IN THE MATTER OF THE SECURITIES ACT
R.S.O. 1990, c. S.5, AS AMENDED

- and -

IN THE MATTER OF
NORTEL NETWORKS CORPORATION and NORTEL NETWORKS LIMITED
(collectively, "Nortel")

STATEMENT OF ALLEGATIONS OF STAFF OF THE ONTARIO SECURITIES COMMISSION

A. The Respondents

1. Nortel Networks Corporation ("NNC") is a reporting issuer in Ontario and its shares are listed on both the Toronto and New York stock exchanges under the symbol "NT".

2. Nortel Networks Limited ("NNL") is the principal direct operating subsidiary of NNC. NNL is a reporting issuer in Ontario and its preferred shares are listed on the Toronto Stock Exchange under the symbol "NTL". All of NNL's issued and outstanding common shares are held by NNC.

3. The principal executive offices of NNC and NNL (collectively referred to herein as "Nortel" or the "Company") are located in Toronto, Ontario.

B. Overview of Allegations

4. The conduct at issue relates to Nortel's financial results for the fiscal year ended December 31, 2000, the third and fourth quarters of 2002 and the first and second

quarters of 2003. These time periods are referred to herein individually as the "Relevant Fiscal Periods" and collectively as the "Material Time".

5. All dollar amounts referred to herein, unless otherwise stated, are in U.S. dollars and, unless otherwise stated, all references to financial results are to Nortel Networks Corporation's results reported in its consolidated financial statements for the relevant period prepared under generally accepted accounting principles ("GAAP") in the United States ("U.S. GAAP").

6. For each of the Relevant Fiscal Periods, each of NNC and NNL prepared and filed with the Commission two sets of financial statements which were represented to have been prepared either in accordance with U.S. GAAP or GAAP in Canada ("Canadian GAAP"), as the case may be.

7. Sections 77 and 78 of the *Securities Act*, R.S.O., 1990, c.S.5, as amended (the "Act") direct that all financial statements filed with the Commission must be prepared in accordance with Canadian GAAP. Moreover, all financial statements and material filed with the Commission must not be misleading or untrue or omit a fact which would render it misleading.

8. Staff allege that Nortel filed financial statements with the Commission during the Material Time that were not prepared in accordance with Canadian GAAP and therefore such filings were contrary to sections 77 and 78 of the Act.

9. Staff further allege that Nortel made representations in its financial statements filed with the Commission for each of the relevant fiscal periods that such financial statements had been prepared in accordance with Canadian GAAP or U.S. GAAP, as the case may be, and that such statements were materially misleading or untrue or did not state a fact that was required to be stated or that was necessary to make the statement not misleading, and thereby acted contrary to the public interest.

10. Staff further allege that the inappropriate provisioning and revenue recognition practices described herein, that were found by the Independent Review or the Revenue

Independent Review (as defined below) to have occurred, were contrary to the public interest.

C. Overview of Facts Alleged

11. During the Material Time, the emphasis by former members of Nortel's senior corporate finance management on meeting revenue and/or earnings targets led to a culture within the finance organization of Nortel that condoned two types of inappropriate accounting practices (described in paragraphs 13 and 14 below), which did not comply with applicable GAAP and were contrary to the public interest.

12. Further, during the Material Time, Nortel failed to implement appropriate internal controls and procedures to identify, monitor, control and fully disclose the accounting practices described in paragraphs 13 and 14 below, which failure was contrary to the public interest.

(i) Revenue Recognition

13. During the 2000 fiscal year, former Nortel senior corporate finance management inappropriately changed Nortel's accounting policies several times either to recognize revenue prematurely or to defer the recognition of revenue to a subsequent period. After changing internal accounting policies, these same senior corporate finance managers did not understand the relevant U.S. GAAP requirements, misapplied these U.S. GAAP requirements and, in certain circumstances, "turned a blind eye" to these U.S. GAAP requirements. As a result, revenue was recognized for numerous transactions for the fiscal year ended December 31, 2000 in a manner not in accordance with U.S. GAAP. This conduct was driven by the need to close the gap between actual and targeted revenue and earnings.

(ii) Provisioning

14. During the third and fourth quarters of 2002 and the first and second quarters of 2003, former Nortel corporate and finance management endorsed, and finance employees carried out, accounting practices relating to the recording and release of certain accrued

liabilities and provisions that were not in accordance with U.S. GAAP or Canadian GAAP. In three of those four quarters, these practices were undertaken to meet internally imposed pro forma earnings before taxes targets. While the dollar amount of most of the individual provisions was relatively small, the aggregate value of the provisions made the difference between a profit and a loss, on a pro forma basis, in the fourth quarter of 2002 and the difference between a loss and a profit, on a pro forma basis, in the first and second quarters of 2003. The pro forma calculation was used by the Company to make its determination on whether to award various bonuses under bonus plans that provided for payments tied to a pro forma profitability metric.

15. As a result of these practices and internal control deficiencies, Nortel was required to restate its publicly disclosed U.S. GAAP and Canadian GAAP financial statements for the Relevant Fiscal Periods and other fiscal periods as described herein.

D. The Restatements

(i) First Restatement

16. In May 2003, Nortel commenced certain balance sheet reviews at the direction of certain former members of management that led to a review and analysis of the Company's assets and liabilities (the "Balance Sheet Review").

17. The objectives of the Balance Sheet Review were reported to be to: (i) identify balance sheet accounts that, as at June 30, 2003, were not supportable and required adjustment; (ii) determine whether such adjustments related to the third quarter of 2003 or prior periods; and (iii) document certain account balances in accordance with Nortel's accounting policies and procedures.

18. The Balance Sheet Review was supplemented by additional procedures carried out between July and November 2003 to quantify the effects of potential adjustments and review the appropriateness of releases of certain contractual liability and other related provisions (also called accruals, reserves or accrued liabilities) in the six fiscal quarters ending with the fiscal quarter ended June 30, 2003.

19. The Balance Sheet Review, as supplemented, resulted in the restatement (effected in December 2003) of Nortel's consolidated financial statements for the years ended December 31, 2002, 2001 and 2000 and for the quarters ended March 31, 2003 and June 30, 2003 (the "First Restatement").

20. The net effect of the adjustments made to NNC's financial statements in the First Restatement was a reduction in accumulated deficit of $497 million, $178 million and $31 million as at December 31, 2002, 2001 and 2000, respectively. Among the adjustments made as part of the First Restatement, approximately $935 million and $514 million of certain liabilities (primarily accruals and provisions) carried on NNC's previously reported consolidated balance sheet as at December 31, 2002 and 2001, respectively, were released to income in prior periods.

21. On December 23, 2003, each of NNC and NNL filed with the United States Securities and Exchange Commission (the "SEC") its amended Annual Report on Form 10-K/A for the year ended December 31, 2002 and amended Quarterly Reports on Form 10-Q/A for the quarters ended March 31, 2003 and June