for this transaction was changed because Deloitte changed its mind. A consideration of the specifics of this restatement of the JDS Uniphase transaction makes it clear that it is dangerous to generalize about items that are restated.

[492] When the facts of this specific restatement are known, it is clear that the accused could not have known that the original treatment of the \$500 million purchase price discount was an error or wrong or false. Such words are not appropriate when describing the fact that Deloitte changed its mind.

Perot Systems

[493] Mr. Crosson found a second accrued expense/liability – Perot Systems.

[494] In March 1996, Perot Systems and Nortel Networks Corporation combined to jointly pursue certain identified business opportunities. In 1997, there were significant performance defaults by Nortel. Nortel Networks Corporation and Perot Systems settled their dispute over these defaults in August 1998 upon the following terms:

- Nortel paid \$2 million to Perot Systems;
- Nortel agreed to provide Perot Systems with \$5 million in product credits;
- Nortel agreed to award Perot Systems a total of \$75 million in business over five years ending August 1, 2003.

[495] From 1998 to the end of December 2002, Nortel had provided Perot Systems with approximately \$48 million worth of business. By the close of Q4 2002, Nortel had identified the fact that it still had to provide \$27 million worth of work by August 2003 to meet its settlement obligations. Nortel received legal advice in November 2002 to the effect that Perot Systems had a legal right to invoice them for the \$27 million difference.

[496] Nortel was looking for an opportunity to establish a more permanent relationship with Perot Systems. Nortel wanted to continue to do business with Perot Systems and Perot Systems wanted to continue to do business with Nortel. Nortel did not want to receive an invoice for \$27 million. Both sides wanted to avoid litigation.

[497] When Mr. Crosson submitted his Q4 2002 results, he did not provide for or set up an accrued expense/liability to reflect the risk of unsuccessful litigation with Perot systems. Mr. Crosson did not believe there was sufficient risk. Mr. Crosson knew that Nortel was struggling and was not going to create an expense if he did not believe the \$27 million risk warranted it. Mr. Crosson agreed that he knew, on January 2, 2003, about a potential exposure under the Perot Systems Settlement Agreement.

[498] After Mr. Harrison's telephone call, there was an accrued liability balance entry made in the general ledger for Q4 2002 increasing accrued expenses and accrued liabilities by \$27 million on account of Perot Systems.

[499] Mr. Crosson indicated that he would not have suggested the \$27 million increase unless he thought it could be justified. Mr. Crosson indicated that any late entry increase in accrued liability balances would have to be supported to the satisfaction of Deloitte & Touche.

[500] Mr. Crosson said initially when he submitted his financial information, he did not submit the Excess and Obsolete Inventory accrued liability balance increase and the Perot Systems Perot systems accrued liability balance increase because the accrued expenses/liabilities which he submitted were within a range with which he could live. He felt he could also support a higher number and, therefore, felt that increases of these two accrued liability balances were supportable. Mr. Crosson also testified that the material that he submitted in support of these increases was genuine.

The solicitation of additional accruals from Jim Kinney for the period Q4 02

[501] Mr. Kinney was trained as a certified management accountant. He started at Nortel in 1980 and worked there continuously until 2004. Commencing in August 2002, he was the Vice-President Finance for Wireless, one of Nortel's business units. He succeeded Michael Gollogly in that position. As the VP Finance for Wireless, Mr. Kinney reported to the accused, Douglas Beatty. There were various Financial Primes within Wireless and those persons reported to Mr. Kinney.

[502] As Vice-President Finance for Wireless, Mr. Kinney was responsible for the consolidation of its global financial performance, financial planning and analysis, liaison with the other line organizations, sales proposals and budgeting.

[503] Mr. Kinney indicated that, in October 2002, he had a phone conversation with the defendant, Michael Gollogly. Mr. Gollogly advised Mr. Kinney that there were issues with the Wireless balance sheet and acknowledged some responsibility for their existence. Mr. Gollogly instructed Mr. Kinney to clean up the balance sheet. Mr. Gollogly was not specific about the items which were problematic. Mr. Kinney said that Mr. Gollogly, as Controller, was instructing

him to get a thorough understanding of what was on the balance sheet, why it was there and, most importantly, whether it should stay on the balance sheet.

[504] Mr. Kinney said that the balance sheet cleanup at Nortel began in earnest in December 2002 with a conference call among himself, people on his staff, Karen Sledge, in her role as U.S. controller, and Mary Cross, in her role as Controller for North America. It was agreed that Wireless would review its balance sheet quarter by quarter, region by region and entity by entity. The purpose of the review, according to Mr. Kenny, was to determine whether accrued liability balances should remain on the balance sheet.

[505] Mr. Kinney said he had no contact with Douglas Beatty or Frank Dunn about the balance sheet cleanup that he was undertaking.

[506] Mr. Kinney explained the difficulty he faced trying to clean up the Wireless balance sheet. Whether liabilities remained on the balance sheet came down to a judgment call based on the representation of the individual who was responsible for the specific accrued liability balances on the Wireless balance sheet. The tricky part, according to Mr. Kinney, arose because many of the liabilities had to do with liquidated damages or potential customer claims. These items were, therefore, self-determined. Within the sales organization, the decision was dependent upon internal representation that there was a liability and that the liability needed to remain on the balance sheet.

[507] Mr. Kinney said that he viewed the passage of time as the failsafe mechanism. The longer something was on the balance sheet without a claim the more confident he became that it could be taken off the balance sheet. Mr. Kinney said that, in his judgment, an accrued liability balance could be released to the profit and loss statement if there was a high degree of certainty, if not virtual certainty, that the liability no longer existed. Mr. Kinney said he followed the practice of allowing a cooling-off period when he thought an accrued liability balance could be released to the profit and loss statement. Specifically, he waited one extra quarter to make sure that an unexpected exposure did not present itself.

[508] Mr. Kinney also followed the practice of seeking customer representation that the liability was gone and used receipt of that representation as the event which triggered removal of the liability balance.

[509] Mr. Kinney testified that, until July 31, 2003, he thought that balance sheet reconciliation was sufficient justification to remove an accrued liability from the balance sheet. According to Mr. Kinney, when he heard a presentation by Mr. Gollogly which indicated that this was not a sufficient justification, it was "a game changer". The evidence disclosed that Mr. Kinney was not alone in this misconception.

[510] This is perhaps an appropriate place to remark on the fact that Mr. Beatty is a chartered accountant like Mr. Gollogly. I am satisfied that he understood when accrued liabilities could be released to the profit and loss statement. Mr. Kinney recounted that Mr. Beatty explained to him that a change in estimate was a proper way of releasing an accrued liability to the profit and loss statement. Mr. Kinney testified that Mr. Beatty provided him with a reference to the section of

the accountants' handbook dealing with the proprietary of accrued liability balance sheet releases.

[511] Mr. Kinney testified that, for Q4 2002, the Wireless "stretch target" contribution to pro forma earnings before taxes was \$70 million. He agreed that, on January 7, 2003, his submitted numbers had reached that target. Mr. Kinney testified that he received a telephone call from either Brian Harrison or Michael Gollogly. Mr. Kinney was not the only one on this telephone call. He believed there were other Vice Presidents of Finance on the call. They were told that Nortel had a favorable variance to its anticipated earnings and that, as a result, they were being asked to go back and make certain that adequate provision had been made.

[512] Mr. Kinney indicated that he would not have attempted to find and book increases to Nortel's accrued liability balances without the phone call from Mr. Harrison or Mr. Gollogly.

[513] Mr. Kinney solicited Wireless for possible increases in the accrued liability balances and received two responses upon which he acted. The first related to an inventory issue involving a customer in China and the second dealt with an increased risk as a result of Nortel's relationship with France Telecom.

[514] The result of Mr. Kinney's efforts was that he submitted accrued liability balance increases of \$12 million. This \$12 million increase in the accrued liability balances for Wireless was not restated.

[515] Coincidentally, Wireless revenue was reduced by a further \$8 million because, during the closing of the General Ledger, \$8.9 million was removed from Mr. Kinney's revenue calculations by Nortel corporate headquarters.

[516] As a result of searching for and booking the \$12 million in accrued liability balance increases and the \$8.9 million revenue reversal, Wireless missed its stretch target by \$19 million.

[517] Mr. Kinney indicated that he was concerned about the reaction of the President of Wireless because Wireless had missed its target. He also indicated that he was not concerned about the reaction of senior management because senior management set the target and, therefore, could dispense with the target.

Mr. Gollogly's knowledge generally

[518] Because Mr. Kinney took over from Mr. Gollogly and because Mr. Gollogly instructed Mr. Kinney to clean up the Wireless balance sheet, this is an appropriate place to comment on Mr. Gollogly's knowledge concerning Nortel's financial results.

[519] Mr. Kinney said that, when he took over as VP Finance for Wireless, he recognized that the balance sheet for Wireless was not well understood within Wireless. After he took over as VP Finance for Wireless, Mr. Kinney recognized that there were significant excess accrued liability balances on the Wireless balance sheet. He also thought that there were accrued expenses/ liabilities which were not well understood. Mr. Kinney testified that he thought that there were \$180 million in excess accrued expenses/liabilities on the Wireless financial statements at the end of Q2 02.

[520] Mr. Kinney also observed that Wireless used the balance sheet as a means by which to meet its earnings targets. This practice was not peculiar to Wireless. Mr. Gollogly said as much in an e-mail (Exhibit 3, tab 140), dated July 31, 2003. Specifically, he said in the e-mail: "I think we need to reinforce the importance of forecasting. It seems like a throwaway comment, but if we 'cleanup' the balance sheet, the LC's ability to deliver earnings based partly on discretionary elements pretty much goes away. So they will need an incremental level of precision in their forecasting. I do not think the company is ready for this since the general approach is to sandbag good news and close 'hard' to the forecast. But if we cannot move the numbers one way or the other, we may get much more surprised than currently".

[521] I am satisfied beyond a reasonable doubt that Mr. Gollogly knew that there were excess accrued liabilities on Nortel's balance sheet.

[522] I am also satisfied that Mr. Gollogly was determined to do something about this after he became Corporate Controller. I say this because one of his first acts was to begin balance sheet reviews. His instruction to Mr. Kinney is telling, not only in terms of his knowledge, but also his intent to remove these excess accrued liabilities. I am not persuaded that he understood the extent of the problem.

[523] Although slightly out of context, it is perhaps appropriate to point out here that Mr. Richmond testified that the \$900 million in excess accrued liabilities identified in the Comprehensive Balance Sheet Review were not material, in his opinion, to Nortel's financial results in fiscal 2001 and 2002 due primarily to the \$33 billion in losses that Nortel experienced in those years. Mr. Chambers did not offer a contrary opinion.

360 Networks

[524] The largest late entry accrued expense/liability in Q4 02 was \$50 million. This accrual was in relation to 360 Networks litigation. This entry was reviewed during the second restatement. Deloitte's conclusion was "accrual was appropriate based primarily on in-house legal representation". Accordingly, this entry was never restated.

[525] Reference has been made elsewhere to Nortel's preoccupation with providing for every possible risk. With respect to this accrued expense/liability, Mr. Cleghorn, the Chair of the Audit Committee, recalled this matter. Specifically, he recalled that, at a January 2003 Audit Committee meeting, he sought specific assurances \$50 million was a sufficient accrued liability balance for this risk because the 360 Networks claim was for \$100 million.

[526] Mr. Cleghorn's evidence was entirely consistent with other evidence to the effect that it was part of Nortel's culture to provide for every possible risk in order to ensure that there were no surprises.

[527] There is no issue about the appropriateness of this late accrued expense/liability entry which comprised \$50 million of the \$176 million in late entries.

[528] I accept the evidence of Ms. Sledge, Mr. Morita, Mr. Crosson, Ms. Mezon and Mr. Kinney concerning the solicitation of late entry accrued expenses/liabilities.

[529] Nortel's press release of January 23, 2003 also announced a pro forma net loss for Q4 02 of \$62 million. This was the only report of a pro forma financial result. Q4 02 was the last time Nortel ever announced pro forma results. Pro forma financial results for Q4 02 were never restated. Deloitte published no opinion concerning pro forma results because it was not retained to do so.

[530] I am satisfied that the negative impacts of the \$59 million revenue error which Mr. Harrison made in his January 6 calculation and \$50 million late entry accrued liability for 360 Networks, the appropriateness of which has never been challenged, were more than sufficient to create a pro forma loss in Q4 02. I am satisfied that it was Mr. Harrison's snapshot on January 6, 2003 of a pro forma gain before taxes of \$73 million which misrepresented Nortel's pro forma Q4 02 financial result.

[531] I am not satisfied that the reported pro forma loss of \$62 million misrepresented Nortel's Q4 02 financial results.

The manipulation of Nortel's pro forma earnings before taxes to get a bonus

[532] The Crown alleges that the accused manipulated Nortel's pro forma earnings before taxes calculation in order to get a bonus. I reject this submission elsewhere in these reasons.

Did the late entry accrual expenses/liabilities misrepresent Nortel's US GAAP financial results for Q4 02?

[533] Nortel's press release, on January 23, 2003, announced its financial results for Q4 02. Nortel reported a net loss calculated according to US GAAP of \$248 million.

[534] Nortel's Q4 02 financial statements were restated twice.

[535] Exhibit 85B also records that, after the second restatement, Nortel reported a net loss calculated according to US GAAP of \$294 million for Q4 02.

[536] I am not satisfied the difference is a misrepresentation. No witness offered such an opinion.

[537] In addition, in Q4 02, Nortel originally reported total revenue of approximately \$2.5 billion. After the second restatement, Nortel reported total revenue of approximately \$2.6 billion.

[538] In Q4 02, Nortel originally reported a gross margin of 39%. The second restatement reported a gross margin of 42%. Mr. Harrison indicated that it was his experience with Nortel that it typically reported gross margins in the range of 40%. No witness suggested that the difference in reported gross margins was important.

[539] Nortel's press release of January 23, 2003 announced that it was "net cash positive" in Q4 02. The evidence did not suggest that this assertion was a misrepresentation. This was a critically- important piece of information for investors because the evidence indicates that maintaining sufficient cash reserves was a fundamental concern for Nortel's Board of Directors, Audit Committee, senior management and Auditors and fundamental for Nortel's survival.

[540] Nortel's original financial statements for Q4 02 indicated that Nortel had outstanding approximately 4.3 billion shares. The evidence did not suggest that this assertion was a misrepresentation.

[541] I am satisfied that the late entry accrued expenses/liabilities did not result in a misrepresentation of Nortel's US GAAP financial results for Q4 02.

[542] I am not satisfied that Nortel's original published US GAAP financial results misrepresented Nortel's actual financial results.

Susan Shaw's 2002 Summary of Accrued Liabilities

[543] Susan Shaw prepared a compilation dealing with accrued liabilities and presented it to Mr. Gollogly in Q4 02. Her compilation indicated that \$303 million in accrued liabilities were no longer required and available for release.

[544] It is the Crown's position that, despite knowing that there were millions of dollars in excess accruals on the balance sheet, none of the accused advised Nortel's Audit Committee or Deloitte about this situation.

[545] It is also the Crown's position that the accused did not initiate a comprehensive review of Nortel's balance sheet or initiate a restatement of its previously-published financial information.

[546] Ms. Shaw brought her findings to the attention of her superiors, Helen Verity and Linda Mezon. Susan Shaw reported her findings to Mr. Gollogly. Ms. Mezon testified that she brought Ms. Shaw's report to the attention of Mr. Beatty.

[547] Ms. Shaw's compilation informed Mr. Gollogly and Mr. Beatty that \$303 million in accrued liability balances were no longer required and available for release. It also told Mr. Gollogly, who as Corporate Controller was responsible for Non-op, that \$66 million of the no longer required accrued liability balances were Non-op accrued liability balances.

[548] On November 6, 2002, Ms. Shaw sent an e-mail to Mr. Gollogly's assistant attaching an XL spreadsheet entitled "Acc Liab Q3 for FD". I am satisfied that FD refers to the accused Frank Dunn.

[549] Mr. Dunn was financially trained and described as an intelligent detail-oriented person. Given Nortel's precarious position, I am satisfied that financial information of any importance was brought to his attention. I am satisfied that Ms. Shaw's compilation would have been considered important because it had been generated in response to questions from outside financial analysts.

[550] I am satisfied, therefore, that Mr. Gollogly, Mr. Beatty and Mr. Dunn were aware that Ms. Shaw believed that there were \$303 million in accrued liability balances which were no longer required and were available for release.

[551] Some context is helpful in assessing the Crown's position.

[552] Susan Shaw is a chartered accountant. She joined Nortel in 1988 and, in 2002; she was transferred to the Corporate Consolidations Group where she reported to Helen Verity, who was the Director of that group.

[553] During a call with securities analysts in July 2002, one of the analysts asked Douglas Beatty about Nortel's accrued current liabilities. The analyst pointed out that Nortel's accrued current liabilities exceeded \$5 billion and had been increasing over the last few quarters.

[554] The first problem raised by the question was that if the \$5 billion was all cash impacting, then Nortel would not have enough cash to pay all those liabilities. As indicated many times these reasons cash was a critical issue in terms of anything and everything Nortel did.

[555] The second problem with the question was that Nortel's business had been declining in the previous quarters and yet the liabilities did not seem to be trending downward.

[556] As a result of this question, the Assistant Corporate Controller, Linda Mezon, asked Helen Verity to look into the matter. Specifically, Linda Mezon wanted to know which provisions would require payment and, therefore, have an impact on cash. In addition, Ms. Mezon wanted to know when the accrued liability balances would be cleared to the profit and loss statement.

[557] Helen Verity asked the various finance vice presidents throughout Nortel, in an e-mail dated August 2, 2002, to follow up on the question. Ms. Verity assigned the task of compiling the information provided to Ms. Shaw.

[558] Ms. Shaw described the process she followed in preparing her compilation as iterative. The various business units were provided with their liability balances at Q2 2002 (June 30, 2002) and asked whether those liabilities were going to be cash impacting. In addition, they were asked whether all of the accrued liability balances were correct or whether some were greater than necessary. The business units were also asked whether those that were required were going to be utilized within 2002.

[559] There was a template which was provided to the units and Ms. Shaw was in communication with the various business units about the information provided when they returned the completed template; she was also in communication with Helen Verity and Linda Mezon to make sure that she was collecting the information that they wanted.

[560] Ms. Shaw emphasized that, while the business units were being asked for information, they were not being asked to justify their numbers.

[561] Ms. Shaw also indicated that the information which the units were providing was not designed to provide the basis for a determination of what accrued liabilities should be released to income.

[562] Finally, Ms. Shaw indicated that 50% of her work concerned contractual liabilities because they composed 40% of the total liabilities on Nortel's consolidated balance sheet. Given that Nortel's total liabilities exceeded \$5 billion, contractual liabilities exceeded \$2 billion.

[563] I am satisfied that the primary purpose, from Ms. Shaw's point of view, was to determine the cash impact of Nortel's accrued liabilities as at Q2 2002.

[564] One of the pieces of information which Ms. Shaw uncovered was that, in the opinion of the various business units, there was a total of \$303 million in accrued liabilities which were no longer required and available for release.

[565] Ms. Shaw's Summary of Accrued Liabilities was not kept a secret. E-mail evidence was introduced which indicated that senior accountants of Deloitte & Touche were aware of her work.

[566] The \$303 million in excess accrued liabilities was broken down into categories.

[567] Two thirds of this total is contractual liabilities. A contractual liability was an accrued liability that arose out of a promise to perform that Nortel had made in agreeing to supply a product or service. Put simply, when the total revenue which Nortel was to receive from the contract to supply a product or perform a service was recognized, the cost of providing that product or service for the life of the contract also had to be estimated and recognized.

[568] Of the remaining one-third of these accrued liabilities, which were no longer required and available for release (approximately \$100 million), \$66 million was attributed to Non-op, which was a non-operating unit under the control of Nortel's Corporate Controller, Michael Gollogly. Mr. Gollogly had only recently (July 25, 2002) assumed this position when Ms. Shaw presented him with her final compilation in October 2002.

[569] To put the \$66 million in excess accrued liabilities in context, it should be remembered that Ms. Shaw's report also identified the fact that Non-op had, at the end of Q2 2002, total accrued liabilities of \$315 million. In other words, at the end of Q2 2002, \$249 million in accrued liabilities were, according to Ms. Shaw, required by Non-op and \$66 million were not required.

[570] In addition, it should be remembered that Ms. Shaw was consolidating results being provided to her. She was not determining which specific accrued liability balances were required and which specific accrued liability balances were no longer required.

[571] On September 16, 2002, Ms. Shaw met with Linda Mezon to explain the results of her consolidation so that Linda Mezon could meet with Michael Gollogly and provide him with a progress report.

[572] On October 2, 2002, Mr. Gollogly was formally briefed by Ms. Shaw and others on the final results of her consolidation. Ms. Shaw indicated that, during the meeting, Mr. Gollogly was concerned to know the persons who had provided the information contained in her compilation. It was her impression that Mr. Gollogly was attempting to acquire a level of confidence about the financial information in her report.

[573] It is important to remember that the numbers in Ms. Shaw's report were those available for the period ending Q2 2002, *i.e.*, June 30, 2002. The numbers in this report were never updated.

[574] Mr. Richmond provided some assistance on the implication of Ms. Shaw's report. Mr. Richmond was not shown the report and, given his position and responsibilities as Senior Advisory Partner in the Nortel/ Deloitte's relationship, there is no reason why he should have been shown the report. Suffice to say, Deloitte was aware of Ms. Shaw's report and documentary evidence suggested that a person within Deloitte was to liaise with Ms. Shaw while she was preparing her compilation. This person was never identified in the evidence.

[575] Mr. Richmond said his reading of Ms. Shaw's report suggested to him that she had performed "some sort of analysis and concluded that there were \$303 million of provisions that were so-called no longer required". Mr. Richmond stated that there would be a need to review whether that was an accurate statement. He said it would have to be reviewed carefully with many different people to find out whether \$303 million was the correct number. After that had been done, consideration would be given to the appropriate way of returning the \$303 million to Nortel's profit and loss account.

[576] I am satisfied that, while Ms. Shaw's report would require follow-up, it would not support, as the Crown suggested, a restatement of Nortel's previously-published financial statements. Mr. Richmond testified that restatements are a serious matter. Obviously, an unverified internal compilation could not provide the basis for the restatement of previously-published financial results.

[577] Mr. Michael McMillan was asked, in 2004, to follow-up on Ms. Shaw's report. The purpose of this project was, in part, to find out what happened to the reserves that had been identified by Ms. Shaw's October 2002 report as no longer required and available for release

[578] Prior to preparing his report, Mr. McMillan met with Ms. Shaw, reviewed her original mandate and located the templates upon which she relied. Mr. McMillan requested the business units to locate all documentation which they had used to satisfy Linda Mezon's original e-mail requesting information.

[579] Mr. McMillan developed a template for the business units to use in determining what happened to the forecasted balances. Mr. McMillan consolidated the submissions from the various business units and reviewed his report with Deloitte & Touche.

[580] Mr. McMillan reported on March 26, 2004. Mr. McMillan provided a copy of his report and an explanation to the law firm of Wilmer Cutler Pickering which, along with Huron Consulting LLP, was reviewing on behalf of the Audit Committee the reasons why Nortel had to restate some of its prior published financial statements.

[581] By March 26, 2004, the accused had been virtually suspended. There was no suggestion that they played any role in the preparation of Mr. McMillan's report.

[582] As far as Corporate and Non-op were concerned, Mr. McMillan came to the following conclusions:

Corporate

- the forecasted releases were mainly specific and traceable; only \$1 million was unidentified;
- \$7 million in forecasted real estate releases were, subsequent to Ms. Shaw's Compilation, found to be supportable accrued liability balances and not released; \$1 million of this balance was used.
- \$1 million release dealing with a supplier bankruptcy was determined to be valid and released in Q4 2002;
- \$4 million out of \$15 million accrued on account of asset shrinkage was released in Q4 02 and the remainder was reclassified;
- \$5 million which had been accrued on account of late terminations was released in Q1 2003;
- \$5 million accrued as a specific Controller's provision was not released in 2002 or 2003; this accrual was re-profiled during the Second Restatement;
- \$1 million accrued on account of annual report printing was released in Q3 2002 and this was found to be a valid release;
- \$28 million accrued on account of dispute resolution was released in Q3 02 and this was determined to be a valid release;

Non-Op

- \$20 million on account of Intercompany Out Of Balance was released in Q3 2002 and reversed to Q4 2001 in the First Restatement;
- \$20 million could not be linked to a specific balance and was, therefore, categorized as unidentified.

[583] Mr. McMillan indicated that a portion of the forecasted releases in the original study were not linked to specific provisions and, for that reason, it was necessary to go back to the business units to determine whether the forecast was in relation to a specific provision or a basket of provisions.

[584] Mr. McMillan determined that \$222 million of the \$303 million was released in Q3 2002 and Q4 2002. Specifically, he determined that \$146 million in releases occurred in Q3 2002; \$76 million in releases occurred in Q4 2002. No witness testified that the release of this \$222 million was material to Nortel's 2002 financial results.

[585] As originally calculated Nortel lost \$1.8 billion in Q3 02 and \$250 million in Q4 02. Nortel lost approximately \$3.6 billion in fiscal 2002. These releases to income were not material to Q3 02, Q4 02 or fiscal 2002 financial results.

[586] In addition to carrying out the specific task of preparing this accrued liability analysis, Ms. Shaw had ongoing responsibilities for reporting on the status of accrued liabilities in Corporate and Non-op. As a result, she was able to confirm that \$20 million of the \$66 million was released in Q3 2002 to Nortel's profit and loss statement. This \$20 million would have favorably impacted earnings. I attach no significance in terms of the accuracy of Nortel's financial statements to the release of these excess provisions in Q3 2002 because Nortel lost \$1.8 billion in Q3 2002.

[587] Mr. McMillan determined that \$10 million in releases occurred in Q1 2003 and \$14 million in releases occurred in Q2 2003. No further evidence was led concerning these releases and I am unable to determine whether they were released in the normal course of business or otherwise.

[588] Mr. McMillan concluded that \$57 million in releases were either not released or so vaguely described in Ms. Shaw's report that they could not be identified.

[589] Ms. Shaw testified that she thought Mr. McMillan's conclusions concerning her report were accurate.

[590] The release of this \$303 million in accrued liabilities would not be cash impacting but would favorably impact earnings by \$303 million. The entire \$303 million would not be material to Nortel's 2002 balance sheet or profit and loss statement. In 2002, Nortel had approximately \$5.2 billion in liabilities on its consolidated balance sheet. Nortel's consolidated profit and loss statement for 2002 reported losses of \$3.6 billion.

Q4 2002 Conclusion

[591] I am satisfied that Mr. Gollogly did not accept Mr. Harrison's assertion on January 6, 2003 that Nortel's pro forma gain before taxes on that date was \$73 million.

[592] I am satisfied that Mr. Gollogly was quite right to be skeptical about this result because Mr. Harrison had made a \$59 million error on the revenue side in his January 6 calculation.

[593] I am satisfied that Mr. Harrison and Mr. Gollogly, with the knowledge and consent of Mr. Dunn and Mr. Beatty, were attempting to manage Nortel's financial results in this quarter for the following reasons:

- First, the Wireless business unit, for which Mr. Kinney was the Vice-President Finance, had achieved its stretch target of \$70 million. It is not logical that Mr. Kinney would be asked to go over his results to see if he had made any errors or if there were risks for which he wanted to provide unless the intention was to negatively manage the pro forma gain which Mr. Harrison had reported;
- Second, all of the persons solicited by Mr. Harrison or Mr. Gollogly were only asked to provide additional accrued expenses/liabilities. They were not asked if there were any positive impacts to income which they had erroneously failed to report.

[594] However, it is clear that Mr. Harrison erroneously included \$59 million in his revenue calculation. It is also clear that the 360 Networks' late entry accrued liability expense/liability of \$50 million is unchallenged. These two required adjustments (totaling \$109 million) turn Mr. Harrison's forecasted earnings before taxes into a loss.

[595] In the same vein, if I consider Mr. Harrison's erroneously calculated pro forma gain of \$73 million as a starting point and then account for the negative impacts of the \$59 million revenue error and the \$176 million in late entries of accrued expenses/liabilities, the pro forma loss before taxes should have been greater than the \$62 million which Nortel reported in its January 23, 2003 press release. Accordingly, there must have been positive impacts to Nortel's pro forma gain (loss) which are not clear from the evidence. In short, there must have been other changes to Nortel's pro forma calculations which are not apparent from the evidence.

[596] I am not satisfied Nortel's pro forma financial results for Q4 02 were correctly reflected in Mr. Harrison's January 6 Outlook calculation.

[597] I am not satisfied that Nortel had pro forma earnings before taxes in Q4 02.

[598] The evidence does not establish that Nortel's published Q4 02 pro forma \$62 million loss misrepresented Nortel's Q4 02 financial results.

[599] When I consider all the evidence, including the evidence to which I have made specific reference, I am not satisfied beyond a reasonable doubt that the accruals solicited by Mr. Harrison and recorded in Q4 02 resulted in a misrepresentation of Nortel's US GAAP financial results for Q4 02 or fiscal 2002.

[600] I am not satisfied that Nortel's financial results for Q4 02 were misrepresented due to the solicitation of late entry accrued liability expenses/balances.

[601] I am satisfied that \$222 million of the \$303 million identified by Ms. Shaw in 2002 as provisions no longer required and available for release were, in fact, released in Q3 02 and Q4 02. I am also satisfied that a portion of the \$57 million identified as unreleased was so noted because it could not be identified and, therefore it cannot be determined whether those unsupported provisions were released or not in 2002 or 2003.

[602] I am not persuaded that the release of these accrued liability balances in Q3 02 and Q4 02 materially misrepresented Nortel's financial results in those periods or for the fiscal year 2002.

[603] The circumstances surrounding the \$10 million released in Q1 2003 and the \$14 million, released in Q2 2003 were not disclosed in the evidence. I am not satisfied that those releases misrepresented Nortel's financial results in Q1 03 or Q2 03.

[604] I am not satisfied beyond a reasonable doubt that the manner in which Nortel dealt with the \$303 million in accrued liability balances identified by Susan Shaw as no longer required and available for release in her October 2002 compilation misrepresented Nortel's financial results in Q4 02, fiscal 2002, Q1 03 or Q2 03.

Q1 03 & Q2 03*The release of \$361 million in Q1 03 and \$372 million in Q2 03*

[605] Quantitatively, Nortel released \$361 million in accrued liability balances to its profit and loss statement in Q1 03. The Crown contends that, in its original filings, the accused, on behalf of Nortel, falsely represented that these accruals were in the normal course.

[606] Included in the \$361 million and accrued liability balance releases were \$80 million in accrued liability balance releases relating to Non-op. The Crown contends this \$80 million was improperly released and, further, that the motive for the improper \$80 million release was the desire on the part of the accused to qualify for a bonus and to meet previously-published financial targets.

[607] Mr. Cleghorn, the Chair of the Audit Committee, testified that he thought that, apart from the \$80 million, the balance of the \$361 million in releases was in the normal course.

[608] The first restatement reviewed the release of these accrued liability balances and determined that \$111 million of these balances should be restated. The Crown contends that this underestimated the extent of the problem because, during the second restatement, an additional \$106 million was identified and re-profiled or restated.

[609] The Crown contends that the combined effect was that \$218 million was restated and that this demonstrates, along with other evidence, that the \$361 million was not in the normal course and that the first restatement was not comprehensive.

[610] Quantitatively, Nortel released \$372 million in accrued liability balances to its profit and loss statement in Q2 03. The Crown contends that, in its original filings, the accused, on behalf of Nortel, falsely represented that these accruals were in the normal course.

[611] The first restatement reviewed the release of these accrued liability balances and determined that \$105 million of these balances should be restated. The Crown contends that this underestimated the extent of the problem because, during the second restatement, an additional \$105 million was identified and restated.

[612] The Crown contends that the combined effect was that \$210 million was restated and that this demonstrates, along with other evidence, that the \$372 million was not in the normal course and that the second restatement was not comprehensive.

[613] The Crown's expert did not express an opinion consistent with the Crown's contention.

[614] The Crown attempted to demonstrate the financial effect of the \$361 million in Q1 03 and the \$372 million in Q2 03 by means of a chart which it constructed and which was received as Exhibit 42E. Mr. Harrison confirmed the entries in the Exhibit reproduced the entries in his Outlooks. Mr. Chambers expressed no opinion concerning this chart.

The Crown's Chart – "operations" Ex. 42E

[615] It is necessary to make an observation about Exhibit 42E in order to avoid its misapplication in this trial.

[616] The Crown introduced this chart which it had prepared; the chart was based on Mr. Harrison's Outlooks and Roadmaps (forecasts). Mr. Harrison confirmed that the entries in the Exhibit reproduced entries in his Outlooks.

[617] There is a column in the chart marked "Operations". I attach no weight to this column. To the extent that the Operations column was intended to describe positive or negative net income from the actual operations of the business units, I find it to be unreliable.

[618] Mr. Harrison indicated Operations for him was something that he tracked. It was a metric he created; it was a metric to show the earnings, excluding the positive impact of the release of accrued liabilities to the profit and loss statement.

[619] The evidence established that, in order to calculate net income from a business unit's operations or its normalized results for a particular quarter, one had to eliminate both the positive impacts of releasing accrued liability balances to the profit and loss statement in that quarter and the negative impacts of setting up accrued expenses/ liabilities in that quarter.

[620] An example of this calculation for the Wireless business unit is found in Exhibit 42G. The analysis starts with the actual results for the period Q4 02; that is \$46 million. According to Exhibit 42G, Wireless set up \$196 million worth of accrued expenses/liabilities in Q4 02 which had a negative impact on its net income of \$196 million. According to the Exhibit, Wireless released \$181 million in accrued liabilities in Q4 02 to its profit and loss statement which had a positive effect on its net income of \$181 million. To determine Wireless' "normalized results", both of these impacts must be eliminated. The net effect of this calculation is that net income is increased by \$15 million.

[621] Accordingly, as described in Exhibit 42G, the normalized result for Wireless in Q4 02 is \$60 million approximately.

[622] A comparison with Mr. Harrison's calculation reveals why this aspect of the Crown's chart is unreliable. Mr. Harrison's calculation only involved eliminating the positive impact of the release of \$181 million. Mr. Harrison confusingly called this metric which he had created "Operations". Applying Mr. Harrison's methodology leads to a net loss in his "Operations" metric of \$135 million.

[623] Confusing Mr. Harrison's metric with the normalized results for the Wireless business unit leads to the erroneous conclusion that Wireless lost \$135 million on account of its Operations when, in fact, Wireless enjoyed a \$60 million gain on operations.

[624] To the extent that the Operations column in the Crown's chart was intended to describe positive or negative net income from actual operations, it is unreliable. I attach no weight to Mr. Harrison's Operations metric. Mr. Harrison's Operations metric does not accurately establish operational losses at any time during the time-frame of the indictment.

[625] The evidence established that, in Q1 03, Nortel's set-up \$1.1 billion in accrued liability balances and released \$361 million in accrued liability balances to the Q1 03 profit and loss statement.

[626] The evidence established that, in Q2 03, Nortel set up \$1.2 billion in accrued liability balances and released \$372 million in accrued liability balances to the Q2 03 profit and loss statement.

[627] This activity with respect to accrued liability balances was fully-disclosed to Nortel's Audit Committee by Mr. Gollogly.

[628] I propose now to comment on certain specific releases which were disclosed in the evidence.

The PWC release – \$19 million-originally released Q1 03

[629] This release was specifically referred to in the Wilmer Cutler Pickering Review. It was part of a list of fourteen items listed in the review that the authors said required further study. Each of these items was, according to Mr. Kerr, analyzed from cradle-to-grave. According to Mr. Kerr, this meant an analysis of the accrued liability balance from the moment it was established. Any activity in the accrued liability balance was specifically considered.

[630] This accrued liability balance was released to the profit and loss statement in Q1 03. Accordingly, it is part of the \$361 million in accrued liability balances in Q1 03 which the Crown maintained were not in the normal course. The PWC release was not restated in the first restatement. It was specifically identified in the Wilmer Cutler Pickering review. It was then analyzed from cradle-to-grave during the second restatement.

[631] Some context is helpful in considering this accrued liability balance.

[632] In April 2000, Nortel outsourced certain services to PWC. In 2002, Nortel decided to bring these services in-house. An accrued liability balance in the amount of \$19 million was set up to account for certain disputed invoices between Nortel and PWC.

[633] The repatriation of the services was substantially completed in December 2002. The Final Close of the Disengagement Agreement between Nortel and PWC occurred on January 17, 2003.

[634] Nortel originally released the \$19 million PWC accrued liability balance to its profit and loss statement in Q1 03, the quarter in which the Disengagement Agreement closed.

[635] On April 13, 2004, Nortel received legal advice from its senior counsel. This advice was to the effect that closings of the disengagement agreement for all locations, other than those in France, were completed before December 31, 2002. It was counsel's opinion that no claims against Nortel could originate from the French locations, despite the fact that the closing of the disengagement agreement with respect to locations in France did not take place until January 17, 2003.

[636] Upon receiving this legal opinion in April 2004, Deloitte decided that the \$19 million accrued liability balance should be restated from Q1 03 to Q4 02. Deloitte was also of the view that the legal opinion of April 13, 2004 did not represent new information and, as a result, the failure to originally release the \$19 million accrued liability in Q4 02 was classified as an error.

[637] The \$19 million was restated to Nortel's Q4 02 profit and loss statement.

[638] As can be seen from the details of this release, the original set-up of the release properly recorded an accrued liability.

[639] I am not satisfied that the release in Q1 03, as opposed to Q4 02, can fairly be classified as false. I am not persuaded that the failure to restate this accrued liability balance release in the first restatement demonstrates that the first restatement was not comprehensive or a continuation of the fraud alleged in this indictment. I am satisfied that the release in Q1 03 is exactly what Deloitte said it was: namely, an error. Furthermore, it was an error that is understandable once the facts are known.

[640] Finally, it has not been demonstrated that the accused were, in any sense, responsible for this error or the failure to consider the error in the first restatement.

The Genuity release – \$23 million originally released Q1 03

[641] This is another accrued liability that was originally released in Q1 03. It was part of the \$361 million in total releases for that quarter. It was not restated during the first restatement.

[642] It was also identified by Wilmer Cutler Pickering as a release which should be reviewed and, as such, was subject to "cradle-to-grave" reconsideration.

[643] Some context is helpful in considering this accrued liability balance.

[644] Nortel had several claims against Genuity, totaling approximately \$156 million. Genuity alleged that Nortel was liable for substantial claims arising out of their business relationship. Specifically, Genuity alleged that Nortel had supplied defective equipment, had resiled from a guarantee and, finally, that Nortel was liable to Genuity for contributions to a joint development and marketing fund.

[645] Genuity filed a petition for re-organization under the US Bankruptcy Code in November 2002. At the same time, Genuity proposed to sell all of its assets free and clear of pre-existing claims to an arm's length third-party purchaser.

[646] The arm's length purchaser received permission to purchase Genuity's assets in Q1 03 and the \$19 million accrued liability balance was released to Nortel's profit and loss statement.

[647] Nortel's counsel advised that part of Genuity's claim was well-founded in its opinion. Nortel and Genuity reached a settlement at the end of Q2 03. Nortel's counsel was of the view that the settlement would not be approved by the Bankruptcy Court because they believed it would be opposed by others interested in Genuity's bankruptcy. However, there was no opposition to the settlement and the Bankruptcy Court approved the settlement in Q3 03.

[648] During the second restatement, the release was reviewed. The opinion of the Deloitte reviewers was that the Q1 03 release was appropriate. However, the U.S. National Office of Deloitte & Touche overruled the Deloitte reviewers and required that this conclusion be changed. Deloitte's U.S. national office required that the \$23 million release in Q1 03 be classified as an error on the basis that the release should have occurred in Q2 03 instead of Q1 03.

[649] This release also undermines the position taken by the Crown with respect to the Q1 03 and Q2 03 releases. The Genuity release reveals that the \$23 million released in Q1 03 was restated into Q2 03. The Crown's submission is undermined because it only takes into account releases that were restated out of Q2 03; it ignores the releases that were restated into Q2 03. This same observation applies to Q1 03. The Crown's submission does not take into account those releases restated into Q1 03.

[650] Finally, the specifics of this accrued liability balance indicate that it was restated because Deloitte, in essence, disagreed with itself.

[651] There is no evidence that would permit me to conclude that any or all of the accused were responsible for this error or for the failure to restate it in the first restatement.

The Optical Warranty release – \$8 million released in Q2 03

[652] In Q1 2001, the Optical Warranty accrued liability balance became underfunded by \$21 million. Adjustments were made to the balance in 2001 and 2002. These adjustments reflected changes in the standard costs for the Optical Network Repair Group. The problem was that customers were using the warranty at a higher rate than had been used to calculate the accrued liability balance. In other words, the accrued liability balance on account of the Optical Warranty was not adequate.

[653] However, during the first half of 2002, it was discovered that the Optical Network Repair Group's standard costs, which were used to record warranty usage, were overstated by about 64% in 2001. This problem was corrected in Q2 02. This meant that the accrued liability balance for Optical Warranty was overfunded; however, the accrued liability balance remained overfunded because of the Optical Networks management team did not have confidence in its data.

[654] By Q2 03, there was twelve months' usage data available. Accordingly, the accrued liability balance for the Optical Warranty was reduced by \$8 million in Q2 03.

[655] The \$8 million reduction in the Optical Warranty accrued liability balance was reviewed and confirmed during the first restatement. It was the opinion of Deloitte during the first restatement that the \$8 million change was due to a change in estimate.

[656] The \$8 million with which we are concerned was considered again during the second restatement because it was specifically mentioned in the Wilmer Cutler Pickering review.

[657] In April 2004 during the second restatement, the decision that the \$8 million was released to income as a result of a change in estimate and, therefore, in accordance with US GAAP. The release was confirmed again.

[658] However, for reasons that are not clear, the matter was reviewed yet again in October 2004. This time it was decided that the Optical Warranty model that was used in arriving at the decision to release \$8 million to the profit and loss statement was, itself, inherently flawed. The model was inherently flawed because it had not been revised to reflect the significant changes that had taken place in the Optical business unit's environment in 2001 and 2002. Accordingly, a New Warranty Model was developed. This new model was applied retroactively to 1999.

[659] Accordingly, the \$8 million Q2 03 release was determined to be an error. In addition, the new Warranty Model was applied to all changes in the Optical Warranty accrued liability balance from 1999 to 2003. The changes which had taken place in the Optical Warranty accrued liability balance from 1999 to 2003, based on the old model, were determined to be errors as well.

[660] A consideration of the specific details surrounding the restatement of this accrued liability balance leads to the conclusion that the decision to restate was taken based on a New Warranty Model which did not exist in Q2 03. The new model did not exist when the accused were employed at Nortel.

[661] The evidence does not demonstrate that the accused had any role in the decision to release this accrued liability balance in Q2 03 or any knowledge that the old warranty model was flawed.

Conclusion

[662] The specific releases to which I have referred demonstrate that the decision to restate on account of an error can be the same thing as saying that there was a decision to restate on account of a difference of opinion.. Clearly new information can affect the decision to restate. Arguably hindsight can be a factor in the decision to restate.

[663] I agree with the Crown that the fact that accrued liability balances were restated is capable of supporting an inference that financial results were misrepresented, but I am not persuaded by the evidence which I have heard that I should draw such an inference in this case.

[664] As a result, I cannot give effect to the Crown's submissions concerning the inferences I should draw from the fact that original Q1 03 and Q2 03 accrued liability balance releases were restated.

[665] I am not satisfied beyond a reasonable doubt that the three accused misrepresented Nortel's Q1 03 and Q2 03 financial results by releasing to income \$361 million and \$372 million respectively in accrued liability balances. Further I am not satisfied that the original release to income of \$361 million and \$372 million misrepresented Nortel's financial results.

The release of \$80 million in Non-op accrued liability balances and the entitlement to a bonus

[666] There was no triggering event in Q1 03 that would have justified the release of this \$80 million in accrued liability balances to Nortel's profit and loss statements for Q1 03. This fact was well-known to everyone.

[667] The Crown alleges that the release of this \$80 million in Non-Op accrued liabilities to the profit and loss statement in Q1 03 had the effect of changing pro forma losses in Q1 into a profit which resulted in substantial Return to Profitability and Restricted Stock Unit bonuses being paid to all three defendants in May 2003.

[668] Put differently, it is the Crown's position that, without the release of this \$80 million, the profit targets required for the payment of these bonuses would not have been met and none of the accused would have been entitled to a bonus.

[669] It is the Crown's position that Mr. Hathway was misled when he was informed by either Mr. Gollogly or Mr. Beatty that the Return to Profitability Bonus would have been paid even without the release of the \$80 million.

[670] The Crown also alleges that the three accused failed to disclose the fact that there was a direct connection between the \$80 million release of accrued liabilities and the payment of these bonuses. Specifically, the release of the \$80 million offset the liability (\$73 million) associated with paying the Return to Profitability Bonus.

[671] The Crown takes the position that the disclosure in the April 24, 2003 release made it appear as though these two events were unrelated. Specifically, the press release in the Crown's view failed to draw a direct connection between the \$80 million release and the payment of the bonuses (*i.e.*, it did not say that the \$73 million RTP Bonus was payable because of the release of the \$80 million) nor did the press release mention that the \$80 million was related to other excess accrued liabilities; namely \$109 million in unsupported accrued liabilities which remained on Nortel's consolidated balance sheet.

[672] It is also the Crown's position that Nortel's SEC filings for Q1 03 obfuscated the nature of the \$80 million release.

[673] The Crown also alleges that the release of this \$80 million improperly reduced US GAAP losses.

[674] It is the Crown's position that the improper release of this \$80 million resulted in the publication of financial statements which misrepresented Nortel's financial results.

[675] It is the Crown's position that even if, based on the Second Restatement financial statements, the bonus milestones would have been met at some point in 2003, the timing of those payments would have been different in the sense that the payments would have been made in different quarters of 2003. The Crown maintains Nortel was at risk when the bonuses were paid based on false results and it does not matter that the bonuses would have been payable later in 2003 based on the restated results for that year.

[676] I have no difficulty in accepting the fact that all three accused knew what targets had to be hit before they were entitled to the Return to Profitability Bonus and the Restricted Stock Unit Bonus. I attach no significance to that fact; it is simply rational economic behavior. The inference is easily drawn from the access that all three accused had access to Outlooks (forecasts), as well as their positions in the company. The evidence was, for example, that Mr. Dunn played a role in deciding the milestones for the Return to Profitability Bonus.

[677] Releasing the \$80 million in accrued liabilities to the profit and loss statement was specifically considered by Deloitte & Touche in an internal memo, which appears to have been produced to the Crown on December 23, 2011.

[678] Counsel for Deloitte indicated in the letter producing the memo that it had been previously produced to “other regulators”. Counsel for Deloitte indicated in the letter producing the memo that it was a “desk file”, which apparently means it was never finalized and incorporated into Deloitte’s audit working papers. I infer this information was provided to explain the late production.

[679] Apparently, after the draft memo was turned over to the unidentified regulators, Deloitte was asked a series of questions by one or more of these regulators which they answered. The questions and answers were also turned over to the Crown on December 23, 2011 and produced in this trial as business records of Deloitte & Touche.

[680] The trial in this matter commenced in January 2012. The authors of the memo, Diana De Acetis, Peter Chant and Chris Allen, were not called as witnesses.

[681] It is trite that business records are capable of proving the facts contained within them. I am not required to find that these business records or any other business records prove the facts contained in them. However, I found this business record to be particularly helpful, despite the fact that it was a “desk file.”

[682] The draft memo to the Nortel Networks Corporation file of Deloitte & Touche LLP was primarily written by Diana De Acetis. However, during the course of the drafting of the memo, Ms. De Acetis received significant content and input from two other Deloitte accountants, namely, Peter Chant and Chris Allen. Tony Ciciretto assisted by providing information to Ms. De Acetis, but was not otherwise directly involved in the memo’s preparation. In addition, according to the memo’s introduction, Don Hathway, John Cawthorne and others reviewed the memo. It appears from Exhibit 11 tab 42 that Mr. Hathway also provided information to Ms. De Acetis, Mr. Chant and Mr. Allen prior to the preparation of the memo.

[683] When Ms. De Acetis prepared this memo, she was a senior manager in Deloitte’s Complex Accounting and Transaction Expertise Group. As a member of that group, Ms. De Acetis had provided technical assistance and advice to members of the Nortel engagement team in respect of a number of issues which had arisen during the course of the quarterly reviews in Q1 and Q2 2003.

[684] Ms. De Acetis reported to Peter Chant. Mr. Chant was a partner and practice group leader of the Complex Accounting and Transaction Expertise Group. Mr. Chant was not a member of the engagement team that performed Deloitte’s audits or quarterly reviews at Nortel in Q1 and Q2 2003. However, like Ms. De Acetis, he provided technical assistance and advice to members of that engagement team from time to time in respect of a number of issues that arose in connection with the Q1 and Q2 2003 quarterly reviews.

[685] Chris Allen was a partner at Deloitte, who worked on the Nortel engagement during the Q1 and Q2 2003 reviews. Mr. Allen was a senior member of the Deloitte engagement team for Nortel.

[686] Tony Ciciretto was, during the Q1 and Q2 2003 reviews, responsible for supervising Deloitte's review work in respect of Nortel's Corporate Analysis and Consolidations Group in Brampton. Mr. Ciciretto's name appears on very many e-mails which were received in evidence as business records. I infer from the documentation that Mr. Ciciretto was a senior member of the Nortel engagement team. Mr. Ciciretto was not called as a witness.

[687] According to the information provided to the Crown by Deloitte, the memo was created because, in April 2003 during the course of performing its review work, Deloitte's engagement team noted that Nortel had released \$80 million in accrued liabilities. Deloitte's engagement team identified a number of documentation and support issues with respect to these accrued liabilities. In late June or early July 2003, Deloitte's engagement team became aware that Nortel intended to release in its financial results for Q2 03 a number of additional accrued liability balances which were no longer required on Nortel's balance sheet. Once again, the engagement team identified documentation and support issues. Based on Deloitte's advice, Nortel did not release these accrued liabilities to the profit and loss statement.

[688] As a result of these documentation and support issues, Diana De Acetis was asked to conduct a review of Nortel's release of the \$80 million in accrued liability balances to the profit and loss statement in Q1 2003 to determine whether these releases were appropriate under US GAAP. I should add here that, in terms of topic and timing, this is an extremely pertinent inquiry.

[689] According to the information provided to the Crown, Ms. De Acetis obtained background information from Mr. Ciciretto and other members of the Deloitte engagement team for Nortel. Ms. De Acetis prepared an initial draft of the memo in July 2003 and then received comments from Chris Allen and others. Further drafts were generated during July and August. In September, Ms. De Acetis received further comments from Peter Chant. By late September or early October 2003, work on the preparation of the draft memo itself was halted.

[690] The draft memo bears the date of July 15, 2003. At this point according to the evidence, it was clear to Deloitte that Nortel had unsupported accrued liabilities on its balance sheet and that a Comprehensive Balance Sheet Review was required.

[691] The draft memo identified six corporate level provisions totaling \$80 million, which Nortel determined in Q1 2003 were no longer required or which could not otherwise be justified on its balance sheet at their current balances. In addition to itemizing these accrued liability balances, the memo set out when the accrued liabilities were recorded, the reason for initially recording them and the reasons and support for their reversal in Q1 2003.

[692] The memo concluded that \$6 million worth of releases resulted from a change in estimate triggered in Q1 2003. Therefore, the release of this \$6 million was entirely in accordance with US GAAP.

[693] The memo concluded that the remaining five accrued liability balances totaling \$74 million could not be supported. Of this amount, two of the balances, EDSN (\$9 million) and Capital Tax (\$10 million), had been recognized as errors in the year in which they were created, that is 2002, and so their release in Q1 2003 was considered to be the correction of an error.

[694] The memo concluded that the remaining three accrued liability balances released to the profit and loss statement in Q1 2003; namely, Intercompany Out Of Balance (\$35 million), QST (\$5 million) and Short Close (\$15 million) were errors, although the memo specifies that a portion of the Short Close release in Q1 2003 was in accordance with US GAAP.

[695] The memo then spends three pages analyzing whether the releases were material to the Q1 2003 financial statements. The analysis references Staff Accounting Bulletin 99 of the SEC, which has been referred to repeatedly during this trial, as the foundation for a materiality analysis. No materiality expert testified during the trial. The Crown's expert did not comment on the materiality analysis in this memo.

[696] The memo concluded that "the reversal of the provisions was not considered on a qualitative and quantitative basis to be material to Nortel's financial statements for Q1 2003..."

[697] One of the tests for materiality which is set out in Staff Accounting Bulletin 99 is whether the misstatement "changes a loss into income or vice versa". Accordingly, the memo recalculates Nortel's net income for Q1 2003, excluding the effects of the release of the \$80 million in accrued liability balances to the profit and loss statement. The memo concludes, after making the appropriate accounting adjustments that Nortel would have had net income of \$2.2 million without the benefit of the release of the \$80 million to income. The memo concludes that this net income of \$2.2 million would have been earned after allowing for payment of the Return to Profitability Bonus and the Success Plan Bonus. The Success Plan Bonus was the performance-based bonus for a large portion of employees. Accordingly, the release of the \$80 million did not turn a loss into a profit.

[698] More specifically, the memo concludes, in an Appendix, that the Return to Profitability Bonus target is achieved whether the \$80 million in accrued liability balances is released to the profit and loss statement or not.

[699] The memo also concludes that the Success Plan Bonus earnings, revenue and cash flow targets are met whether the \$80 million in accrued liability balances is released to the profit and loss statement or not.

[700] Thus, the memo concludes that the thresholds for these two bonuses would have been met whether or not the \$80 million in accrued liability balances is released to the profit and loss statement.

[701] The memo, which was received as Exhibit 251D, is quite thorough. It analyzes six specific accrued liabilities totaling \$80 million and it calculates the financial state of affairs relevant for our purposes that would have existed had the \$80 million remained on the balance sheet of Nortel instead of being incorporated into its profit and loss statement.

[702] Mr. Harrison testified that he did not calculate the Return to Profitability Bonus plan target in the same fashion as Deloitte & Touche. His evidence in this regard was not particularly helpful.

[703] A review of the minutes of the Human Resources Committee of the Board of Directors of Nortel Networks Corporation, known in Nortel speak as the Joint Leadership Resources Committee (“JLRC”), demonstrates that the bonus target for the Return to Profitability Bonus is to be calculated using Nortel’s method in 2002 of calculating pro forma gains before taxes.

[704] The only issue is whether Deloitte’s calculation is consistent with that definition. The lack of similarity between Mr. Harrison’s method of calculating the target for the Return to Profitability Bonus and Deloitte’s method is of no assistance.

[705] Deloitte’s calculation is contained in one of the Appendices to the memo. The only way to describe this Appendix is by the document number, DT 601338. The Appendix has two purposes: its first stated purpose is to evaluate the effects of the release to income of \$80 million of accrued liability balances in Q1 03 on Nortel’s ability to achieve the Return to Profitability Bonus and Success Plan Bonus thresholds. In this memo, the release of accrued liability balances to the profit and loss statement is described as the “reversal of provisions”. The second stated purpose is to evaluate the effects of the reversal of these provisions reported on net income for Q1 03.

[706] As a result, this Appendix addresses two important issues in this trial.

[707] The first calculation concludes that the Return to Profitability Bonus target is met with and without the release of the \$80 million. The calculation is plainly set out. It starts with Nortel’s loss from continuing operations as reported and then adjusts for the pro forma items that are called for by the 2002 definition of pro forma income; namely, the amortization of acquired technology, stock compensation expense, special charges, and gains on the buyback of bonds. It then adjusts for the cost of the bonuses and arrives at positive pro forma gains before taxes of \$161 million. It then adjusts or subtracts the \$80 million with which we are concerned and it concludes that the Return to Profitability Bonus target is met.

[708] Mr. Dans testified about this calculation, although I found his evidence to be vague. He agreed with the adjustment for the amortization of acquired technology, stock compensation, special charges and gains on the buyback of bonds. To the extent that he said that Deloitte, in this Appendix, did not adjust for the cost of the Return to Profitability Bonus, he was in error. If I misunderstood Mr. Dans’ evidence, it does not matter because the Deloitte calculation did adjust for the cost of the bonus.

[709] Deloitte included in its calculation two positive adjustments totaling \$28 million. Mr. Dans did not agree with these adjustments. It does not matter. Assuming Mr. Dans is correct, pro forma gains before taxes are \$133 million. If I had to decide this matter, I would prefer the Deloitte analysis in the Appendix to Mr. Dans’ conclusory statement.

[710] The Appendix then considers the Success Bonus Plan which had three targets: an earnings target, a revenue target and a cash flow targets. Deloitte, in this memo, concluded that all three targets were met with or without regard to the \$80 million with which we are concerned.

[711] I observe here that the Restricted Stock Unit Bonus Plan, with which we were also concerned in this trial, is not referred to in this memo. It was never suggested that a threshold for this bonus plan was achieved in Q1 03.

The effect of the \$80 million on earnings

[712] The appendix then considers the effect of the \$80 million with which we are concerned on reported earnings. It concludes that Nortel achieved positive earnings with or without the \$80 million. This calculation appears on document DT 601339. Mr. Dans did not comment on this calculation.

[713] Apart from the calculation's conclusion, the analysis contains a note dealing with foreign tax credits. The note reveals that the authors of this memo participated in a conference call with a person identified as John Van Oglrop. The purpose of the call was to obtain clarification about certain foreign tax credits. It appears that a foreign tax credit, which had been recorded as a recoverable asset, had been written off in Q1 2003 and it should have been written off in 2002. This meant that the accrued liability balance for foreign tax credits was overstated by \$20 million in Q1 2003 and understated in 2002. The note is interesting because it demonstrates the thoroughness with which the authors of this desk memo approached their task.

Conclusion concerning the Bonus Payments & earnings

[714] I am satisfied that the Return to Profitability Bonus was payable in Q1 2003 with or without the release of \$80 million in Non-op accrued liability balances. I am satisfied that the Success Plan Bonus was payable with or without the release of \$80 million in Non-Op accrued liability balances. The Restricted Stock Unit Bonus Plan was not an issue in Q1 03.

[715] I am satisfied that Nortel achieved net US GAAP income in Q1 03 with or without the \$80 million.

[716] I am satisfied that Mr. Hathway was not misled when he was told by either Mr. Beatty or Mr. Gollogly that the Return to Profitability Bonus would have been paid with or without the release of the \$80 million in Non-op accrued liability balances.

[717] I am not satisfied that the accused used Non-op "cookie jar" accrued liability balances to manage earnings and permit the payment of a bonus in Q1 03.

[718] I am not satisfied that the inclusion of the \$80 million with which we are concerned in Nortel's profit and loss statement for Q1 03 misrepresented Nortel's financial results.

The materiality of the release of \$80 million of Non-op accrued liability balances

[719] Ms. De Acetis, Mr. Chant and Mr. Allen considered whether the \$80 million in Non-op accrued liability balances, which were released to Nortel's profit and loss statement in Q1 03, were material to the Q1 03 financial statements.

[720] Notwithstanding the fact that this is entitled a draft memo, the materiality analysis is instructive.

[721] The memo concluded that, from a quantitative perspective, the \$80 million was material because the materiality threshold used for Deloitte's Q1 03 audit review was \$14 million. These authors noted that the \$14 million threshold was calculated in accordance with the stated policy of the Deloitte & Touche firm.

[722] The authors then considered whether the \$80 million was material from a qualitative perspective.

[723] Staff Accounting Bulletin 99 of the SEC mandates both a quantitative and qualitative analysis prior to a materiality determination.

[724] No materiality expert was called during the trial.

[725] The draft memo then applies all of the considerations which are set out in Staff Accounting Bulletin 99.

[726] The draft memo concludes that all six accrued liability balance releases all relate to estimates which are inherently imprecise. The memo concludes that the degree of imprecision is high due to the changes at Nortel and in the industry. According to the authors, there is an inability to accurately predict liabilities of the type that make up the \$80 million.

[727] The memo concluded that the \$80 million in changes do not mask a change in earnings or other trends. Six (\$6) million in releases were in accordance with US GAAP. Of the remaining \$74 million \$44, million was reported in "other income". Of the remaining \$30 million, \$25 million was due to the reversal of a tax provision. The short close liability release (\$5 million) was reported as a part of selling, general and administrative expenses during a time when sales, general and administrative expenses were going through dramatic reductions. The remaining \$5 million was composed of a portion of the Out Of Balance account which related to Research and Development. Apparently, the classification of items within selling, general and administrative expenses and research and development expenses did not affect trends for those financial statement line items.

[728] The memo then concluded that the \$80 million did not hide a failure to meet analysts' expectations. In order to make this determination, the authors reviewed a variety of analysts' reports and concluded that they focused primarily on revenues, gross margins, operating expenses and operating income and earnings before interest taxes depreciation and amortization (commonly known as "EBITDA").

[729] The memo then examined whether the \$80 million changed a loss into income. It was the opinion of the authors that, without the \$80 million, Nortel would have made a net income of \$2.2 million after payment of the Return to Profitability Bonus and the Success Bonus.

[730] Pursuant to the provisions of Staff Accounting Bulletin 99, the authors then addressed the question of whether the \$80 million concerned a segment or other portion of Nortel's business that had been identified as playing a significant role in Nortel's profitability. The authors answered this question in the negative because Nortel reported contribution from four segments. Research and Development ("R & D") and "Other Income" were excluded from this calculation. Selling, General and Administrative expense was included when calculating contribution to profit, but the contribution of this item was small.

[731] The authors concluded that the release of the \$80 million did not affect Nortel's compliance with regulatory requirements.

[732] The authors also concluded that the \$80 million did not affect Nortel's compliance with loan covenants and other contractual requirements. These requirements required Nortel to have a tangible net worth of \$1.8 billion or more. In Q1 03, Nortel reported a tangible net worth of \$2.33 billion.

[733] Finally, the authors concluded that the release of the \$80 million did not conceal an unlawful transaction.

[734] As part of their analysis, the authors commented on the fact that Nortel specifically disclosed the release of the \$80 million of favorable impacts in the 10-Q Report for Q1 03.

[735] The authors pointed out that the effect on Nortel's earnings of the release of the \$80 million was brought to the attention of Nortel's Audit Committee on April 23, 2003 prior to Nortel's publication of its financial results.

[736] After making all these observations, the authors set out their conclusion. They noted that, quantitatively, the \$80 million appeared to be material. The authors concluded that the \$80 million did not have any of the qualitative characteristics that would indicate a particular concern to users of the financial statement. These items were, at the most, 5% of any particular line item in which they were included and fully disclosed in the notes to the financial statements.

[737] When the authors considered all of these factors, their collective conclusion was that, if the \$80 million had been removed from the financial statements, it would not have altered the total mix of information available to an investor.

[738] It was the authors' opinion that the \$80 million was not material in the broadest sense of the term.

[739] Mr. Hathway, from late February 2003 Deloitte's lead audit partner on the Nortel 2003 audit, attempted to distance himself from these conclusions by saying that it was based on the knowledge that Deloitte had at the time the memo was prepared.

[740] On cross-examination, he seemed to say that it was still possible that US GAAP was not complied with, but the non-compliance was immaterial.

[741] Later on in his cross-examination, Mr. Hathway indicated that he did not agree with the conclusion that the Return to Profitability Bonus target would have been met with and without the \$80 million. He suggested that the authors, although he seemed to be referring to Ms. De Acetis, may not have understood the metric for calculating the bonus, although he conceded that Ms. De Acetis would have done her best to understand it before doing her calculation. It would have been a simple matter for Mr. Hathway to explain the error in Ms. De Acetis's calculation. He never did this on cross-examination or on re-examination.

[742] I do not know how Mr. Hathway could presume to disagree with Ms. De Acetis' calculations when he admitted in his direct examination that he did not have a detailed understanding of the Nortel pro forma calculations. He stated that he recommended that Nortel discontinue disclosing pro forma earnings in its Q1 03 financial statements, which Nortel did do.

[743] Mr. Hathway admitted that he reviewed the memo. Mr. Hathway said he had a vague recollection of providing his comments to the author of the memo, but he could not remember what his comments were.

[744] Mr. Hathway said that he would have made changes or edits to the memo, but did not do so because it was determined that there would be a restatement of earlier published financial statements and that the payment of the bonus would be looked at as part of the restatement.

[745] Finally, Mr. Hathway said that the author of the memo, by which he seemed to mean Diana De Acetis, was not part of the engagement team and was not familiar with everything that was going on at Nortel. This particular assertion is misleading.

[746] Ms. De Acetis was consulted on other matters and obviously was familiar with the Nortel file [see: Exhibit 228, tab 215].

[747] In addition, the memo, which Mr. Hathway seemed to view as only the work of Ms. De Acetis, was co-authored by her superior, Mr. Chant, as well as Mr. Allen.

[748] Mr. Allen joined the Nortel engagement in 2001. In Q1 03 and Q2 03, he was a senior member of the Deloitte engagement team for Nortel. Finally, Mr. Allen attended the meeting on April 15, 2003, where each one of the accrued liability balance releases which made up the \$80 million, which is the subject of the memo, was specifically discussed prior to Deloitte agreeing to their Q1 03 release.

[749] Mr. Chant was a partner in the firm and was the practice group leader of the Complex Accounting and Transaction Expertise Practice Group to which Ms. De Acetis was assigned.

[750] Mr. Ciciretto, who provided information to Diana De Acetis, was a senior member of Deloitte's Nortel engagement team.

[751] I simply do not accept this portion of Mr. Hathway's evidence. He admits he was asked for his comments about this memo. I am satisfied he would have provided those comments in a

timely way. I do not understand why he would not have insisted on his comments being incorporated into the memo.

[752] The notion that Mr. Hathway had some comments concerning and disagreements with the memo, which he may have communicated to the author, but which were ignored and never recorded in writing, seems unlikely. I do not believe Deloitte would conduct itself in this fashion. It seems far more logical to me that the memo would have been changed to reflect Mr. Hathway's comments or that his comments and edits would have been described in the memo in some form that made clear the portions with which he disagreed.

[753] I do not accept this portion of Mr. Hathway's evidence based on the thoroughness of the memo.

[754] The Crown's expert, Mr. Chambers, did not comment on this memo.

Conclusion

[755] I accept the analysis and conclusions in the draft memo prepared by Ms. De Acetis, Mr. Chant and Mr. Allen. I reject Mr. Hathway's evidence to the effect that the calculations in this draft memo are somehow not correct. This memo represents a coherent materiality analysis and I find it persuasive.

[756] I am satisfied that the release of the \$80 million from Nortel's balance sheet to its profit and loss statement was not material to Nortel's Q1 03 financial results.

[757] I am not satisfied that including the \$80 million with which we have been concerned in Nortel's Q1 03 profit and loss statement or removing the \$80 million from Nortel's Q1 03 consolidated balance sheet misrepresented Nortel's financial results for Q1 03 to the public or to Nortel's Audit Committee and its Board of Directors.

[758] I am satisfied that the thresholds for the Return to Profitability Bonus and the Success Bonus Plan were met with or without the release of the \$80 million.

Susan Shaw's list of \$189 million Non-op accrued liabilities

[759] Reference was made earlier to Ms. Shaw's 2002 report. This is a second occurrence involving Ms. Shaw. It involves Non-op accrued liability balances with which she was concerned in Q1 03. This occurrence not only involves the \$80 million to which I have referred, but an additional \$109 million in accrued liability balances.

[760] One of Susan Shaw's responsibilities was to analyze and be responsible for Non-op accrued liability balances. Throughout Q4 2002, Ms. Shaw had been expressing to her superior, Helen Verity, uneasiness about some of Non-op accrued liability balances for which she lacked support.

[761] In February 2003, Ms. Shaw started reporting to Brian Harrison because Helen Verity left Nortel. In an effort to educate Mr. Harrison about Non-op and to bring to his attention the

problem with some of the accrued liability balances, Ms. Shaw classified the Non-op accrued liabilities on a chart which was entered into evidence as Exhibit 11, tab 11.

[762] On this chart, she referred to the accrued liability balances which concerned her as "releasable provisions". Specifically, Ms. Shaw's concerns were that the "releasable provisions" on the chart were not current, didn't seem to be changing and lacked sufficient backup. Ms. Shaw believed that the problem with backup flowed both from the fact that there had been substantial staff reductions (two out of every three employees had been dismissed) and because facilities had been closed resulting in documents being packed up and put into storage making it virtually impossible to search for supporting documentation. Ms. Shaw pointed out that she was not suggesting that backup for these accrued liabilities did not exist; she was simply saying that she did not have that backup.

[763] Ms. Shaw also cautioned that prematurely releasing an accrued liability which was truly required would create an exposure at a point in the future when the accrued liability crystallized. The evidence established that failing to provide for a risk was very countercultural at Nortel.

[764] Ms. Shaw thought she met with Mr. Harrison in the latter part of February 2003 and, at that meeting, presented her list of Non-op accrued liabilities and explained the Non-op balance sheet. During the course of her explanation, she identified \$189 million worth of "releasable provisions" or accrued liability balances which, in her view, had to be removed from the balance sheet.

[765] Ms. Shaw's list of releasable provisions presented a problem: there was no justification for retaining these accrued liability balances on the balance sheet; there was no justification for releasing them in Q1 03; Mr. Dunn, Mr. Beatty and Mr. Gollogly had to provide certifications with their financial filings to the effect that, based on their knowledge, Nortel's financial statements fairly presented Nortel's financial condition; the auditors had to provide an opinion that the financial statements "present fairly, in all material respects, the financial position of Nortel Networks...".

[766] Mr. Harrison was unable to assist Ms. Shaw with the problem. Mr. Harrison was not a chartered accountant. He was a Registered Industrial Accountant; later called a Certified Management Accountant. Quite illogically, he suggested that they release half of it in Q1 03 and half of it in Q2 203. Mr. Harrison described his solution as "an elegant way of, you know, getting out of the problem". Mr. Harrison's solution was hardly elegant. Ms. Shaw was a chartered accountant; she was not comfortable with his suggestion. Mr. Harrison agreed to raise the issue with Mr. Gollogly.

[767] When Susan Shaw returned from a winter holiday, she was advised that Mr. Harrison was proposing to release \$75 million of the Non-Op accrued liabilities on her list of releasable provisions. Mr. Harrison indicated, in his e-mail of March 24, 2003, that he was waiting confirmation from Mr. Beatty and Mr. Gollogly. Later, Ms. Shaw was advised that an additional \$9 million from her list of releasable provisions was added to the liabilities that were to be released (total \$84 million). Ms. Shaw was unable to say who made this decision.

[768] Ms. Shaw testified that she was then asked to prepare an explanation of these releases, both for Nortel's purposes and so that Nortel could explain the accrued liability balance releases to Deloitte & Touche.

[769] Ms. Shaw's written explanation was entered into as an exhibit. Specifically, it appears at tab 20 of Exhibit 11. By the time Ms. Shaw began to prepare her explanation, the list of accrued liability balances to be released had been reduced to \$80 million from \$84 million. Ms. Shaw did not know how the reduction came about. This \$80 million in accrued liability balances is the same \$80 million to which I have previously referred.

[770] Ms. Shaw's prepared explanatory notes described the \$80 million in accrued liability balances. Ms. Shaw testified that she prepared an additional chart which showed the \$109 million remaining accrued liability balances. This chart was introduced as Exhibit 67G.

[771] The Crown submitted that the decision to only release \$80 million in accrued liabilities in Q1 03 is illogical. The Crown submits there is no difference between the \$80 million which was released in Q1 03 and the remaining \$109 million which was not released.

[772] The Crown submitted that Ms. Shaw was aware of these liabilities in Q4 02. The Crown submitted many of them appeared on her \$303 million liability list which she compiled in August 2002. The Crown pointed out that the \$189 million in accrued liability balances were restated as part of the Comprehensive Balance Sheet Review and the first restatement process. Therefore, the Crown submits that the inclusion of these accrued liability balances in Q4 02, Q1 03 and Q2 03 represented the inclusion of false financial information on Nortel's consolidated balance sheet and as a result Nortel's financial results were misrepresented.

[773] Ms. Shaw e-mailed her typewritten explanatory notes and other information to Joyce Lam and Guillermo Olguin, both of whom are chartered accountants with Deloitte & Touche, on April 14, 2003. Mr. Olguin forwarded her e-mail and attachments to John Cawthorne, Tony Ciciretto, Chris Allen and others on April 14, 2003.

[774] Ms. Shaw indicated that she sent her material to Deloitte & Touche in advance of a joint meeting between Nortel and Deloitte to highlight for them the fact that \$80 million in accrued liabilities for which there was little backup had been released to the profit and loss statement in one of the preliminary closings of General Ledger for Q1 03.

[775] Mr. Shaw testified that, by the time this document was discussed with Deloitte & Touche on April 15, 2003, the \$80 million had been released to the profit and loss statement. April 15, 2003 was approximately halfway through the close cycle for the preparation of the Q1 2003 financial statements.

[776] At the April 15 meeting, on the Nortel side, Ms. Shaw, Brian Harrison, Linda Mezon, Michael McMillan and Michael Gollogly attended; on the Deloitte & Touche side, John Cawthorne, Don Hathway, Tony Ciciretto, Joyce Lam and Chris Allen attended. Mr. Hathway and Mr. Cawthorne were the two most senior Deloitte & Touche auditors on the Nortel file, with the exception of Mr. Richmond. Mr. Allen was one of the co-authors of the desk file memo to which I referred earlier.

[777] Ms. Shaw said that her role at the meeting was to walk the Deloitte & Touche partners through her explanation of each of the provisions that had been released, as well as the provisions that remained. She said that her own purpose was to make it very clear that her report was the sum total of her knowledge of the accrued liability balances in her chart.

[778] Ms. Shaw testified that she went through each item mentioned. She recalled a lengthy discussion about the Intercompany Out of Balance accrued liability balance because it was an ongoing issue between Nortel and Deloitte. Other evidence established that Mr. Dunn wanted to maintain the provision and Deloitte's wanted the Non-op Intercompany Out Of Balance account reconciled and then eliminated. Ms. Shaw indicated that the Intercompany Out Of Balance portion of the discussion was quite heated.

[779] Ms. Shaw testified that, after the Intercompany Out Of Balance item had been discussed, the meeting proceeded to discuss the other items in her report. She said that Deloitte wanted to know what event had triggered the releases and that she informed them that there really were no triggering events. Ms. Shaw also recalled, at one point, someone on the Deloitte side wanted to know whether Nortel staff understood that there had to be a triggering event before an accrued liability balance could be changed or released to the profit and loss statement. She informed Deloitte that the accrued liability balances had been on Nortel's books for a number of quarters if not years. Ms. Shaw said it was quite evident at the meeting that these balances did not have adequate backup and that their release to the profit and loss statement had not been triggered. She said that Deloitte wanted to know why they were releasing these accrued liabilities in Q1 2003.

[780] Ms. Shaw indicated that after the \$80 million was discussed the remaining accrued liabilities, which totaled \$109 million, were discussed.

[781] The existence of provisions for which there was little support would not come as a surprise to either Mr. Cawthorne or Mr. Hathway despite their lack of experience with the Nortel engagement. In February 2003 Mr. Cawthorne asked for and received a list of "soft provisions" prepared in connection with the 2002 audit. The accrued liability balances on this list totaled \$413 million. Mr. Hathway saw this list because his handwriting is on it. Soft provisions were accrued liability balances with questionable support.

[782] Ms. Shaw elaborated that the other Deloitte partners were experienced with the Nortel account and the liability balances to which she was referring. Ms. Shaw testified that these balances had been on the books for many quarters and, for those experienced with the Nortel account, were not new. She said, for example, everyone from Deloitte, with the exception of John Cawthorne and Don Hathway, who were both new to the file, knew what the Matra Restructuring accrued liability balance was.

[783] Evidence was introduced which established that balance sheet reviews were conducted in 2002 in relation to the balance sheet for Non-op. Ms. Shaw testified that these balance sheet reviews could go on for hours and that partners from Deloitte & Touche attended. Ten e-mails were introduced, which indicated that, in 2002, accountants with Deloitte & Touche were reviewing and asking questions about changes in accrued liabilities in Non-op in Q3 2002. I accept this aspect of Ms. Shaw's evidence.

[784] John Cawthorne, Tony Ciciretto, Joyce Lam and Chris Allen did not testify. Only Don Hathway testified and gave evidence about the April 15, 2003 meeting. Mr. Hathway was not part of the Nortel engagement prior to early 2003.

[785] Ms. Shaw testified that, in her mind, there was no difference between the \$189 million, which she initially identified, and the \$80 million which was actually released in Q1 2003. Ms. Shaw said that, after she made her presentation and after the partners at Deloitte & Touche had finished asking her questions, she and others left the meeting. Ms. Shaw estimated that the portion of the meeting which she attended lasted for about forty-five minutes. She said four people remained behind in the meeting room: John Cawthorne, Don Hathway, Linda Mezon and Michael Gollogly.

[786] I accept Ms. Shaw's evidence concerning the \$109 million Non-Op accrued liability balances which remained on Nortel's balance sheet. Her conduct as she described it is entirely consistent. Ms. Shaw had responsibility for Non-op's liabilities; she had concerns about some of them. She brought her concerns to the attention of her superiors. As a chartered accountant, she understood the importance of making sure that Nortel's auditors understood that there was no support for the \$80 million in accrued liability balances that were being released to the profit and loss statement and no support for the \$109 million in accrued liability balances which remained on Nortel's balance sheet. She was quite candid in describing her own discomfort with these liability balances.

[787] The \$80 million remained released to income in Nortel's published financial results for Q1 2003. The \$109 million remained on Nortel's published balance sheet where it always been included in Nortel's \$5 billion in liabilities...

[788] Ms. Shaw made further inquiries about the \$109 million in Q2 03. She testified that she consulted with a broader group concerning the remaining \$109 million of Non-op accrued liability balances. She described it as "taking more time and really going deeper into the provisions..." Ms. Shaw indicated that no new information concerning the remaining provisions was discovered. It was her evidence that "quite a bit of time was spent trying to find out about some of these items". Ms. Shaw testified that, because so many people had left the company, it was impossible to track down the information. I accept this aspect of Ms. Shaw's evidence.

Should the \$189 million have been dealt with in Q4 02?

[789] The Crown suggested that the accrued liability balances, which appeared in Ms. Shaw's \$189 million list, also appeared in her Accrued Liability Analysis report which she presented to Mr. Gollogly in October 2002. The Crown suggested, in argument, that this meant that Mr. Gollogly should have decided in October 2002 that these accrued liability balances were not supportable and dealt with them at that time. I reject this argument.

[790] Ms. Shaw's Accrued Liability Analysis Report in October 2002 (Exhibit 1, tab 5) listed all of the Non-op accrued liabilities. This list totaled \$315 million. Ms. Shaw identified each accrued liability balance and the total. Ms. Shaw did not state in her Report that all of these accrued liability balances could not be supported and should be released. Ms. Shaw indicated in

her Report that \$66 million of Non-op accrued liability balances could not be supported and should be released. Ms. Shaw did not identify these individual balances.

[791] In February 2003, Ms. Shaw, in her capacity as a person responsible for the Non-op accrued liability balances, met with Mr. Harrison to whom she was directly reporting. She met with him about the state of accrued liability balances in Non-op. In that meeting, Ms. Shaw advised Mr. Harrison that there were \$189 million in Non-op accrued liability balances which, in her view, at that time were not supportable. In her notes which she prepared for that meeting, she referred to these accrued liability balances as “Releasable Provisions.” In her notes, Ms. Shaw specifically identified each one of these provisions. Mr. Gollogly was not present at that meeting.

[792] There is no basis for suggesting that Ms. Shaw had disclosed to Mr. Gollogly in the fall of 2002 the specific Non-op accrued liability balances which were incorporated into the memo which she were prepared for the April 15, 2003 meeting with Deloitte.

[793] The Crown also suggested that Mr. Gollogly did not deal with the \$189 million in accrued liability balances in Q4 02 because he wished to maintain them as a “cookie jar” to assist in managing earnings. I reject this argument for the same reason.

The knowledge of Mr. Dunn, Mr. Beatty and Mr. Gollogly

[794] I have already indicated elsewhere that I am satisfied that Mr. Dunn, Mr. Beatty and Mr. Gollogly were very aware of financial developments within Nortel.

[795] I am also satisfied that accrued liability balances owned by the two non-operational units of Nortel; namely, Corporate and Non-op, were under the control of the Controller. The Crown relied on this fact to suggest that all three accused were more familiar with accrued liability balances in Corporate and Non-op.

[796] The decisions to be taken with respect to this \$189 million were important. Nortel’s financial situation was still precarious although improving. It is clear that Mr. Gollogly was at the meeting with representatives of Deloitte in April 2003 when the decision to release the \$80 million in accrued liability balances was confirmed.

[797] The evidence discloses, and Mr. Gollogly well-understood, his obligations as Nortel’s controller. I am satisfied that he brought to Mr. Beatty’s attention this \$189 million balance sheet problem. Mr. Dunn was described in the evidence as a strong, intelligent detail-oriented leader.

[798] I am satisfied beyond a reasonable doubt that Mr. Gollogly, Mr. Beatty and Mr. Dunn were aware of Ms. Shaw’s and Nortel’s \$189 million in releasable provisions.

[799] The Crown relied on the presence of two accrued liability balances in Non-op as a further indication of the familiarity of all three accused with Corporate and Non-op accrued liability balances. The two accrued liability balances to which the Crown referred were known as the Degree of Difficulty (“DOD”) bonus and the General Provision.

[800] I am satisfied that all 3 accused were familiar with Non-op accrued liability balances. However, reference was made to these 2 accrued liability balances and it is helpful to look at them in detail and see what they demonstrate.

The accrued liability balance for the Degree of Difficulty bonus – \$25 million

[801] The Degree of Difficulty accrued liability balance was created when Mr. John Roth was Nortel CEO. It was created to provide for the risk created by the fact that Mr. Roth had the authority, at his discretion, to pay a bonus to a senior executive. As a result, the Degree of Difficulty bonus was payable at the discretion of the CEO. Ms. Mezon indicated that details surrounding the payment of a Degree of Difficulty Bonus were considered confidential to the CEO. The other Bonus Plans disclosed in the evidence were payable upon the recommendation of the JLRC committee of the Board of Directors.

[802] Mr. Roth left Nortel in 2000. Accordingly, this accrued liability balance was set up prior to that time. The original accrued liability balance was \$19 million and later increased to \$25 million.

[803] Due to the fact that Nortel was in extremely difficult financial circumstances from 2000 forward, it is not surprising that Mr. Dunn never attempted to use this balance to pay a bonus.

[804] The Crown suggested that the accused attempted to release this provision as a substitution for the Intercompany Out Of Balance provision. It is the Crown's position that Deloitte & Touche would not agree to the release of any portion of the Intercompany Out Of Balance accrued liability balance in Q2 03 because the entire Intercompany Out Of Balance account was under review. It is the Crown's position that the accused then attempted to release both the Degree of Difficulty accrued liability balance and the General Provision as a substitute.

[805] It is also the Crown's position that this provision had been identified in February 2003 by Susan Shaw's as a provision that should not be on the balance sheet and that it ought not to have been, therefore, retained on the balance sheet in Q1 03.

[806] The inclusion of the Degree of Difficulty bonus in Ms. Shaw's notes simply demonstrates that she knew nothing about the details surrounding this accrued liability balance. Ms. Shaw had no documentation herself because details surrounding the payment of a degree of difficulty bonus were considered confidential. She knew that it had been on the books for a long time and that it had not changed. As a result, Ms. Shaw included reference to this bonus in the notes she prepared for her discussion with Deloitte in April 2003. In her April 14, 2003 Report, Ms. Shaw recorded a brief description of the bonus plan and then the words "left in place per Frank Dunn".

[807] This is perhaps an appropriate place to note that documentation existed supporting this bonus plan. It was approved by Nortel's Board of directors when it was created. The person, who had the authority to pay the bonus, Mr. Dunn, was still employed at Nortel. Ms. Shaw's note "left in place per Frank Dunn" obviously means that Ms. Shaw had received information from someone that Mr. Dunn wished to retain the discretion to pay a bonus to a senior executive.

[808] Nortel did not attempt to release this accrued liability balance in Q1 03. In Q2 03, the attempt to release this accrued liability balance was unsuccessful because Mr. Hathway would not approve it and the other balances which totaled \$142 million. Even if the release of this accrued liability balance would have been material to Nortel's profit and loss statement in Q2 03, it never happened. All that happened was that this \$25 million accrued liability balance remained on Nortel's balance sheet where it always been.

[809] Mr. Hathway testified that, at the April 15, 2003 meeting, he questioned reference to this accrued liability balance because Ms. Shaw, in her memo, did not indicate whether a bonus was going to be paid.

[810] Even if the Crown's submission is correct and it is true that Mr. Gollogly, Mr. Beatty and Mr. Dunn attempted to release this accrued liability balance to substitute, in part, for the fact that they could not release the Intercompany Out Of Balance accrued liability balance that is not the end of the matter. The release never took place. It is not a crime for a corporation to try to achieve a financial target. A line is crossed when, in pursuit of that goal, financial statements are released to the public which misrepresent the corporation's financial results. No such misrepresentation was brought about by an unsuccessful attempt, if that is what happened, to release the accrued liability balance associated with the Degree of Difficulty bonus.

[811] Mr. Richmond testified that it was Deloitte's opinion that leaving the \$142 million on the Nortel balance sheet pending The Comprehensive Balance Sheet Review did not misrepresent Nortel's financial results. Mr. Chambers, the Crown's expert, did not offer a contrary opinion.

[812] I attach no significance to the existence of the Degree of Difficulty accrued liability balance. I attach no significance to the fact that Mr. Dunn wanted it left in place in Q1 03 and subsequently changed his mind in Q2 03. I attach no significance to the fact that the 3 accused unsuccessfully attempted to release this balance in Q2 03.

The accrued liability balance for the General Provision \$10 million

[813] In an undated note, Ms. Shaw records that the General Provision was set up to cover various items confidential to the Controller.

[814] The evidence indicated that the timing of the set-up of this General Provision was unclear. Documentary evidence indicated that this accrued liability balance was set-up either in Q3 00 or Q4 01. Mr. Beatty was the Controller of Nortel at the time. Helen Verity testified that this provision was, in fact, held by the Controller. Ms. Mezon said she had very little knowledge about this accrued liability balance except that it was confidential.

[815] This provision was not released in Q1 03. Ms. Shaw referred to it in her notes for the April 15, 2003 meeting with Deloitte & Touche. In her report, the only note Ms. Shaw recorded concerning this accrued liability balance was "left in place per Doug Beatty". Ms. Shaw had no information about this accrued liability balance except that it was confidential and held by the Controller. Ms. Shaw indicated that this limited information had come from Brian Harrison or Linda Mezon.

[816] Ms. Shaw indicated that the name of the accrued liability balance in the General Ledger cannot be relied upon to define it. Ms. Shaw indicated that the only way to know the risk for which an accrued liability balance was providing was to read the specific backup for it.

[817] Ms. Shaw pointed out in her evidence that this accrued liability balance was well-known to Deloitte & Touche. It had been on the Nortel books for many quarters.

[818] Mr. Hathway indicated that he questioned the provision at that April 2003 meeting when he saw it on Susan Shaw's list. He testified that US GAAP did not permit a general provision and that, unless there was more to this provision than Susan Shaw had provided, it was not permitted. Mr. Hathway agreed that, even though he was new to the Nortel file, he was aware that some of the provisions on Susan Shaw's list, including this one, had been on Nortel's balance sheet for a long period of time. As indicated earlier Mr. Hathway had seen a soft provisions list totaling \$413 million which had been provided to Mr. Cawthorne in February 2003.

[819] Mr. Richmond testified that an accrued liability balance intended to provide for liability generally, that is, a provision that was not tied to a specific liability, existed inside corporate Canada and in the United States prior to 1999. In 1999, he testified there was a clear attempt to eliminate this type of accrued liability balance. Accordingly the purpose of the provision needed to be understood.

[820] Obviously Mr. Beatty could have been asked about the provision at any time. If the provision was for a specific purpose then the only question would be whether Mr. Beatty thought it was possible that he might use it. If the provision was general in nature it had to be eliminated because it was contrary to US GAAP.

[821] An attempt was made to release this accrued liability balance to the profit and loss statement in Q2 03. Ms. Shaw could not remember how it was that she learned that this balance was to be released. Specifically, it was part of the \$59 million in Non-op accrued liability balances which were included in the \$142 million of accrued liability balances which were, for a short time during a preliminary close of Nortel's Q2 03 general ledger, released to Nortel's profit and loss statement.

[822] In a note explaining why, in Q2 03, this accrued liability balance should be released to the profit and loss statement, Ms. Shaw explained that specific drawdowns and the timing of those drawdowns were unknown and, therefore, the accrued liability balance should be eliminated.

[823] This accrued liability balance was not released to Nortel's Q2 03 published profit and loss statement. Karen Sledge testified that, during the first restatement, this accrued liability balance was completely eliminated.

[824] The Crown suggested that the accused attempted to release this provision as a substitution for the Intercompany Out Of Balance provision. It is the Crown's position that Deloitte & Touche would not agree to release any portion of the Intercompany Out Of Balance accrued liability balance to Nortel's profit and loss statement because the entire Intercompany

Out Of Balance account was under review. It is the Crown's position that the accused then attempted to release both this balance Degree of Difficulty balance as a substitute. This never happened.

[825] Even if the Crown's submission is correct and it is true that Mr. Gollogly, Mr. Beatty and Mr. Dunn attempted to release this accrued liability balance to substitute, in part, for the fact that they could not release the Intercompany Out Of Balance accrued liability balance that is not the end of the matter. The release never took place. It is not a crime for a corporation to try to achieve a financial target. A line is crossed when, in pursuit of that goal, financial statements are released to the public which misrepresent the corporation's financial results. No such misrepresentation was brought about by an unsuccessful attempt, if that is what happened, to release the accrued liability balance associated with the General Provision.

[826] It is also the Crown's position that this provision had been identified in February 2003 by Susan Shaw's as a provision that should not be on the balance sheet and that it ought not to have been, therefore, retained on the balance sheet in Q1 03. Ms. Shaw identified this provision as one that Mr. Beatty wanted left in place. The only question is whether this accrued liability balance existed to provide for a specific risk.

[827] As indicated this accrued liability balance was never released. It was included in the \$142 million. It never affected Nortel's profit and loss results. It remained on the balance sheet where it had always been. Mr. Richmond testified that it was Deloitte's opinion that leaving the \$142 million on the Nortel balance sheet pending The Comprehensive Balance Sheet Review did not misrepresent Nortel's financial results. Mr. Chambers, the Crown's expert, did not offer a contrary opinion.

[828] I attach no significance to the existence of the General Provision accrued liability balance. I attach no significance to the fact that Mr. Beatty wanted it left in place in Q1 03 and subsequently changed his mind in Q2 03. I attach no significance to the fact that the 3 accused unsuccessfully attempted to release this provision in Q2 03.

The \$142 million in accrued liabilities which Nortel wished to release in Q2 03

[829] Mr. Hathway testified that Mr. Gollogly advised him that, in the initial close or one of the initial closes of the General Ledger for Q2 03, Nortel had identified \$142 million of reserves that did not have support and had released those reserves to the profit and loss statement, thereby positively impacting earnings by \$142 million. Mr. Gollogly asked Mr. Hathway if this would be acceptable to Deloitte & Touche. Mr. Hathway objected.

[830] Mr. Hathway indicated that his objection was that, because these amounts must have had no support at the end of Q1 03, when these amounts were combined with the \$80 million released to income in Q1 03, they would have amounted to a material error in Nortel's profit and loss statement.

[831] As a result of Mr. Hathway's objection, Mr. Gollogly returned the \$142 million to Nortel's balance sheet where it had always been. This happened at the next preliminary close of the General Ledger. Mr. Hathway had no recollection of discussing the \$142 million release with Mr. Beatty or Mr. Dunn.

[832] As a result of this occurrence, Deloitte insisted that Nortel undertake a comprehensive review of its balance sheet. Mr. Gollogly had already instituted a balance sheet review. However, this comprehensive balance sheet review was agreed on between Mr. Dunn and Mr. Richmond, endorsed by Nortel's Audit Committee and disclosed in Nortel's public filings.

[833] The results of the comprehensive balance sheet review led to a decision to restate for the first time Nortel's previously-published financial results.

[834] Included in these \$142 million balances were \$59 million in Non-op accrued liability balances from the \$109 million in Non-op balances which Ms. Shaw discussed with Deloitte on April 15, 2003.

[835] The return of the \$142 million in releases resulted in the return to Nortel's balance sheet of \$55 million out of the \$59 million in Non-op accrued liability balances. The one release which did not return to the balance sheet was a \$4 million release that had to do with Siemens, which is discussed elsewhere in these reasons.

[836] No published Nortel financial results reflected this \$142 million as a component of Nortel's earnings.

[837] There is no doubt that Mr. Dunn and Mr. Beatty were aware of the momentary release of the \$142 million. Mr. Dunn told both Mr. Richmond and the Audit Committee that the \$142 million represented all of the remaining unsupported accrued liability balances on Nortel's balance sheet. It was Mr. Dunn's view that those liability balances should remain released to Nortel's Q2 03 profit and loss statement with the appropriate disclosure in Nortel's financial statements and press release. Mr. Beatty attended the Audit Committee meeting where these releases were discussed.

Conclusion

[838] I am also satisfied that the attempt to release \$142 million in accrued liability balances in Q2 03 did not misrepresent Nortel's financial results because Mr. Hathway objected to the release and Mr. Gollogly returned the \$142 million to Nortel's balance sheet where those balances had always been.

[839] Mr. Richmond testified that it was Deloitte's opinion that leaving the \$142 million on the Nortel balance sheet pending The Comprehensive Balance Sheet Review did not misrepresent Nortel's financial results. Mr. Chambers, the Crown's expert, did not offer a contrary opinion. I adopt this conclusion is my own.

[840] The \$109 million in balances which remained on Nortel's balance sheet as Non-op accrued liability balances were defined by Ms. Shaw as releasable provisions. Their presence on the balance sheet raises an issue concerning the appropriateness of the certification signed by the

accused as part of the Nortel financial filings and the appropriateness of the Deloitte audit opinions while those releasable provisions were on the balance sheet.

[841] Mr. Richmond testified that the \$142 million, which contained \$59 million from Ms. Shaw's list, was appropriately parked on the balance sheet pending the Comprehensive Balance Sheet Review.

[842] The Crown's expert, Mr. Chambers, in his report offered no opinion concerning the appropriateness of the certifications of Mr. Dunn, Mr Beatty or Mr. Gollogly. He also offered no comments concerning the Deloitte opinion which accompanied the Q1 03 published financial statements.

[843] I am not satisfied that it is safe for me to draw a conclusion about this particular aspect of the matter in the absence of such evidence.

[844] I am not satisfied beyond a reasonable doubt that the retention on Nortel's balance sheet of \$109 million of accrued liability balances which Ms. Shaw identified as releasable misrepresented Nortel's financial results.

[845] I am satisfied, based on my acceptance of Ms. Shaw's evidence, that Ms. Shaw at the April 15, 2003 meeting fully-disclosed to Deloitte the circumstances surrounding the release of \$80 million in accrued liability balances, as well as the circumstances surrounding and the decision to keep the remaining \$109 million in accrued liabilities on the balance sheet.

[846] The \$80 million which was released in Q1 03 had been conclusively determined to be unsupported. Deloitte, the Audit Committee, Ms. Shaw and all the accused knew that there were no triggering events in Q1 03 which required the release of this \$80 million. It was obviously the view of everyone involved that the disclosed release of this \$80 million would not materially affect Nortel's balance sheet profit and loss statement and thereby misrepresent Nortel's financial results. As indicated elsewhere in these reasons, I agree with this conclusion. I mention it here to note that the way in which the release of the \$80 million was handled was unobjectionable.

[847] Disclosure of the fact that Nortel's financial results for Q1 03 were positively affected by the release of this \$80 million was included in Nortel's published financial statements and the press release announcing the Q1 03 financial results.

[848] When I consider all of the evidence, including the evidence to which I have specifically referred, I am not satisfied that the release of this \$80 million misrepresented Nortel's financial results.

The use of Outlooks and Roadmaps in 2003

[849] Nortel management used documents known as Outlooks and Roadmaps in connection with forecasting. Several Outlooks, approximately five, were prepared for every quarter.

[850] Mr. Brian Harrison prepared many of the Outlooks and Roadmaps which were entered into evidence. Mr. Harrison was assigned to the Global Planning and Reporting Group.

[851] Mr. Harrison said the Outlook's purpose was to provide insight into the estimates that the various business units provided to management. Mr. Harrison indicated that, in the volatile environment in which Nortel found itself, with cash challenges, downsizing and a soft market, forecasting was important.

[852] Mr. Harrison indicated that the Outlook process called for him to collect forecasts and other information from each of the business units through their financial representatives and consolidate those forecasts into an overall view. The Outlooks which he produced included information about accrued liability balances that the business units had released in the quarter; the Outlooks included information about possible releases of accrued liability balances to income. Mr. Harrison's evidence in this regard is confirmed by notations identifying possible releases which appear on some of the Outlooks.

[853] Mr. Harrison received the financial information used in his Outlooks from contacts within the Finance Groups of the various units within Nortel.

[854] Mr. Harrison prepared Outlooks whenever he received news of any importance from the various business units.

[855] The business units engaged in active operations were known as: Enterprise, Wireline, Wireless, and Optical. There were two other units, Corporate and Non-Op, referred to on these Outlooks and Roadmaps. As indicated earlier, Corporate was a consolidation of the various corporate functions such as real estate, human resources etc.; Non-op was a catchall – a collection of everything that was left over.

[856] Mr. Harrison did not perform calculations to arrive at the numbers employed in the Outlooks which he created; he did perform the mathematical calculations within the Outlook itself.

[857] Mr. Harrison included a Gross Margin in his Outlooks calculation because Gross Margin, in his experience, was a useful metric for profitability. In Mr. Harrison's experience, Nortel's gross margin during the time-frame of this indictment was in the 40% range.

[858] Mr. Harrison testified that he prepared a document known as a Roadmap. His evidence was that Roadmaps were started in February 2003; they were prepared in Q1 03 and Q2 03 and not after that time. Mr. Harrison described them as a modeling exercise.

[859] According to Mr. Harrison, a Roadmap was more ambitious than an Outlook; it described where Nortel wanted to go rather than where it was heading. Mr. Harrison said that the difference between an Outlook and a Roadmap was that a Roadmap reflected what the business units would like to achieve or had been asked to achieve. Roadmaps included items positively affecting earnings such as higher sales, reduction of expenses and accelerated deal closings to record revenue sooner and releases or possible releases of accrued liability balances to income.

[860] Mr. Harrison indicated that he received information on a variety of fronts from the business units concerning what had actually occurred in relation to their attempts to achieve their targets.

[861] Mr. Harrison testified that it was his responsibility to work with the business units to determine how the business units were going to achieve the target.

[862] Mr. Harrison described the Roadmap as a hypothetical scenario. He indicated that it was not clear to him when he was creating these hypotheses that they were doable; rather, they were based on the best information he had from the various business units.

[863] Mr. Harrison indicated that the targets in the Roadmaps came from Mr. Beatty, although in one instance, a target for a Roadmap came from Mr. Dunn. Mr. Harrison stated that the targeted figure was pro forma income earnings before taxes. Mr. Harrison indicated that he passively accepted the target and prepared his Outlooks with the target as a given.

[864] Mr. Harrison indicated that the practice of setting targets was a long-standing one at Nortel; this practice did not originate with Mr. Beatty or the other defendants. Mr. Harrison also testified that the practice of preparing Outlooks pre-dated Mr. Beatty's appointment as CFO.

[865] Mr. Harrison testified that, despite the fact that he reported to the Controller, the main customer for his Outlooks and Roadmaps was the CFO, Douglas Beatty, although e-mail evidence demonstrated that, on occasion, the Outlooks and Roadmaps were shown to Mr. Dunn and the business unit presidents, who were collectively referred to as the "FAD Cabinet".

[866] I am satisfied that the targets set by Mr. Beatty and contained in the Roadmaps were approved by Mr. Dunn. Given the precarious financial position of Nortel, it is inconceivable that financial targets would be set for the various business units without the approval of the CEO. Mr. Gologly was also aware of these targets because he was on the Outlook distribution list.

[867] Mr. Harrison left Nortel in June 2003 and, thereafter, the Outlook process, including Roadmap preparation, was taken over by Mr. Peter Dans. Mr. Dans had assisted with the preparation of Outlooks prior to taking over from Mr. Harrison.

[868] According to Mr. Dans, the Outlook was part of a standard process whereby the Global Planning and Reporting Group collected forecasts from the various leadership categories and consolidated them into a forecast for the subsequent quarters.

[869] Mr. Dans described the Outlook process as a short-term forecast that tended to focus on two or three quarters out from the time the Outlook was prepared.

[870] Mr. Dans said that he first became aware of Roadmaps in February or March 2003. Mr. Dans indicated that, from that point onward, the Outlook package also included a Roadmap and was, therefore, received by all persons who were on the Outlook distribution list.

[871] It was Mr. Dans' evidence that a Roadmap was an analysis or scenario that was put together by the Global Planning and Reporting Group. It was quite often based on an Outlook. According to Mr. Dans, the Global Planning and Reporting Group came up with targets for revenue and profitability. Mr. Dans then reviewed his analysis with his superior, Peter Browne, and then with Douglas Beatty. Mr. Dans understood that Mr. Beatty reviewed these targets with Mr. Dunn.

[872] Mr. Dans' evidence in this regard is slightly different than Mr. Harrison's. In my view, Mr. Harrison sought to distance himself from the target-setting process which I found odd, given that he was the Director of Global Planning and Reporting. I prefer the evidence of Mr. Dans in this regard concerning the origination of targets.

[873] Mr. Dans testified that the Corporate Planning and Reporting Group where he was also assigned would ask the various business units to indicate the extent to which balance sheet releases were included in their forecasts and then record these releases separately within the Outlook package. Mr. Dans indicated that the Global Planning and Reporting Group did not segregate provision releases according to whether they had been triggered in the current quarter; they just looked at provision releases in general. It is clear that balance sheet releases to income were recorded on the Outlooks and Roadmaps and I accept Mr. Dans' evidence in this regard.

[874] Some of the Outlooks referred to accrual liability releases as "balance sheet"; this was later changed to "other" at the suggestion of Mr. Beatty. Mr. Beatty apparently offered no reason for the terminology change.

[875] Mr. Harrison testified that the Outlook distribution list was limited. Mr. Dans testified that Mr. Beatty would further distribute the Outlook package if he thought it advisable. The Outlook package was forwarded to Mr. Peter Browne when Mr. Harrison reported to him and to Michael Gollogly when Mr. Harrison reported to him.

[876] I attach no significance to the fact that the distribution of Outlooks and Roadmaps was relatively narrow because there are disclosures issues which arise when confidential financial information is widely disseminated within the corporation but not otherwise publicly made known.

[877] The Crown pointed out that the presentations made to the Board of Directors consistently understated what senior management believed Nortel's actual results would be. Mr. Harrison, who prepared the Outlooks, offered his own observation which was that commitments to the Board of Directors were more conservative generally. Mr. Harrison explained that his Outlooks had a short shelf life. They were frequently replaced by other Outlooks. Board communications were more rigid and less frequent and, in his experience, more conservative. Mr. Harrison said the Outlooks were a short-term management tool to generate discussion. The Board update was more like placing a marker to explain how Nortel was doing versus its budget.

[878] The Crown suggested that the Board was not given accurate information about Nortel's performance. The Crown suggested that Mr. Beatty deliberately understated Nortel's financial results and withheld Mr. Harrison's Outlooks.

[879] The Crown's suggestion applies to all three accused because the evidence was that Mr. Dunn, Mr. Beatty and Mr. Gollogly attended Audit Committee and Board of directors meetings when Board updates were presented.

[880] I am satisfied that any financial presentation to the Audit Committee or the Board of Directors was, in effect, a representation to the Board by all three accused.

[881] I previously referred to Exhibit 42E and the portion of it I found unreliable. I now propose to refer to other information contained in that exhibit. Exhibit 42E was used by the Crown to put some specificity to the argument that the Audit Committee received understated estimates concerning Nortel's financial performance.

[882] On January 23, 2003, Mr. Beatty provided the Board with a financial forecast update for Q1 03 which predicted a pro forma loss of \$112 million. Mr. Beatty also advised the Board that Nortel could expect a US GAAP loss of \$240 million.

[883] On February 27, 2003, Mr. Beatty provided the Board with a financial forecast update for Q1 03 which predicted a pro forma loss of \$50 million. Mr. Beatty also advised the Board that they could expect a US GAAP loss of \$128 million.

[884] By March 28, 2003 Mr. Beatty provided the Board with a financial forecast update for Q1 03 which predicted a pro forma loss of \$20 million. Mr. Beatty also advised the Board that they could expect the US GAAP loss of \$48 million.

[885] On April 24, 2003, Mr. Beatty advised the Board that Nortel achieved a pro forma profit of \$40 million. Mr. Beatty also advised the Board that Nortel achieved US GAAP profit of \$54 million.

[886] It would be obvious to the Board that Nortel's results for Q1 03 were improving throughout the quarter. Secondly, among other things, the Board would know that these results were based on revenues of \$2.4 billion which helps to put the fluctuations into perspective.

[887] In Q2 03 (which began April 1, 2003), Mr. Beatty advised the Board on April 22, 2003 in a financial update that Nortel would report pro forma earnings before taxes for Q2 03 of \$25 million. Mr. Beatty also advised the board to expect a US GAAP loss of \$54 million.

[888] On May 2, 2003, Mr. Beatty advised the Board to expect a pro forma profit of \$25 million. Mr. Beatty also advised the Board to expect the US GAAP loss of \$54 million.

[889] On May 29, 2003, Mr. Beatty advised the Board in a financial update that Nortel was anticipating a pro forma profit for Q2 03 of \$25 million. Mr. Beatty also advised the Board to expect the US GAAP loss of \$54 million.

[890] On July 28, 2003, the Board was advised that Nortel's pro forma profit for Q2 03 was \$34 million. Mr. Beatty also advised the Board that Nortel experienced a US GAAP loss of \$14 million.

[891] Nortel's revenues for Q2 03 were \$2.3 billion.

[892] In Q3 03 (which began July 1, 2003), the Board was advised in a financial update, dated July 28, 2003, to expect a pro forma loss before taxes of between \$30 million and \$60 million. Mr. Beatty also advised the Board to expect the US GAAP loss of between \$40 million in \$70 million.

[893] On September 25, 2003 in two financial updates, the Board was advised that Nortel's pro forma gain before taxes for Q3 03 was predicted to be \$65 million or, alternatively, between \$50 and \$75 million. Mr. Beatty also advised the Board that the US GAAP income was predicted to be \$51 million or, alternatively, between \$45 million and \$65 million.

[894] On October 23, 2003, the Board of Directors was advised that Nortel was expecting a pro forma profit before taxes of \$172 million. Mr. Beatty also advised the Board to expect a US GAAP profit of \$179 million.

[895] On November 21, 2003, the Board was advised that for Q3 03 the pro forma gain before taxes was \$179 million. Mr. Beatty also advised the Board that Nortel US GAAP profit was \$185 million.

[896] Nortel's revenues for Q3 03 were \$2.2 billion.

[897] The evidence indicated that forecasting can be difficult. Nortel's difficulty with forecasting in Q1 03 is demonstrated by the circumstances surrounding the Arris proposal.

The Arris Proposal

[898] On the day after Mr. Beatty provided his January 23, 2003 Board update (which predicted a US GAAP loss of \$240 million), he received an e-mail telling him about a proposal from the Board of Arris. Nortel owned 27% of Arris and the majority owners of Arris wanted to buy Nortel out. The buyout, if it took place, would increase Nortel's US GAAP income by approximately \$137 million.

[899] In Q1 03 Nortel, eventually accepted a proposal from Arris, although the transaction did not close until March 2003, shortly before the end of Q1 03.

[900] Obviously, Mr. Beatty could not go to the Audit Committee the day after he made his financial update presentation and advise them that there was a possibility of a dramatic improvement in US GAAP net income in Q1 03. It was not clear until March that there would actually be a deal. There was evidence that the chair of the Audit Committee was in regular contact with Mr. Dunn and was very often given a "heads up" about what was happening.

[901] The Arris Proposal illustrates not only the vagaries of forecasting, but also the sense of urgency on the part of Mr. Beatty and others within Nortel to close the transaction in Q1 03 and significantly improve US GAAP earnings in that quarter.

Deloitte's interest in forecasting

[902] Mr. Harrison testified, and his evidence was confirmed by e-mail correspondence and Deloitte and Touche business records, that the forecasting process which he used was reviewed by Nortel's auditors in Q4 2002.

[903] Mr. Harrison also indicated that Deloitte & Touche were interested in forecasting to assist in planning. At this time, Deloitte was required to express an opinion on the likelihood of Nortel

remaining in business in the twelve months following their audit or quarterly review This confirms Mr. Harrison's evidence in this regard.

[904] Accordingly, I accept Mr. Harrison's evidence concerning Deloitte's interest in forecasting.

[905] Mr. Dans indicated that Deloitte and Touche were provided with a copy of the final Outlook for Q1 2003 and Q2 2003. It was also his recollection that Deloitte & Touche were provided with both a preliminary and final Outlook for Q2 03. Mr. Dans confirmed that the process worked out with Deloitte & Touche was that they were given the last Outlook of the quarter so that they could compare the actual results with the final Outlook. In addition, there was a telephone conference with each of the heads of the business units, Mr. Dans and representatives of Deloitte & Touche during which the actual results were presented and variances, if any, between those results and the final Outlook explained. Exhibit 53 confirms that the Outlook, dated September 17, 2002, was provided to Deloitte & Touche as part of their audit of the forecasting process. In addition, some further confirmation of Mr. Dans' evidence is provided in Exhibit 65 – an internal Deloitte & Touche e-mail – forwarding “the most recent outlook/forecast”. There was some evidence that the Outlooks provided to Deloitte & Touche were in a different format than the internal Nortel Outlook package; the content, however, was similar.

[906] Exhibit 2, tab 94 is an e-mail. This e-mail records that “D & T will be looking for the Outlook and the list of accrued liability balances to be released to the profit and loss statement”. This e-mail establishes that at least some of the Outlooks produced by Mr. Harrison and Mr. Dans were provided to Deloitte & Touche and that these Outlooks included the accrued liability balances that were to be released to the profit and loss statement.

[907] I accept Mr. Dans' evidence that Outlook packages were provided to Deloitte & Touche during Q1 and Q2 2003 and that Deloitte & Touche was aware of the Outlook forecasting process which he employed. Mr. Dans could not recall Deloitte & Touche receiving Roadmaps and I find that none were provided to them.

[908] During the close period when the consolidated financial results were being prepared, Mr. Harrison also prepared for Mr. Gollogly and the Assistant Controller, Linda Mezon, a similar looking document, also called an Outlook, based on actual numbers to provide management with a perspective on the evolving financial results for the quarter. This update was prepared daily and each time there was an update of the General Ledger. By this method, management could compare the actual results recorded in the General Ledger with the targeted results that Mr. Harrison had been preparing in the form of Outlooks and Roadmaps throughout the quarter.

[909] I accept the evidence of Mr. Harrison and Mr. Dans concerning the preparation and distribution of Outlook packages including Roadmaps. Their evidence in this regard was entirely consistent with the documentary evidence.

[910] I am satisfied that the Board was given accurate, albeit understated, updates about Nortel's progress through each of the three quarters to which I referred. I am satisfied that the Board was given predictions about Nortel's performance which were deliberately understated in

the sense that Mr. Dunn, Mr. Beatty and Mr. Gollogly were confident that the targets which they had predicted could be achieved. The Audit Committee and the Board of Directors were composed of experienced sophisticated directors whom I would expect to be able to assess management's targets.

[911] I do not find it unreasonable that the three accused would avoid promising the Audit Committee more than it might be able to deliver. Hitting the target was an important part of Nortel's culture. Mr. Kinney offered the observation that one negotiated targets to succeed not to fail and I accept his evidence in this regard as an accurate description of the Nortel approach to target setting.

[912] I am satisfied that the financial updates provided to the Board of Directors accurately presented Nortel's financial results. Even if I had not come to this conclusion, I would not have been persuaded by the evidence that it was proven beyond a reasonable doubt that the financial updates misrepresented Nortel's financial results.

The 2003 Outlooks and Roadmaps tracked proposed releases

The February 19, 2003 teleconference

[913] I have already commented on the fact that the Outlooks and Roadmaps tracked releases of accrued liability balances to income. The Crown also introduced other evidence which, in its submission, supported the idea that the accused were managing earnings by arbitrarily releasing accrued liability balances to income contrary to US GAAP and thereby misrepresenting Nortel's financial results to the investing public and Nortel's Audit Committee and Board of Directors

[914] Mr. Harrison testified that he participated in a conference call on February 19, 2003 with Mr. Beatty, Mr. Gollogly and the four Vice-Presidents of Finance for the four business units: Wireline, Wireless, Enterprise and Optical. Mr. Dunn did not participate in the call.

[915] At this time, Mr. Harrison had prepared a Roadmap which was part of a series of documents entitled, "2003 Financial Commitment". This document was prepared for Mr. Beatty, who intended to present it at Mr. Dunn's cabinet meeting. Mr. Dunn's cabinet, or the FAD Cabinet, consisted of all the persons reporting directly to Mr. Dunn; that is, the Presidents of the business units.

[916] Mr. Harrison's Roadmap contained a target of a \$20 million pro forma loss before taxes. This represented an improved target from a previous Q1 03 Roadmap. Similarly, there was a new improved Q2 03 target.

[917] In Q1 03, the Roadmap required Corporate to achieve a \$2 million improvement over budget; the Roadmap required Non-op to achieve a \$13 million improvement over budget.

[918] Mr. Harrison said Corporate and Non-op were not revenue-producing business units. It was Mr. Harrison's view that Corporate could achieve the increase required (\$2 million) by spending less. It was Mr. Harrison's view that there were a variety of income and expense lines, including releasing accrued liability balances to the profit and loss statement in Non-op that could be used to achieve the \$13 million improvement required of it by the Roadmap.

[919] The Roadmap indicates that there is still a \$12 million shortfall which is represented by a \$12 million “plug” to hit the target. This plug is recorded under Non-op. Mr. Harrison indicated that he recorded the shortfall under Non-op because it was the least contentious way to record it. Apparently, if Mr. Harrison had tried to record the \$12 million shortfall under any of the active business units, the heads of those units would have objected.

[920] Mr. Harrison testified that he made notes of the conversation on the Roadmap which was entered as a Nortel business record (Exhibit 1, tab 45). He identified his handwriting on portions of the Roadmap.

[921] Part of the documentation shows whether meeting the Roadmap target will result in the payment of Return to Profitability Bonus, the RSU bonus and the Success Bonus.

[922] Mr. Harrison made notes of the call as the call was progressing. According to Mr. Harrison’s notes, the Vice-President of Finance for Wireless said he could meet his \$70 million Roadmap and that he would be releasing \$50 million of accrued liabilities to his profit and loss statement in order to do that. The Vice-President for Enterprise said that he could achieve his target and that Enterprise would be releasing \$8 million of accrued liability balances to the profit and loss statement. The Vice-President Finance for Wireline indicated that it would be able to achieve its Roadmap target and would be releasing \$20 million. The Finance Vice-President for Optical indicated that it could achieve its target and it would be releasing \$21 million in accrued liability balances. There appears to have been no discussion concerning the shortfall.

[923] According to Mr. Harrison’s notes, the various Finance Vice-Presidents indicated that they could achieve the Roadmap target and that they would be releasing, in total, \$99 million of accrued liability balances to the profit and loss statement.

[924] This presentation also contains a Roadmap for Q2 03. This Roadmap sets a target of positive \$54 million in earnings before taxes. This Roadmap contains a “plug” or shortfall of \$22 million.

[925] According to Mr. Harrison’s notes, the Vice-President Finance for Wireless indicated that it could reach this target and that it would be releasing zero accrued liability balances. The Vice-President Finance for Enterprise indicated that it could achieve its Roadmap target for Q2 03 and that it would be releasing \$7 million in accrued liabilities from its balance sheet to its profit and loss statement. The Vice-President Finance for Wireline indicated that it could achieve its Q2 Roadmap target and that it would be releasing \$15 million. Mr. Harrison noted that the Vice-President of Finance for Optical indicated that it could achieve the Roadmap target and that it would be releasing \$20 million in accrued liability balances. There appears to have been no discussion concerning the shortfall.

[926] Mr. Harrison said that these Vice-Presidents were indicating what they realistically thought they could achieve.

[927] Mr. Harrison’s evidence in-chief was to the effect that the information concerning the release of accrued liability balances was in addition to the acceptance of the target by the various Finance Vice-Presidents. The gist of his evidence was, for example, that the Vice-President

Finance for Enterprise indicated in the conference call that Enterprise could not meet the \$85 million target suggested for it in the Roadmap in Q1 03, but could meet a target of \$80 million and that included in its revenues would be \$8 million in accrued liability balances that had been released to the profit and loss statement.

[928] Mr. Crosson, who attended the teleconference, had no specific recollection of the teleconference.

[929] Mr. Kinney described the Roadmap as a “what if scenario”. Mr. Kinney’s version of this teleconference prior to the trial apparently had been that he had been given the target for Wireless on February 3, 2003 and asked to use the release of accrued liability balances from Wireless’ balance sheet to meet the target.

[930] At the trial, however, Mr. Kinney’s evidence was different. Mr. Kinney confirmed that his original recollection of this matter was that he could not remember a telephone call on February 19, 2003. However, over the years, he had been shown documents to help refresh his memory and that, as a result of looking at those documents; he had come to believe what I set out in the previous paragraph.

[931] Mr. Kinney agreed that counsel for Mr. Dunn had shown him documents at an interview immediately prior to his testimony. Mr. Kinney agreed that, based on those documents, he was now satisfied that the \$75 million target for Wireless came from Wireless itself as far back as December 13, 2002. Documentary evidence tendered on cross-examination made it clear that the President of Wireless suggested the \$70 million target to Mr. Dunn on January 15, 2003. Apparently, there had been some negotiation between the President of Wireless and Mr. Dunn in January 2003, which resulted in the target for Wireless being pushed back to \$70 million from \$75 million.

[932] It was very clear on cross-examination that Mr. Kinney’s recollection of this matter has been confused over the years. Mr. Kinney concluded by saying, “I am the first to admit that I have probably mixed them all up...”

[933] Mr. Kinney testified that he and his staff paid attention to potential releases of accrued liability balances to the profit and loss statement. Mr. Kinney stated that he and his staff would try to resolve outstanding issues and obtain releases from his customers so that accrued liability balances could be released to the profit and loss statement in a particular quarter. He mentioned Qualcomm as an example of an issue that he thought he would be able to resolve in Q1 03. He also indicated that there were some matters not resolved in Q4 02 which he thought could be resolved in Q1 03.

[934] Finally, Mr. Kinney was referred to an Outlook, dated February 6, 2003, in which Wireless projected \$48 million in releases of accrued liability balances. Mr. Kinney agreed that it appeared that he already knew at the time of the February 3 phone call that Wireless was projecting \$48 million in releases of accrued liabilities.

[935] Projections about balance sheet releases were not always positive. Specifically, Mr. Kinney pointed out that when he was asked about possible releases of accrued liability balances

for Q2 03, he indicated there would be zero releases from Wireless in that quarter. In December 2002, Mr. Crosson told Mr. Harrison that he was considering increasing the accrued liability balance for excess and obsolete inventory by \$50 million. Mr. Harrison recorded this on his December 19, 2002 Outlook. Mr. Crosson changed his mind.

[936] I am satisfied that Mr. Kinney's recollection of the telephone calls of February 3 and February 19, 2003 is unreliable.

[937] I am also satisfied that the documentation confirms Mr. Harrison's evidence of these two teleconferences. The Q1 Roadmap at Exhibit 1, tab 45 was a target which represented an improvement upon Nortel's Q1 03 budget target. This target, I am satisfied, was communicated to Mr. Harrison by Mr. Beatty and then discussed with the Vice-Presidents of Finance of the various business units.

[938] I am satisfied that these discussions, as recorded in Mr. Harrison's notations on Exhibit 1, tab 45, represented two pieces of information: whether the business unit could meet the revised target and to what extent the unit would be relying upon releases of accrued liability balances.

[939] Nortel was in an extremely difficult financial situation; forecasting was both difficult and important.

[940] I am satisfied that Mr. Harrison was interested in this information because he thought it was part of his job to understand whether or not Nortel's various business units were generating positive net income on their operations.

[941] The reference to balance sheet releases in the Roadmaps is disconcerting. On the one hand, tracking releases suggests earnings management; on the other hand, it is undeniable that Mr. Kinney indicated that Wireless would have zero balance releases in Q2 03. Mr. Harrison noted his comments on Exhibit 1, tab 45, document number 505-5637. Mr. Kinney's comment of zero balances, as noted by Mr. Harrison at the time, is consistent with the Vice-Presidents of Finance for the business units keeping Mr. Harrison aware of the contribution anticipated from balance sheet releases in each quarter.

There was also a part of Nortel's culture which understood that the balance sheet could be used to achieve the target. In a July 31, 2003 e-mail, Mr. Gollogly makes the following observation: "it seems like a throwaway comment, but if we clean up the balance sheet, the LC's ability to deliver earnings based partly on discretionary elements pretty much goes away". There are other references in emails to digging up "opportunities" and having "flexibility".

[942] The claim by Mr. Harrison and Mr. Dans that they tracked proposed accrued liability balance sheet releases throughout the quarter in their Outlooks and Roadmaps for forecasting purposes and so that they could encourage events triggering these releases within the quarter is supported by notes that appear in the Outlook packages. For example, see the Q2 2003 Roadmap at Exhibit 2, tab 78. The Roadmaps also include notes concerning the setup of accrued liabilities and expenses (see: for example, Exhibit 1, tab 35). The Outlooks also include written notes concerning potential impacts which have yet to be included in the forecast (see also: Exhibit 1, tab 35).

[943] I am not satisfied that that these two telephone calls represent an example of Mr. Gollogly, Mr. Beatty and the Vice-Presidents of Finance of Nortel's business units discussing how they would each resort to their balance sheet without regard to US GAAP to meet the February Roadmap financial earnings before taxes target of \$20 million referred to in Exhibit 1, tab 45.

[944] I am satisfied that Mr. Harrison, for his own forecasting purposes, wanted to know the extent to which releases of accrued liability balances were assisting the business units in meeting their financial target.

[945] I am not satisfied that these two telephone calls represent Mr. Gollogly, Mr. Beatty and the Vice-Presidents of Finance of Nortel's business units deciding to use approximately \$100 million in excess accrued liabilities to meet financial targets.

The June 6, 2003 Outlook and the surrounding events

[946] The Crown also suggested that the true nature of the Outlook and Roadmap process was demonstrated by events which occurred around the June 6, 2003 Outlook.

[947] Mr. Beatty made notes of his attendance at the June 18 Frank Dunn Cabinet meeting. Mr. Dunn's cabinet consisted of the Presidents of Nortel's business units. Mr. Beatty's notes read in part "FAD Staff Meeting... Q2 results-embarrassed/ashamed-no RTP-grow the top line/cut costs".

[948] The Crown asked me to infer that Mr. Beatty recorded Mr. Dunn's comments. The e-mail traffic prior to the meeting makes it clear that Mr. Beatty was presenting his June 6, 2003 Outlook. As part of the backup for his presentation, Mr. Beatty had what was termed a "Q2 2003 Bottom-up Roll up". The Bottom-up Rollup reflected the actual experience of the business units in Q2 03 as of June 6, 2003. Q2 03 ended on June 30, 2003.

[949] The Bottom-up Rollup stated that, if the books were closed on June 6, 2003, Nortel would experience a pro forma loss before taxes of \$45 million and a loss calculated according to US GAAP of \$95 million.

[950] The Crown suggested that, on June 20, 2003, two days after the Frank Dunn cabinet meeting, Nortel's Bottom-Up Rollup suggested that, if the books were closed that day, Nortel would experience a pro forma gain before taxes of \$50 million and US GAAP net income of zero.

[951] This improvement, according to the Crown, resulted from a \$129 million increase in liability balances released to the profit and loss statement. Specifically, on June 6, accrued liability balance releases totaled \$179 million and, on June 18, totaled \$308 million.

[952] Finally, the Crown points out that the June 20 Outlook also tracked whether the required RSU Bonus Plan milestone would be met.

[953] If one accepts the Crown's argument, then one has to assume that the Presidents of the business units left Mr. Dunn's cabinet meeting on June 6 and returned to their business units and

began releasing accrued liability balances to the profit and loss statements to improve their financial performance so that Mr. Dunn would no longer feel “embarrassed and ashamed” and so that they would avoid any consequences attendant upon Mr. Dunn feeling like that. While this sounds plausible enough, it actually is not when you consider what was actually going on within Nortel at this time.

[954] Mr. Dans testified, and his evidence in this regard was not challenged, that Nortel had been going through a process of balance sheet reviews initiated by Mr. Gollogly in June 2003. These reviews are to be distinguished from the Comprehensive Balance Sheet Review which was formally launched on July 31, 2003. These reviews were being used to identify excess accrued liability balances, as well as any accrued liability balances that were to be released in Q2 03 in the normal course. All of these balances were fed centrally into corporate headquarters in Brampton so that headquarters could understand them. Initially, the accrued liability balances were released into the profit and loss statement and then reviewed by a corporate control team working with Deloitte & Touche. Obviously, some releases would be normal course releases and others would represent a cleaning-up of the balance sheet.

[955] Not surprisingly, it was in Q2 03 that Mr. Gollogly informed Mr. Hathway that \$142 million in releases for which there was no support had been released to Nortel’s profit and loss statement in an early preliminary closing of the general ledger.

[956] I do not find it logical that the Presidents of the business units would indiscriminately release accrued liability balances to attempt to satisfy Mr. Dunn in the face of this type of scrutiny. To the extent that these excess accrued liability balances represented a “cookie jar”, they were, in effect, at least partially emptying the “cookie jar” in a pointless exercise. Decisions to release liability balances which were not US GAAP compliant would likely be discovered when the release was reviewed by headquarters and the auditors.

[957] Assuming that the Presidents were upset by Mr. Dunn’s comments and move to do something about it, it is unlikely that this could have taken place between June 18 and June 20. Mr. Dans testified that his Outlooks were based on information which the business units had received and consolidated from the regions in which they were operating. When Mr. Harrison was soliciting the set-up of late entry accrued expenses/liabilities in Q4 02, his contacts within the Regions first had to call their own contacts to identify specific accrued expenses/liabilities. It seems reasonable that, in seeking to locate specific accrued liabilities for release, a similar process would be followed. It is difficult to see this being done within two days. Further, there was no necessity to complete the process within two days because Q2 03 did not end until June 30, 2003 and the business units were not required to close in their sub-ledgers for a few days after that.

[958] I cannot accept the Crown submission. The events surrounding the June 6 and June 20 Outlooks seem to me to be disconnected from the submission of accrued liability balances to Nortel head office.

The release of the \$4 million Siemens accrued liability balance

[959] The Crown suggested that the way in which the Siemens accrued liability balance was manipulated illustrated the management of earnings to achieve a bonus target. The Siemens \$4 million dollar release occurred originally in Q2 03. This is an appropriate place to examine that release in detail.

[960] In connection with the January 28, 2000 acquisition of a company called Qtera, that company and two of its employees were named as defendants in a lawsuit filed by Siemens ICN in Palm Beach County Florida. The lawsuit (Siemens v. Qtera, Diner & Cao) alleged, among other things, misappropriation of trade secrets.

[961] An accrued liability balance was set up to allow for the fact that Nortel might be unsuccessful in defending the lawsuit. The original accrued liability balance was in the amount of \$36 million; it was part of a larger entry involving various Qtera balances.

[962] The original accrued liability balance was set up in Q3 01. In Q4 01, a portion of this balance, namely \$32 million, was internally re-classified from Corporate to the United States where the litigation was taking place. This left the \$4 million balance in Corporate on account of the Siemens litigation.

[963] Mr. Beatty was Nortel's Controller at this time and responsible for Corporate accrued liability balances.

[964] Nortel entered into a settlement agreement with Siemens on September 17, 2001. Nortel's first payment to Siemens on account of the settlement in the amount of \$20 million occurred on October 25, 2001. A final payment of \$12 million due in October 2002 remained.

[965] Mr. Beatty was required, as the CFO, to authorize the final \$12 million payment. Upon being requested to authorize this payment, Mr. Beatty asked Mr. Gollogly, the Controller in October 2002, to look into the matter and advise him about it. Mr. Beatty was later told that the proposed final payment amount was correct and the final payment was made in October 2002. Accordingly, as of October 2002, approximately \$32 million of the original \$36 million accrued liability balance had been used. The accrued liability balance in the amount of \$4 million remained with Corporate.

[966] When Ms. Shaw met with Mr. Harrison in February 2003 to discuss Non-op accrued liability balances, she did not identify the Siemens \$4 million accrued liability balance as one that should be released.

[967] In the notes she prepared for her meeting on April 15, 2003 with representatives of Deloitte, the Siemens \$4 million was not part of the \$80 million that had been released in Q1 03. However, the \$4 million Siemens accrued liability balance was referred to in Ms. Shaw's notes as a Non-op liability balance. Specifically, Ms. Shaw recorded: "this provision was established in Q3 01 for potential exposures relating to a legal suit with Siemens. This settlement was made in Q4 02 after extremely rancorous dealings with Siemens. It was determined by management that this provision would be left in place for a couple of quarters after the settlement to ensure no further claims were made or adjustments to the settlement".

[968] The Siemens \$4 million accrued liability balance was released to the profit and loss statement in Q2 2003; ultimately, the \$4 million excess accrual balance was restated during the First Restatement to Q4 2001 when the litigation was settled.

[969] Deloitte's view in the first restatement was that this matter should not have remained an accrued liability balance after the settlement was entered into in Q4 01.

[970] The Crown suggested that accrued liability balances were restated because they were false. This entry, along with others, illustrates the difficulty with the Crown's assertion. Simply put, the Crown's submission ignores the possibility that there can be a difference of opinion.

[971] Indeed, there would have been a difference of opinion in connection with this entry. Mr. Hathway stated that proper accounting mandated that there be no remaining accrued liability balance for this matter subsequent to the final payment, rather than the entering into of the settlement agreement. Mr. Hathway's opinion, as expressed in his evidence and Deloitte's opinion during the First Restatement are obviously different.

[972] The truth of the matter probably is that there is more than one financial quarter to which this \$4 million accrued liability balance could properly be restated. Put differently, one chartered accountant might conclude that the triggering event for the release of the accrued liability balance was the entering into of the written settlement of the litigation in Q4 01; another chartered accountant acting in good faith might conclude that the triggering event for the release of the accrued liability balance was Nortel's final settlement payment.

[973] Interestingly, the Crown asserted, in its closing submissions that the correct course of action was to clear the \$4 million from Nortel's balance sheet after the final settlement payment.

[974] Management's decision to release the accrued liability balance one or two quarters after the final settlement payment was excessively cautious, but entirely consistent with Nortel's culture.

[975] I decline to draw any inculpatory inference from the retention of the accrued liability balance, given Nortel's history of ensuring that every liability was properly provided for.

[976] The Siemens accrual liability balance had been on the Nortel balance sheet since 2001 and, thus, had been reviewed in one form or another for every quarter since then. No secret was made of the fact that the litigation had settled and that Nortel had made a \$20 million payment on account of that settlement in October 2001.

[977] As discussed elsewhere, in Q2 03, Mr. Gollogly advised Mr. Hathway about the release during a preliminary close of the books of \$142 million in accrued liability balances. Mr. Hathway did not approve of this release, with the result that the \$142 million was returned to Nortel's balance sheet in subsequent draft Q2 03 financial statements. However, the \$4 million Siemens balance remained released. Given the controversial nature of the \$142 million accrued liability balance release in Q2 03, I am satisfied that Deloitte adverted to the Siemens release at that time.

[978] The Crown's position is that the Siemens accrual was not released when it should have been and remained for the accused to utilize in Q2 03 in order to achieve a Restricted Stock Unit Bonus Plan milestone.

[979] This assertion requires some consideration of the Restricted Stock Unit Bonus Plan.

The Restricted Stock Unit Bonus Plan

[980] As the name implies, this bonus was payable in shares unless the executive receiving the bonus elected to receive payment in cash. No such election was made in Q2 2003.

[981] Payment of this bonus was not made on an "all or nothing" basis. In other words, a percentage of the total allocation for a particular quarter could be paid. For example, the JLRC Committee of the Board of Directors (the Board's HR Committee) could determine and recommend to the Board of Directors that 90% of the bonus was earned, in which case that percentage of the bonus would be paid out.

[982] The performance period for payment of this bonus was January 1, 2003 to December 31, 2005. The proposed performance milestones were four distinct "Return on Sales before Tax" percentage targets. The percentage was calculated on Sales, as the description of the milestones suggests. In other words, the milestone considered what percentage Nortel's return on sales before tax was of total sales. In addition, the milestones were calculated "on a **rolling four** quarter basis". [Emphasis added]

[983] The first milestone required a Return on Sales before Tax percentage of sales of equal to or better than negative 6.5% calculated "on a rolling four quarter basis."

[984] The "rolling four quarter basis" for the calculation means that, if you want to make the Restricted Stock Unit Bonus Plan milestone calculation in Q2 03, you have to look back four quarters starting with Q2 03; namely, Q2 03, Q1 03, Q4 02 and Q3 02.

[985] The final payment on account of the Siemens settlement was made in Q4 02. If the \$4 million had been released to the profit and loss statement in Q4 02, as Mr. Hathway thought it should, it would have been included in the RSU Bonus Plan milestone calculation in the same way as it was when it was originally released in Q2 03 because the calculation of the percentage is "on a rolling **four** quarter basis" and Q4 02 and Q2 03 are in the same four quarter set.

[986] Accordingly, the release of the \$4 million to the profit and loss statement in Q4 02 or Q2 03 would have the same effect on the ability of the accused to benefit from the Restricted Stock Unit Bonus Plan.

[987] The Crown's position seems to be that, because the Siemens accrual was not released when it should have been, it remained in a "cookie jar" to be utilized in Q2 03 in order to achieve the RSU milestone.

[988] In the first restatement, the \$4 million was restated to Q4 01 when Nortel and Siemens entered into their settlement agreement. It is true that, at that point in time, Mr. Dunn was the CEO and Mr. Beatty was the Controller. I am not satisfied that the evidence demonstrates that

Mr. Dunn or Mr. Beatty played any role in the decision to retain the \$4 million Siemens accrual balance in Corporate in Q4 2001.

[989] It is also true that, in Q4 01, Nortel reported negative net income of \$1.8 billion. I am not persuaded that, in that quarter facing that level of negative net income, Mr. Beatty and Mr. Dunn decided to manipulate liabilities and set them aside in a “cookie jar” for a rainy day. It seems more reasonable to me that their thoughts at the time would be that the rainy day was upon them.

[990] Ms. Shaw’s note, based on her inquiries, was prepared in Q1 03 and it provides that management decided to leave the \$4 million excess accrued liability balance in place for a “couple of quarters” to ensure no further claims were made and that there were no further adjustments to the settlement. Her note suggests that management made a decision in Q4 02 to retain the \$4 million as an accrued liability for a “couple of quarters” which would be to Q2 03, which was the quarter when the \$4 million was released to the profit and loss statement. This decision meant there were no surprises in connection with the Siemens settlement without making it harder to achieve the Restricted Stock Unit Bonus Plan milestone of -6.5% calculated on a rolling 4 quarter basis.

[991] Leaving the accrued liability on the balance sheet for a time after it was releasable is consistent with Mr. Kinney’s approach to releasing accrued liabilities. Mr. Kinney said he followed the practice of allowing a cooling-off period, when he reached a point in time when he thought he could reduce an accrued liability balance. Specifically, he would wait one extra quarter to make sure that some unexpected exposure did not present itself. This is similar in approach to what happened with the Siemen’s \$4 million. I do not condone Mr. Kinney’s practice because it was contrary to US GAAP; I simply mention it.

Conclusion

[992] I am not satisfied beyond a reasonable doubt that the three accused used the \$4 million Siemens accrued liability balance to falsely represent to Nortel’s Audit Committee, JLRC committee and board of directors that Nortel had achieved the financial results of meeting the Restricted Stock Unit Bonus Plan milestone of -6.5%.

[993] I am not satisfied that the restatement of this accrued liability balance to Q4 01 proves anything. Mr. Hathway thought that the accrued liability balance should have been released in Q4 02 when the final settlement payment was made. This seems to be a reasonable conclusion. It apparently was not correct according to Deloitte’s opinion in the first restatement. The difference of opinion demonstrates that one should be careful before drawing an inculpatory inference based, in part, on the fact that an accrued liability balance was restated. The circumstances surrounding the restatement of an item are significant.

[994] Finally, I am not satisfied beyond a reasonable doubt that any or all of the three accused knew that the \$4 million Siemens’ accrued liability balance should have been released in Q4 01.

The draft letters Mr. Gollogly prepared for the Board of Directors and the Audit Committee in July 2003

[995] Some of the evidence concerned two unsent letters authored by Mr. Gollogly, in which he questioned whether Nortel had truly returned to profitability. The Crown pointed out that the three accused never expressed similar sentiments in Nortel's financial statements or press releases. The relevant time period is July 2003.

[996] Mr. Hathway testified that, shortly before Monday, July 7, 2003, Mr. Gollogly advised him that, in the initial close or one of the initial closes of the books for Q2 03, Nortel had identified \$142 million of accrued liabilities that did not have support and had released those accrued liabilities to the profit and loss statement.

[997] After Mr. Hathway objected, Mr. Gollogly reversed the \$142 million out of the profit and loss statement and put it back on the balance sheet. This reversal happened on Thursday, July 10, 2003.

[998] Mr. McMillan testified that the draft financial results, produced after the \$142 million was returned to the balance sheet, recorded that Nortel had a US GAAP loss of \$14 million for Q1 03.

[999] Mr. McMillan testified that, on Friday, July 11, 2003, he was advised by his superior, Mr. Peter Browne, to make three journal entries. Mr. McMillan said that Mr. Browne provided him with support for the entries and they were made on Friday, July 11, 2003.

[1000] These entries transferred \$20 million in accrued liability balances to the profit and loss statement. They, therefore, had a positive impact of \$20 million on the profit and loss statement. As indicated earlier, prior to this entry, Nortel had a US GAAP loss of \$14 million; thus, this \$20 million positive impact on net income had the effect of changing the \$14 million tiny US GAAP loss into to a tiny gain.

[1001] Nortel's pro forma income for Q2 03 was positive despite the return of \$142 million to the balance sheet.

[1002] Thus, the effect of these three journal entries was that Nortel had both positive pro forma income and positive US GAAP income.

[1003] Mr. McMillan testified that Mr. Gollogly was away when this happened.

[1004] The evidence established that Mr. Dunn had expressed publicly to Mr. Harrison that he did not believe it was in Nortel's interest to have a pro forma gain before taxes and a US GAAP loss at the same time. This was always a possibility because pro forma net income was calculated differently than US GAAP net income.

[1005] Mr. Hathway testified that, on Sunday, July 13, 2003, Mr. Gollogly called him at his home in the United States. Mr. Gollogly told Mr. Hathway that while he, Mr. Gollogly, was out of the office on July 11, 2003; Mr. Beatty had instructed Mr. Gollogly's staff to post three journal entries which transformed the Q2 2003 results from a tiny loss to a tiny profit. Mr.

Hathway indicated that he and Mr. Gollogly agreed to discuss the matter further on Monday, July 14, 2003 when he, that is Mr. Hathway, would be back in Canada.

[1006] Mr. Hathway indicated that Mr. Gollogly's concern centered on the fact that turning a loss into a profit was one of the qualitative factors to be considered in deciding whether an entry to the General Ledger was material.

[1007] Mr. Hathway testified that he saw Mr. Gollogly on Monday, July 14, 2003 at Mr. Gollogly's office in Brampton. He said Mr. Gollogly was very upset about the entries. Mr. Gollogly told Mr. Hathway that he was going to see Mr. Beatty and demand that the three entries be removed from the profit and loss statement and put back on the balance sheet. Mr. Gollogly advised Mr. Hathway that he intended to resign if Mr. Beatty refused. Mr. Hathway described this as a "gutsy move by Mr. Gollogly".

[1008] The three entries were reversed.

[1009] Mr. Hathway indicated that, later, he had a conversation with Mr. Beatty about what had happened. Mr. Hathway indicated that Mr. Beatty's view was that he, that is Mr. Beatty, was Nortel's CFO and, therefore, entitled to make General Ledger entries.

[1010] This is perhaps an appropriate place to make the obvious point that these three entries never had any effect on the profit and loss statement published by Nortel for the period Q2 03. The three entries were put back on the balance sheet before the financial results were published. These entries did not cause the Audit Committee or the Board of Directors to do anything.

[1011] Similarly, the \$142 million in balances released to the profit and loss statement and then returned to Nortel's balance sheet never had an effect on the profit and loss statement published by Nortel for the period Q2 03. The \$142 million was brought to the attention of Nortel's Audit Committee because it prompted the Comprehensive Balance Sheet Review.

[1012] With respect to the three entries totaling \$20 million, the Crown submits that this is another example of senior management at Nortel, in this case Mr. Beatty, doing whatever it takes to meet a target. It is also the Crown's position that I should draw the inference that Mr. Dunn was aware of these matters and approved of Mr. Beatty's actions.

[1013] I have already indicated that I have no difficulty in drawing the inference that Mr. Dunn was aware of important matters affecting Nortel's profit and loss statement. This is especially true with respect to these three matters because they had the effect of turning a tiny US GAAP loss into a tiny profit and Mr. Dunn had publicly-stated that Nortel would be profitable for Q2 03.

[1014] In addition, Nortel, despite the fact that the \$142 million was not released to the profit and loss statement, still had a pro forma profit and, therefore, was in a position that Mr. Dunn did not think advisable; namely, a pro forma profit and a US GAAP loss. Specifically, Mr. Dunn did not want Nortel to be reporting a US GAAP loss while, at the same time, reporting internally positive pro forma income because reporting positive pro forma income would require the payment of bonuses. Mr. Dunn was concerned that Nortel would be criticized for paying its employees bonuses when it was publicly reporting a loss.

[1015] In Q1 03, Nortel reported US GAAP results only. Accordingly, Nortel was publicly reporting a loss and publicly reporting that it was paying bonuses to its employees.

[1016] Mr. Gollogly reported to the Board on July 24, 2003, which was after the \$142 million had been removed from the profit loss statement and returned to the balance sheet, that there was positive pro forma income for the quarter of \$40 million and a positive pro forma income for the year to date of \$48 million. It is not clear from Mr. Gollogly's presentation whether this was a pro forma income calculation according to the 2002 formula or the 2003 formula. The Board of Directors had decided that it was the 2002 formula which was to be used for bonus purposes. However, the evidence suggested that the 2002 formula yielded a higher net income figure than the 2003 formula.

[1017] Mr. Beatty's instruction to release the \$20 million in accrued liabilities to the profit and loss statement had the effect of solving this problem because it converted the tiny US GAAP loss into a profit and thereby created a situation in which Nortel would have been publicly reporting US GAAP net income and publicly reporting that it was paying a bonus.

[1018] I accept the Crown's submission that Mr. Beatty's conduct demonstrates he was, with Mr. Dunn's knowledge and consent, willing to go to considerable lengths to achieve a targeted result.

[1019] I am satisfied that this episode proves that Mr. Beatty, with Mr. Dunn's consent, was prepared to go to considerable lengths to avoid a situation which Mr. Dunn considered awkward.

[1020] I am satisfied that the only reason Mr. Beatty intervened as he did was to manage Nortel's US GAAP income for the purpose of turning a tiny loss into a tiny profit. The effort was unsuccessful.

[1021] To help Mr. Beatty understand how unhappy he was with the three Journal entries, authorized in his absence, Mr. Gollogly prepared two draft letters which were never sent.

[1022] The Crown submits that this entire incident demonstrates that entries made to the General Ledger were intentional. The Crown also submits that these letters demonstrate that Mr. Gollogly was well aware of the significance of turning a tiny loss into a tiny profit or *vice versa*.

[1023] I am satisfied that Mr. Gollogly well-understood the significance from a materiality perspective of turning a tiny profit into a tiny loss or *vice versa*. I am satisfied that the draft letters demonstrate that Mr. Beatty was capable of directing entries to the General Ledger that were quite intentional and quite significant.

[1024] I want to consider the Crown's submission that Mr. Gollogly's concern about Nortel's quality of earnings and return to profitability were not disclosed by Mr. Gollogly or Mr. Beatty. I have no difficulty in assuming that Mr. Gollogly brought the draft letters to Mr. Beatty's attention and used those letters to help persuade Mr. Beatty to reverse the entries to which Mr. Gollogly objected.

[1025] I propose to consider each draft letter separately.

Mr. Gollogly's draft letter to the Chairman of the Board of Directors, the Chairman of the Audit Committee and the Chairman of the Joint Leadership Resources Committee

[1026] This undated draft letter was never sent. However, Mr. Gollogly's draft letter to Mr. Beatty, which was also introduced in evidence, is dated July 14, 2003. I am satisfied that this draft letter was drafted at the same time as the draft letter to Mr. Beatty. The content of the two letters is similar. In addition, the evidence establishes that Mr. Gollogly was in the mood to resign if the three entries were not reversed and the effect of this draft letter, had it been sent, would almost certainly have been his termination.

[1027] In this draft letter, Mr. Gollogly indicates that, due to the fact that the SEC was making inquiries of Nortel in April and May 2003, it was necessary to be particularly vigilant in the application of accounting issues within the company.

[1028] Mr. Gollogly then called attention to unsupported accrued liability balances on Nortel's consolidated balance sheet which he placed in the area of \$192 million. I should note at this point that Mr. Gollogly's \$192 million is the same as the \$142 million referred to in these reasons. The \$142 million was specifically discussed by the Audit Committee. The \$50 million was actually the Intercompany Out Of Balance account which was under review by the auditors and not a secret. Nortel's auditors publicly-reported a problem with Nortel's internal controls which referred to the \$142 million that, for a short time, had been released to income. Mr. Richmond indicated that, when these matters were discussed, some people spoke of \$142 million and others spoke of \$192 million. Mr. Richmond testified that everyone was speaking about the same set of numbers.

[1029] Mr. Gollogly then disclosed that management had a forecast suggesting a \$75 million pro forma loss in Q3 03. He indicates that this forecast begs the question whether further restructuring is required. He suggests that a change in the company-stated policy that a small loss position is un concerning may be in order.

[1030] Finally, Mr. Gollogly says that the Q3 03 forecast calls into question the quality of the Q2 03 results.

[1031] The forecast to which Mr. Gollogly refers was, in a word, incorrect. Nortel reported positive net income of \$185 million in Q3 2003. Nortel's published results for Q3 2003 were not restated in the first restatement. Financial results for Q3 03 were restated in the second restatement. Net earnings remained positive in the amount of \$131 million despite the revenue recognition issues that were prevalent during that restatement.

[1032] In addition, the Crown, in its opening, suggested that the Q3 03 results had been affected by improper earnings management techniques employed by the accused. Evidence was received concerning the extent to which Nortel and Deloitte's staff preserved the integrity of the general ledger for Q3 03. As indicated in my discussion of the financial results for Q3 03, I accept that evidence. I am satisfied that the integrity of the Q3 03 general ledger was maintained.

[1033] Mr. Gollogly then makes reference to a positive impact of \$51 million to the Q2 2003 profit and loss statement. He also makes the point that Nortel's gross margins contain approximately \$50 million worth of positive adjustments due to changes in estimates.

[1034] Mr. Gollogly made a presentation to the Board on April 24, 2003, in which he specifically noted and highlighted at page 38 of his presentation, the \$51 million to which he referred in his draft letter. Thus, the Board of Directors was made aware of this concern.

[1035] The \$50 million in gross margin adjustments was not discussed by Mr. Gollogly. No opinion evidence was offered concerning gross margin calculations. Mr. Harrison indicated that typically Nortel's gross margins were approximately 40%. His evidence in that regard was on contentious.

[1036] In his draft letter, Mr. Gollogly makes reference to the July 11, 2003 journal entries. These entries were reversed on July 14, 2003.

[1037] Mr. Gollogly indicates that he questions the wisdom of making bonus payments because the Q2 03 results are affected by the two items referred to above which total \$101 million. Mr. Gollogly notes, in his letter, that there are many other factors to consider when determining whether to pay bonuses. This latter observation is correct. The evidence disclosed that Nortel's competitors were approaching key Nortel employees and urging them to leave the company. This was a primary reason for the creation of the Return to Profitability Bonus.

[1038] Mr. Gollogly indicates in the draft letter that he feels so strongly about the payment of the bonuses that he will not accept his return to profitability bonus. Mr. Gollogly obviously thought better of the matter and, in fact, accepted his bonus.

Conclusion

[1039] When I consider the content of this draft letter and the other evidence, I am not prepared to accept the Crown submission in regard to the disclosure of the contents of this letter.

[1040] I am satisfied that Mr. Gollogly's concern about the prospects for Q3 03 was misplaced. I am satisfied that the other matters concerning earnings were disclosed to the Audit Committee and, through the Audit Committee, to the Board of Directors with the exception of the gross margin adjustments. There was public disclosure of the Comprehensive Balance Sheet Review and the fact that the auditors had identified a reportable condition as a result of the attempt to release the \$142 million. Finally, Mr. Gollogly's concern over the appropriateness of paying a bonus was a matter beyond his authority. The decision to pay a bonus was a decision for the JLRC committee of the board and the Board of Directors as a whole.

Mr. Gollogly's draft letter to Mr. Beatty

[1041] This is the second draft letter to which the Crown referred.

[1042] Mr. Gollogly begins his letter by referring to certain elements of the Q2 results with which he is uncomfortable.

[1043] He first refers to what he called the three final July 11, 2003 journal entries. These are the three entries totaling \$20 million. He speaks to the need for supporting documentation and indicates to Mr. Beatty that he, that is Mr. Beatty, will have to sign each of the three journal entries. He also indicates that a memo or note is required explaining why the three final entries are not material.

[1044] The three final Journal entries to which Mr. Gollogly objects were reversed on July 14, 2003 prior to the publication of Nortel's financial statements.

[1045] Mr. Gollogly then indicates that he is insisting upon a full and fair discussion of two key elements of the Q2 2003 results with the Audit Committee.

[1046] The first is the inclusion of the \$101 million composed of the \$51 million of customer financing services and \$50 million relating primarily to contract changes in estimates and contract finalization in Nortel's Q2 03 profit and loss statement.

[1047] Nortel's press release, dated July 24, 2003, discloses the fact that selling, general and administrative expenses included the US\$51 million benefit to which Mr. Gollogly referred. In addition, Mr. Gollogly made a presentation to the Audit Committee concerning this \$51 million.

[1048] The second is that the balance sheet as at June 30 contains \$142 million of accrued liabilities that Nortel is investigating and approximately \$50 million of accrued liabilities relating to what he refers to as the "now infamous intercompany out of balance provision..." Mr. Gollogly wants the Board informed that these provisions will likely need to be reversed into the profit and loss statement when Nortel's analysis is complete.

[1049] The second point suggests Mr. Gollogly thinks that the Board needs to know that \$192M will be "reversed into the P&L at some point in the future". If this is what he means, he was simply mistaken concerning what would become of the \$142 million. The Audit Committee and the Board of Directors were well aware of the \$142 million.

[1050] Mr. Richmond indicated that, when these matters were discussed, some people spoke of \$142 million and others spoke of a \$192 million. Mr. Richmond testified that everyone was speaking about the same set of numbers.

[1051] Mr. Richmond also testified that the \$50 million Out Of Balance accrued liability balance, which Mr. Gollogly in his draft letter referred to as the "now infamous intercompany out of balance provision...", had been the subject of discussion between Mr. Dunn and the audit partners for months.

[1052] Due to the fact that Mr. Gollogly referred to the Intercompany Out Of Balance account as "infamous", I think it is appropriate to consider that account in some detail.

The "now infamous intercompany out of balance provision"

[1053] Mr. Richmond indicated that Nortel had maintained an Intercompany Out Of Balance account for many years. Mr. Richmond explained that, when you have a company as large as Nortel, there are transactions that flow from one company to another within Nortel's corporate

world. Therefore, you will have balances due to and due from the various entities in Nortel's corporate world. When you come to do a consolidation, these balances should net out to zero but frequently do not. As a result, an accrued liability balance is maintained to account for the discrepancy. In Nortel's case, this had been true for some years.

[1054] Mr. Richmond indicated that Nortel's Intercompany Out Of Balance accrued liability balance fluctuated. In the years 2001 and 2002, the quantum of the account was driven up with the result that the balances due to and due from the various entities in Nortel's corporate world were out of balance by as much as \$100 million.

[1055] Mr. Richmond explained that Deloitte wanted to work through a reconciliation process and reconcile the balances due to and due from the various Nortel entities to attempt to bring the Intercompany Out Of Balance accrued liability balance to zero.

[1056] Mr. Richmond indicated the Intercompany Out Of Balance account had been the subject of discussion between Mr. Dunn and the audit partners for months.

[1057] The Intercompany Out Of Balance account was well-known to Deloitte. It was the subject of two detailed Deloitte memos, dated April 10, 2003 and April 16, 2003 (Exhibit 227, tab 79). The memos were received as business records of Deloitte & Touche. Neither of the Deloitte's accountants who authored these memos was called as a witness.

[1058] These memos explain, in part, that the Intercompany Out Of Balance account is reviewed monthly and that, at that time, discrepancies are identified. Importantly the memos disclose that discrepancies identified as "material" are cleared.

[1059] The Intercompany Out Of Balance account balance fluctuated as a result of judgment exercised at the senior management level of Nortel concerning what was sufficient. Therefore, the opportunity to achieve an earnings target by varying the Intercompany Out Of Balance account balance presented itself. However, the account was well-known and scrutinized by Deloitte & Touche and material discrepancies were cleared monthly.

[1060] Specifically, the April 16, 2003 memo demonstrates that the reduction in the Intercompany Out Of Balance accrued liability balance by \$35 million, which formed part of the contentious \$80 million Q1 03 release to income, was reviewed prior to the finalization of the Q1 03 financial statements. The reduction was found to be unobjectionable.

[1061] There was nothing infamous about the Intercompany Out Of Balance account. Mr. Gollogly's reference may have been facetious; in which case, it is understandable. If the reference was serious, it was erroneous.

Mr. Gollogly's reference to the unsupported accrued liability balances

[1062] Mr. Richmond indicated that he met with Mr. Dunn between July 11 and July 15, 2003. They agreed that the \$142 million would be "warehoused" on Nortel's balance sheet pending the outcome of the Comprehensive Balance Sheet Review. While Mr. Richmond and Mr. Dunn resolved the matter between July 11 and July 15, in fact, Mr. Gollogly had already reversed the

entry on July 10, 2003. I interpreted Mr. Richmond's evidence to be that Mr. Dunn agreed to leave the \$142 million on Nortel's balance sheet.

[1063] Mr. Richmond indicated that there was a longer discussion concerning Deloitte's insistence that there be a comprehensive balance sheet review. Mr. Dunn said that he had been the Controller, the CFO and the CEO and that he was intimately aware of Nortel's financial affairs and that it was his view that the \$142 million was the end of the matter. Accordingly, it was Mr. Dunn's view that the \$142 million should be released to the profit and loss statement and disclosed in Nortel's Q2 03 press release. Mr. Richmond testified that he expressed Deloitte's view that a comprehensive balance sheet review was required to corroborate Mr. Dunn's position. Mr. Richmond also expressed the view that simply releasing \$142 million of accrued liability balances into a profit and loss statement that otherwise showed a loss of \$14 million would not satisfy regulators.

[1064] Mr. Richmond indicated that, during the meeting, Mr. Dunn agreed that a comprehensive balance sheet review was necessary.

[1065] The minutes of the Audit Committee meeting in July 18, 2003 indicate that Mr. Gollogly made a presentation concerning Nortel's Q2 03 results. His presentation was described as preliminary and subject to change. Part of his presentation outlined "Key Issues." The first item under this heading was entitled "Reserves". Mr. Gollogly's notes indicate that he made reference to the fact that: significant reserves and provisions were recorded on the balance sheet; significant additions, usages and releases of those reserves and provisions had occurred in Q2 03; management had a project underway to gather support and determine the proper resolution of certain reserve balances.

[1066] Mr. Cleghorn confirmed that, at the July 23 Audit Committee meeting, Mr. Dunn indicated that, while he was not pleased at the prospect of a comprehensive balance sheet review, it would result in stronger financial statements.

[1067] Minutes of the Audit Committee for July 24, 2003 indicate that Mr. John Cawthorne made a presentation dealing specifically with an analysis of Nortel's balance sheet. In his presentation, he pointed out that certain balance sheet accruals and provisions were established by management in prior periods dating back to 1999 and earlier. He indicated that these accruals and provisions were recorded by the company during periods when the balance sheet and income statement were much larger. Mr. Cawthorne indicated that these accruals and provisions were receiving greater scrutiny due to the shrinking size of Nortel's overall balance sheet and their materiality to the income statement. His presentation points out that there is a lack of documentation about certain accruals and that, as a result of that and the passage of time and the turnover of personnel, it is unclear what adjustments should have been made to these provisions in prior years. As a result, management has a project underway to gather support and determine the proper resolution of these questionable balances.

[1068] Prior to making this presentation Mr. Cawthorne and Mr. Hathway had received a soft provisions list in February 2003 which listed \$413 million in soft provisions or accrued liability balances was questionable support.

[1069] Finally, Nortel's press release of July 24, 2003 announced a Comprehensive Balance Sheet Review.

[1070] I am satisfied that what Mr. Gollogly mistakenly thought was a problem involving only \$142 million of accrued liability balances and \$50 million of Intercompany Out Of Balance accrued liability balances was brought to the attention of the Audit Committee as Mr. Gollogly suggested in his draft letter.

[1071] I am satisfied that, as of July 24, 2003, some ten days after the date on Mr. Gollogly's draft letter, the Audit Committee was well-aware of the fact that there were potential problems with accrued liabilities.

Mr. Gollogly's reference to the forecasted Q3 03 loss

[1072] Mr. Gollogly also records in this draft letter that he wants a discussion at the Audit Committee of the fact that the current Q3 03 forecast projects a loss in circumstances where the projected revenue for Q3 03 is the same as the actual revenue in Q2 03.

[1073] As indicated in my discussion of Q3 03, this forecast was simply wrong. Nortel reported net income of \$185 million calculated according to the US GAAP despite the fact that revenue for Q3 03 was flat to Q2 03.

[1074] Nortel's published results for Q3 03 were restated in the second restatement; net income was positive in the amount of \$131 million after restatement.

[1075] Nortel also reported positive net income in Q4 03 of \$528 million (Exhibit 85B).

[1076] Mr. Gollogly's concern in this regard seems to have been misplaced.

Mr. Gollogly's concern about Nortel's internal controls

[1077] Finally, due to the fact that there were late adjustments and an ongoing review of unsubstantiated or poorly-supported accrued liabilities, Mr. Gollogly wanted a full debate with Mr. Nick DeRoma, Nortel's General Counsel, on the adequacy of Nortel's internal controls.

[1078] I am not certain whether a debate involving Mr. DeRoma, Mr. Gollogly and others within Nortel took place.

[1079] Mr. Cawthorne, in his presentation to the Audit Committee of July 24, 2003, brought to the committee's attention that Deloitte had identified a reportable condition which, in my view, was sufficient to bring to the Audit Committee's attention the fact that Nortel was experiencing an internal control problem.

Conclusion

[1080] Generally, I am satisfied that the matters of concern to Mr. Gollogly, which he expressed in his draft letter to Mr. Beatty, were disclosed to the Audit Committee. Mr. Gollogly's concern

about earnings in Q3 03 was misplaced. The other issues were disclosed to Nortel's Audit Committee and Board of Directors.

The language in the 2003 press releases and the notes to the first restatement

[1081] The Crown objected to a statement in the press release, dated April 24, 2003, which stated that Nortel's reported results included approximately \$80 million of favorable impacts associated with reductions in accrued liability balances. The press release went on to say that these favorable impacts were more than offset by costs related to the Return to Profitability Bonus Plan and stock-based compensation.

[1082] There is no basis for this objection. The return to profitability bonus was estimated to cost \$73 million. This amount is very close to the \$80 million in favorable impacts. The two entries basically offset each other.

[1083] What is not true is that the \$80 million in favorable impacts permitted Nortel to pay the return to profitability bonus that it would otherwise not have been able to pay. As explained elsewhere, I am not satisfied that such a conclusion is proven by the evidence.

[1084] In my view, the press release simply says that Nortel's earnings were not inflated by this \$80 million because Nortel's expenses included an employee bonus of virtually the same amount of money. The statement in the press release is not false and no objection can properly be maintained to it.

[1085] The Crown also objected to the same press release because it failed to properly describe the \$80 million as excess accruals.

[1086] The Crown also objected to the press release because it said that the press release alluded to the \$80 million in a manner that was almost unintelligible.

[1087] The press release stated "in the first quarter of 2003, our SG&A and R&D and other income-net included approximately \$80 million of favorable impacts associated with reductions in accruals which principally related to the accumulation of charges associated with the integration activities of previously acquired companies and operations originally structured as joint ventures as well as miscellaneous tax matters..."

[1088] The procedure for drafting press releases was not explicitly spelled out in the evidence. The evidence did disclose, however, that there was an Investor Relations Committee and a Press Release Working Group that was a subcommittee of that committee that decided on the wording of press releases. Various persons were canvassed for their views. In addition, the committee had the assistance of internal and external securities lawyers. In addition, Mr. Cleghorn indicated that the Audit Committee would not approve press releases without a sign-off from Nortel's auditors. Mr. Richmond confirmed that he assisted in drafting the April 24, 2003 press release.

[1089] On the evidence before me, I am not prepared to conclude that any or all of the accused are entirely responsible for the wording of Nortel's press releases announcing financial results and other material matters. I am satisfied that the press release was the product of many people

including outside counsel. I also do not accept the Crown's characterization of the wording of the press release as far as the \$80 million was concerned.

[1090] The Crown also asserted that Conservatism was contrary to US GAAP and disclosure of the existence of this practice within Nortel was required in the press release.

[1091] As indicated elsewhere, I am not satisfied that the evidence established that Conservatism was contrary to US GAAP.

[1092] The Crown also suggested that the introductory note to the restated financial statements was false and relied upon a draft note prepared by Mr. Gollogly. Mr. Gollogly's draft was his suggestion concerning the wording of the note that would accompany the restated financial statements and the Item 4 disclosure required by the September 30 10-Q report.

[1093] In his draft of the note, Mr. Gollogly, in part, states the following:

- Nortel initiated a comprehensive review in the 2nd quarter of fiscal 2003;
- the objective of the review was to assess whether previously-recorded accrued liability balances could potentially have a material impact on future financial results;
- preliminary observations indicated a lack of support and documentary evidence for certain accrued liabilities established in fiscal 2002 and 2001;
- the review is now completed and preliminary results indicate that certain accrued liabilities recorded in 2002 and 2001 were either overstated or not drawn down in the correct fiscal period;
- the systemic causes of these errors are the high level of conservatism used to identify Nortel's financial exposure during the period of business realignment, significant workforce reductions resulting in departures from stated finance policies and lost business knowledge around specific internal control processes; and,
- Nortel has determined the need to voluntarily restate its financial statements for the errors contained in previously reported financial statements because the aggregate impact would be material to future financial results.

[1094] Mr. Gollogly indicates an email to Mr. Beatty attaching the draft that this was the first note that he had drafted.

[1095] The first restatement of the financial statements for Q2 03 included a note which disclosed that:

- Nortel had initiated a comprehensive review of its assets and liabilities;
- in excess of \$900 million in accrued liability balances needed to be restated;

- these balances were either initially recorded incorrectly in prior periods or not properly released to the profit and loss statement in the appropriate period;
- in certain cases these accrued liability balances had not been adjusted for changes in estimates in the appropriate periods;
- certain other errors which were not material were also corrected;
- Nortel made certain revenue adjustments, corrected errors related to its deferred income tax assets and foreign-currency accounts and reclassified adjustments to its consolidated balance sheet;
- certain accruals and provisions should not have been recorded because the appropriate conditions in documentation supporting the establishment of these accruals and provisions did not exist at the time of recognition. These accrued liability balances were re-profiled to the periods in which they were created and then eliminated;
- Nortel identified situations where accrued liability balances had been released to the profit and loss statement in inappropriate periods. These accrued liability balances have been recognized in the appropriate periods;
- the restatement includes the release of accrued liability balances established to bring the intercompany payables and receivables into balance. (I note that this is a reference to the Intercompany Out Of Balance account which occupied a certain amount of attention during the course of this trial); and,
- excessive accrued liability balances for discretionary bonuses have been adjusted.

[1096] The Crown relies on the fact that Mr. Gollogly states in his draft that the systemic causes for overstating accrued liability balances or failing to draw them down in the correct fiscal period was a high level of Conservatism used to identify financial exposure during the period of Nortel's realignment from 2000-2002.

[1097] The note in the financial statements does not use the word Conservatism, but it discloses that accrued liability balances were recorded incorrectly in prior periods, not properly released, not adjusted for changes in estimates in the appropriate period.

[1098] The Crown indicated, in its opening, that Conservatism was contrary to US GAAP. The evidence did not support such a conclusion.

[1099] The Crown complained that the press release announcing the first restatement did not say that the restatement was required due to a systemic tendency to overstate accrued liabilities.

[1100] It is true that the note to the restated financial statements does not say that there was a systemic or cultural tendency in Nortel to set-up accrued liability balances on a worst-case

scenario basis. The restatement, however, discloses that over \$900 million in accrued liability balances were excessive because they were not recorded properly, not properly released or not adjusted in a timely manner. The restatement discloses that this happened in 2000, 2001, 2002 and the first two quarters of 2003. A reasonable reader would conclude that the problems identified in the restatement note were systemic at least in the years that were stated.

[1101] I attach no significance to the absence of a reference, in the note accompanying the restated financial statements, to Nortel's financial errors resulting from systemic causes.

[1102] The Crown suggested that the assertion in Mr. Gollogly's draft that certain known errors which were not material were not corrected until the restatement was false. The Crown submitted the errors were material. Mr. Gollogly's draft does not define those errors. It is impossible to know to what he was referring.

[1103] The note that accompanied the restated financial statements makes a similar statement. That note also fails to define the errors to which it refers.

[1104] It is impossible to conclude that either of these references to the correction of unspecified immaterial errors were references to material errors.

[1105] Finally, Mr. Gollogly clearly prepared a draft of the note that was to accompany the restated financial statements. He submitted it first to Blair Morrison, Gordon Davies, Karen Sledge and Gary Beck. The next day Mr. Gollogly forwarded the same note to Mr. Beatty for his consideration. In his e-mail to Mr. Beatty, Mr. Gollogly makes reference to a new draft note which potentially will have been reviewed by someone named Nick. Nortel's General Counsel was Nick DeRoma. While it makes sense that Nortel's General Counsel would review the wording of the note accompanying the restated financial statements, I cannot say for certain to whom Mr. Gollogly was referring.

[1106] I am not satisfied that there is any real difference between Mr. Gollogly's draft and the note that actually accompanied the restated financial statements.

[1107] Even if the note accompanying the restated financial statements was incomplete and I am not satisfied that it was, I am not satisfied that Mr. Gollogly, Mr. Beatty or Mr. Dunn could in their sole discretion determine the final wording of Nortel press releases.

THE CROWN'S CRITICISM OF THE Q3 03 FINANCIAL RESULTS

[1108] The Crown maintained that Mr. Gollogly's concerns about Q3 03 were never properly disclosed either to the Audit Committee or to the public. Mr. Gollogly's concern about Q3 03 earnings was misplaced as indicated earlier. The forecast to which Mr. Gollogly referred was likely a September 19, 2003 Outlook.

[1109] The Crown attacked Nortel's original publication of Q3 03 results. The Crown maintained that Nortel's financial statements, as originally published for Q3 03, misrepresented Nortel's financial results for that fiscal period. Specifically, the Crown maintained that the Q3 03 results were "polluted" because \$391 million in accrued liability balances were released to the profit and loss statement in Q3 03.

[1110] The September 19, 2003 Outlook referred to by Mr. Gollogly in his draft letters indicates that this sum is made up of \$264 million, the release of which was triggered in Q3, and \$127 million the release of which was triggered in earlier quarters of 2003.

[1111] The Crown also highlighted a reference in Mr. Gollogly's diary which the Crown suggested demonstrated his opinion that the accounting oversight in Q3 03 was a "joke". Specifically, Mr. Gollogly indicated, in a diary entry, dated October 7, 2003, "intense scrutiny on Q3-it is a joke". This reference occurs on a page which is entitled "LC\Region Finance Call". The diary entry seems to be recording comments that were made during this telephone call. It is not clear from the entry that the comment represents Mr. Gollogly's view or one of the callers that it is a joke to suggest that there is intense scrutiny on Q3.

[1112] The Crown also relied on a note made by Mr. Beatty. This note states "Q3 was 'Amnesty' time from now on people will be fired for not following proper accounting practices". The Crown asked me to interpret this reference as a statement by Mr. Beatty that Q3 was everyone's last opportunity to manage earnings by releasing accrued liability balances to the profit and loss statement.

[1113] Mr. Beatty's note is dated September 30, 2003 and the document purports, on its face, to be notes of the Finance Conference Call. The note appears under a bullet point entitled "what is needed going forward". The first item that is needed, according to the note, is an understanding of how much the world has changed from a regulatory point of view. The second thing that is needed, according to the note, is that Q3 was amnesty time and that from now on people will be fired for not following proper accounting practices. The third item that is required, according to the note, is that if you are in doubt about what to do, you are to ask Karen's team who have the final say. The note is dated September 30, 2003, which is the last day of Q3.

[1114] With respect to Mr. Beatty's note, it seems to me to be more reasonable to construe the statement, assuming for a moment it was made by Mr. Beatty, as a promise not to fire employees who disclose, in Q3 03, items which should be removed from the balance sheet. This would certainly be consistent with the worldwide effort to comprehensively review the balance sheet.

[1115] The Crown also relied upon the fact that the September 19, 2003 Outlook prepared by Mr. Dans forecasted net income of \$178 million and the press release of October 23, 2003 announced net income of \$179 million. The Crown suggested that it was extraordinary that Mr. Dans' forecast could be so accurate.

[1116] In this regard, it is also a fact that Mr. Dans produced an Outlook, dated September 2, 2003, (seventeen days earlier) in which he projected net income for Q3 03 at \$19 million.

[1117] It is more reasonable to me to conclude that Mr. Dans produced Outlooks which forecasted varying levels of net income; one of which, in Q3 03, happened to be quite accurate.

[1118] Wilmer Cutler Pickering, on behalf of Nortel's Audit Committee, in effect, investigated the behavior of the three accused and their report resulted in all three accused being fired. Wilmer Cutler Pickering concluded with respect to Q3 03 and Q4 03: "In light of concerns raised by the inappropriate accounting judgments outlined above, the Audit Committee expanded its

investigation to determine whether excess provisions were released to meet internal EBT targets in each of these two quarters. No evidence emerged to suggest an intent to release provisions strategically in those quarters to meet EBT targets”. Wilmer Cutler Pickering indicated that a further review down to a low threshold would be conducted and that any changes would be reflected in the second restatement.

Preservation of the integrity of the Q3 03 General Ledger

[1119] Returning to the Crown’s suggestion that the Q3 03 general ledger was polluted, some care needs to be taken with references to non-trigger items finding their way into the Q3 03 general ledger due to the way in which Nortel and Deloitte used the Q3 03 General Ledger during the Comprehensive Balance Sheet Review.

[1120] The Comprehensive Balance Sheet Review took place during Q3 03. Ms. Sledge described the steps taken to preserve the integrity of the Q3 03 general ledger:

- Balance sheet items identified as not belonging on the balance sheet any longer were given a specific code in the General Ledger;
- The code identified them as items that potentially would need to be restated. These separately coded balance sheet items were separately tracked in a parallel system because they were recorded in a database as items marked for potential restatement;
- Ms. Sledge testified that these entries were tracked very carefully. These balance sheet items, by definition, were items that needed to come off the balance sheet, but did not belong in the Q3 profit and loss statement;
- These separately coded items were then audited by Deloitte & Touche; and,
- When it was decided that prior published financial statements were, in fact, going to be restated, the coded items removed from the General Ledger and restated to the appropriate prior financial period.

[1121] Ms. Sledge testified that she felt rushed into the October 23, 2003 press release but, nevertheless, she felt that Nortel’s balance sheet and profit and loss statement and financial records were accurate. In this regard, it should be remembered that the October 23, 2003 press release specified that the financial results were preliminary results.

[1122] During the Crown’s opening submissions, reference was made to the fact that Ms. Sledge prepared a project update for Mr. Gollogly, dated October 10, 2003, and that the presentation stated that the preliminary Q3 03 results were “polluted”. In this presentation, the word polluted is placed in quotation marks. Ms. Sledge testified that the slide was prepared by one of her staff and meant to convey that all of the unsupported balances were initially released to the Q3 03 profit and loss statement because they could not remain on the balance sheet. The items were separately coded and then restated when it was determined that a restatement was necessary.

[1123] I attach no significance to the fact that one of the pages of Ms. Sledge's report to Mr. Gollogly contains the word polluted in quotes. The unsupported balances were separately coded so that they could be identified and, in that sense, the Q3 03 results were, for a time, "polluted."

[1124] I am satisfied that the process employed by Ms. Sledge and her team and audited by Deloitte preserved the integrity of the Q3 03 results.

[1125] Mr. Chambers did not offer the opinion in his report that the Q3 03 financial results were polluted or otherwise contaminated.

Conclusion

[1126] When I consider this evidence, I am not satisfied that the Q3 03 results were false due to the improper release of accrued liability balances to the profit and loss statement.

[1127] In Q3 03, the total accrued liability balances released to the profit and loss statement, in fact, totaled \$391 million. This is a significant volume of releases. Some of these releases were in the normal course and some were not. Steps were taken to identify which was which. The integrity of Nortel's General Ledger was maintained. There was no misrepresentation of Nortel's Q3 03 financial results.

[1128] I am not satisfied beyond a reasonable doubt that Nortel's original Q3 03 financial statements misrepresented Nortel's financial results.

CONCLUSION

The excess and unsupported accrued liabilities

[1129] I am satisfied beyond a reasonable doubt that all three accused, by virtue of their long experience with Nortel and their positions of responsibility, well-understood how the men and women in the field were implementing Nortel's policy of Conservatism.

[1130] I am satisfied beyond a reasonable doubt that they knew that the policy of Conservatism and its implementation had created excess accrued liabilities which could be released to assist in meeting financial targets. Liabilities were very often estimated by men and women in the field on a worst-case scenario basis. As well, in order to avoid exposing Nortel to risks that were not provided for, there was a reluctance to reduce accrued liability balances in the appropriate quarter in response to a triggering event. The result was the presence of excess accrued liabilities on Nortel's balance sheet.

[1131] The evidence does establish, and I so find, that excessive accrued liabilities existed because genuine accrued liabilities were not released when they should have been and because genuine accrued liabilities were not adjusted when they should have been. I am not satisfied that any or all of the accused understood the extent of the excess accrued liabilities on Nortel's balance sheet.

[1132] I am satisfied that, in addition to excess accrued liabilities, there were accrued liabilities on Nortel's balance sheet which could not be supported.

[1133] The evidence persuades me that accruals were present on Nortel's consolidated balance sheet which could not be supported by documentation. I am satisfied that the downsizing of Nortel, which involved the closing of offices, the selling of real estate and, undoubtedly, the storage of documents, created a situation in which supporting documentation for some of existing accrued liability balances could not be located. Further, the loss of employees (two out of every three worldwide) created a situation in which the institutional memory concerning the unsupported accruals no longer existed within the company.

[1134] I am satisfied beyond a reasonable doubt that all 3 accused knew that there were unsupported accrued liabilities on Nortel's balance sheet. I am not satisfied that any or all of the accused understood the extent of the unsupported accrued liabilities on Nortel's balance sheet.

[1135] I am satisfied that neither the unsupported nor the excess accrued liabilities were fictitious. This finding does not mean that the release of accrued liabilities could not be used to manage earnings or achieve a pre-published financial target. It simply means that both the unsupported and the excessive liability balances originated from real risks.

[1136] I am satisfied, on the evidence, that Mr. Gollogly, virtually from the time he took over as Corporate Controller, turned his attention to Nortel's balance sheet.

[1137] I am satisfied that the enormous losses suffered by Nortel in fiscal 2000 and 2001 created a situation in which senior management, Nortel's Board of Directors and Nortel's auditors were concentrating their efforts and energy on doing what was necessary to make sure that Nortel had sufficient cash reserves to survive.

Q4 2002(Q4 02)

[1138] Mr. Harrison initially reported in his January 6 snapshot pro forma earnings before taxes of \$73 million. It is clear that he erroneously included \$59 million in his revenue calculation and that the 360 networks accrued liability balance of \$50 million is unchallenged. These two uncontested adjustments are capable of turning Mr. Harrison's forecasted earnings before taxes into a loss.

[1139] I am not satisfied that Nortel's Q4 2002 financial results were pro forma net profitable.

[1140] When I consider all of the evidence, including the evidence to which I have made specific reference, I am not satisfied beyond a reasonable doubt that the late entry accrued expenses/liabilities solicited by Mr. Harrison and recorded in Q4 02 misrepresented Nortel's financial results.

[1141] When I consider all of the evidence, including the evidence to which I have specifically referred, I am not satisfied beyond a reasonable doubt that Nortel's January 23 press release reporting a pro forma net loss of \$62 million misrepresented Nortel's pro forma financial results.

[1142] When I consider all the evidence, including the evidence to which I have made specific reference, I am not satisfied beyond a reasonable doubt that the accruals solicited by Mr. Harrison and recorded in Q4 02 resulted in a misrepresentation of Nortel's US GAAP financial results.

[1143] I am not satisfied beyond a reasonable doubt that the late entry accruals solicited by Mr. Harrison caused a misrepresentation of Nortel's financial results to Nortel's Audit Committee, Nortel's JL RC Committee or Nortel's Board of Directors.

[1144] I am satisfied that \$222 million of the \$303 million identified by Ms. Susan Shaw as provisions no longer required and available for release were, in fact, released in Q3 02 and Q4 02. I am also satisfied that \$57 million worth of accrued liability balances, described by Mr. McMillan as unreleased, included releases which could not be identified.

[1145] I am satisfied that the release of this \$222 million in Q3 02 and Q4 02 did not result in a misrepresentation of Nortel's financial results for those quarters or for fiscal 2002. These releases positively impacted earnings in those quarters but Nortel still lost in excess of \$2 billion in those two quarters.

[1146] I am not satisfied beyond a reasonable doubt that the manner in which the three accused dealt with the \$303 million in accrued liability balances identified by Susan Shaw in her October 2002 compilation resulted in a misrepresentation of Nortel's financial results to the investing public or Nortel's Board of Directors.

The \$80 million in Non-op Accrued liability balances released to the Q1 03 profit and loss statement

The Return to Profitability Bonus

[1147] I am satisfied that the Return to Profitability Bonus was payable in Q1 2003 with or without the release of \$80 million in Non-op accrued liability balances.

[1148] I am satisfied that Mr. Hathway was not misled when he was told by either Mr. Beatty or Mr. Gollogly that the Return to Profitability Bonus was payable with or without the release of the \$80 million with which we have been concerned.

The Restricted Stock Unit Bonus

[1149] I am not satisfied that the \$4 million Siemens accrued liability balance released in Q2 03 misrepresented Nortel's financial results by causing them to indicate that a Restricted Stock Unit Bonus Plan milestone had been reached.

[1150] I am not satisfied that releasing the \$4 million Siemens balance in Q2 03 created a risk to the pecuniary interests of Nortel Networks Corporation contrary to count 2 in the indictment by falsely indicating that the first milestone of the Restricted Stock Unit Bonus Plan had been met.

[1151] I am satisfied that the release of the \$4 million Siemens accrued liability balance in Q4 02 or Q2 03 would have had exactly the same effect as far as the first milestone of the Restricted Stock Unit Bonus Plan was concerned.

[1152] I am not satisfied that any or all of the accused knew that the \$4 million Siemens accrued liability balance should have been released in Q4 01.

The \$80 million generally

[1153] I am satisfied that Nortel achieved net income in Q1 03 with or without the \$80 million.

[1154] I am satisfied that including the \$80 million with which we have been concerned in Nortel's Q1 03 profit and loss statement or removing the \$80 million from Nortel's Q1 03 consolidated balance sheet did not misrepresent Nortel's financial results for Q1 03.

[1155] I am satisfied, based on my acceptance of Ms. Shaw's evidence, that Ms. Shaw, Mr. Gollogly and the other Nortel employees at the April 15, 2003 meeting fully disclosed to their auditors the circumstances surrounding the release of \$80 million in accrued liability balances, as well as the circumstances surrounding the remaining \$109 million in accrued liabilities on the balance sheet.

[1156] The \$80 million which was released in Q1 03 had been conclusively determined to be unsupported. Deloitte, the Audit Committee, Ms. Shaw and all the accused knew that there were no triggering events in Q1 03 which required the release of this \$80 million. It was obviously the view of everyone involved that the release of this \$80 million would not materially affect Nortel's balance sheet or profit and loss statement. As indicated elsewhere in these reasons, I agree with this conclusion.

[1157] Disclosure of the fact that Nortel's financial results for Q1 03 were positively affected by the release of this \$80 million was, in fact, included in Nortel's published financial statements and the press release announcing the Q1 03 financial results.

[1158] I accept the conclusions in the draft memo prepared by Ms. De Acetis, Mr. Chant and Mr. Allen. I find the memo persuasive. I reject Mr. Hathway's evidence to the effect that the calculations or conclusions in this draft memo are not correct.

[1159] I accept the coherent materiality analysis in the draft memo prepared by Ms. De Acetis, Mr. Chant and Mr. Allen.

[1160] I am satisfied that the release of \$80 million in Non-op accrued liability balances to Nortel's profit and loss statement was not material to Nortel's Q1 03 profit and loss statement.

[1161] I am satisfied that the release of the \$80 million from Nortel's balance sheet to its profit and loss statement was not material to Nortel's Q1 03 balance sheet.

[1162] I am satisfied that the release of this \$80 million did not create a risk to the pecuniary interests of Nortel Networks Corporation.

[1163] I am not satisfied that the way in which the three accused dealt with the \$80 million in unsupported accrued liability balances in Q1 03 misrepresented Nortel's financial results to the investing public or Nortel's Audit Committee or Nortel's board of directors.

The attempt to release the \$142 Million

[1164] I am also satisfied that the attempt to release \$142 million in unsupported or excess accrued liability balances in Q2 03 did not misrepresent Nortel's financial results. Mr. Hathway objected to the release and Mr. Gollogly returned the \$142 million to Nortel's balance sheet where those balances had always been.

[1165] I am satisfied that the presence of this \$142 million in accrued liability balances on Nortel's balance sheet in Q2 03 did not misrepresent Nortel's liabilities or otherwise misrepresent Nortel's financial results in Q2 03. Mr. Richmond was clearly of this opinion; the Crown expert Mr. Chambers did not offer a contrary opinion.

[1166] Because the presence on Nortel's balance sheet of \$142 million in unsupported/excess accrued liability balances was disclosed to Nortel's Audit Committee in a way which resulted in a Comprehensive Balance Sheet Review, I am satisfied that the presence of this \$142 million in unsupported balances on Nortel's balance sheet did not create a risk to the pecuniary interests of Nortel Networks Corporation.

Nortel's published financial results for Q3 03

[1167] When I consider this evidence, I am not satisfied that the original published Q3 03 financial statements misrepresented Nortel's financial results for Q3 03 due to the improper release of accrued liability balances to the profit and loss statement or for any other reason.

[1168] In Q3 03, the total accrued liability balances released to the profit and loss statement, in fact, totaled \$391 million. This is a significant volume of releases. Some of these releases were in the normal course and some were not. Steps were taken to identify which was which to ensure that the published financial statements were not affected inappropriately. Neither Mr. Chambers nor any other witness offered the opinion that the steps were inadequate.

[1169] I am satisfied that the steps taken to preserve the integrity of the Q3 03 financial statements were successful with the result that Nortel's financial results for that quarter were not misrepresented.

The Comprehensive Balance Sheet Review

[1170] The first restatement produced \$900 million in favorable impacts to shareholders. The \$900 million in excess accrued liabilities represented expenses/liabilities on the balance sheet that did not have to be recognized. It was never suggested that these accrued liability balances ought not to have been restated. As a result of restating these balances, shareholder equity was increased.

[1171] I am satisfied that the Comprehensive Balance Sheet Review was comprehensive. It identified more than \$900 million in excessive accrued liabilities.

[1172] I am satisfied that there was intense pressure to complete the Comprehensive Balance Sheet Review as quickly as possible. I do not attribute this imperative to the accused alone. I accept the evidence of Mr. Richmond that there was an agreement among the Board, senior

management and Deloitte that the comprehensive balance sheet review should be completed “as rapidly as was humanly possible”. I am satisfied that this imperative existed because the accused and Nortel’s Audit Committee wanted to make their appropriate filings with the SEC and the Ontario Securities Commission within normal reporting lines. I am not satisfied, on the evidence, including the evidence specifically referred to, that the Comprehensive Balance Sheet Review was not comprehensive because timelines were short.

[1173] The evidence falls far short of proving that the accused, either individually or collectively, attempted to frustrate the Comprehensive Balance Sheet Review or the first restatement of Nortel’s previously-published financial results. Deloitte, specifically Mr. Richmond, insisted on the Comprehensive Balance Sheet Review and I am satisfied that Deloitte would not have accepted such obstruction and would have brought the matter to the attention of the Audit Committee.

[1174] I am not satisfied that the first restatement was under-resourced. Deloitte was free to add staff as they saw fit. Mr. Richmond did not hesitate to recommend that Nortel staff and Deloitte staff be compelled to take a long weekend. I have no doubt he would have recommended that Nortel find additional staff for the Comprehensive Balance Sheet Review if it had come to his attention that the project, which Deloitte had insisted upon, was being compromised because it was under-resourced on the Nortel side.

[1175] I am satisfied that the scope of the Comprehensive Balance Sheet Review was reasonable. The scope of the Comprehensive Balance Sheet Review was accepted by Nortel’s auditors and its Audit Committee. Throughout the Comprehensive Balance Sheet Review, there was no suggestion that the scope of the review was too narrow.

[1176] I accept the evidence of Mr. Richmond, Ms. Sledge, Mr. McMillan and others attesting to the effort that went into the Comprehensive Balance Sheet Review.

[1177] I accept the evidence of Mr. Dans that there was a trending analysis done at the conclusion of the first restatement which validated the results of that restatement.

[1178] An accrued liability balance when Deloitte decided there had been an error. In order to understand what to make of the error, one has to understand the specifics of the release. An example is the JDS Uniphase transaction. Deloitte gave Nortel an opinion in 2001 concerning the accounting for this transaction which Nortel accepted. Deloitte confirmed its original advice on January 9, 2003. During the second restatement, Deloitte changed its opinion entirely. Nortel accepted Deloitte’s new opinion and, as a result, restated \$319 million worth of revenue. Deloitte behaved in a similar manner when considering the Optical Warranty accrued liability balance.

[1179] It would be imprecise and dangerous to conclude, without knowing the specifics of the transactions, that Nortel’s prior published financial results were false because transactions such as these were restated. The more accurate statement is that Deloitte changed its mind about the accounting treatment for these transactions and, as a result, previously-published financial statements had to be changed. Once the specifics of the transaction are known, it is clear that the three accused could not have known about these so-called errors.

[1180] It would be wrong to infer that the three accused knew that an accrued liability balance that was restated was false in the absence of evidence concerning the specifics of the balance.

[1181] When I consider all of the evidence, it is my conclusion that the second restatement produced different results than the first restatement because the thresholds of the second restatement were different, because the second restatement concentrated on revenue recognition, as well as excessive accrued liability balances, and because Deloitte changed its mind about the accounting for specific transactions. Sometimes, as the specifics of the Genuity accrued liability balance demonstrate, Deloitte disagreed with itself. With respect to that release, the U.S. National Office of Deloitte & Touche disagreed with the Deloitte reviewers at Nortel and overruled them.

[1182] I am not satisfied by the evidence in this case, including the fact that the second restatement resulted in financial statements which were different than Nortel's previously-published and restated financial statements, proves that the previously-published and restated financial statements misrepresented Nortel's financial results. For example, in the period Q4 02, which occupied a considerable amount of the court's time, Nortel's original published financial statements reported a US GAAP loss of \$248 million and revenue of \$2.5 billion. After two restatements, Nortel reported a US GAAP loss of \$294 million and revenue of \$2.6 billion.

The Q1 & Q2 03 accrued liability balance releases

[1183] I am not satisfied beyond a reasonable doubt that the three accused deliberately misrepresented Nortel's original Q1 03 and Q2 03 published financial results by releasing \$361 million and \$372 million, respectively, to Nortel's Q1 03 and Q2 03 profit and loss statements.

[1184] The restated releases referred to in the evidence lead me to the conclusion that the decision to restate on account of an error can be the same thing as saying that there was a decision to restate on account of a difference of opinion. The difference of opinion can occur with the benefit of hindsight. The difference of opinion can be influenced by new information. As indicated earlier, when deciding to restate an accrued liability balance, sometimes Deloitte disagreed with itself. The specifics of each restated item are a story, the details of which cannot be inferred from the ending.

[1185] In the abstract, it is true that the fact that accrued liability balances in Nortel's balance sheet were restated is capable of supporting an inference that, in their original form, the financial statements misrepresented Nortel's financial results. Based on the evidence that I have heard, it is my conclusion that I should not draw such an inference in this case.

[1186] When I consider the evidence generally, including the evidence to which I have referred, I come to the conclusion that I am not satisfied by the evidence that, apart from the \$80 million in Non-op releases, the Q1 03 and Q2 03 accrued liability releases were outside the normal course of business.

[1187] As a result, I cannot give effect to the Crown submissions concerning the inferences I ought to draw from the fact that the original Q1 03 and Q2 03 accrued liability balances were restated.

VERDICT

[1188] For the reasons that I have set out and having regard to all the evidence, I am not satisfied beyond a reasonable doubt that Frank A. Dunn, Douglas C. Beatty and Michael J. Gollogly deliberately misrepresented the financial results of Nortel Networks Corporation and, therefore, I find each of them not guilty of counts one and two in this indictment.

MARROCCO J.

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COURT FILE NO.: 10-00145
DATE: 20130114

ONTARIO
SUPERIOR COURT OF JUSTICE

B E T W E E N:

HER MAJESTY THE QUEEN

– and –

FRANK A. DUNN, DOUGLAS C. BEATTY AND
MICHAEL J. GOLLOGLY

Defendants

JUDGMENT

MARROCCO J.

Released: 20130114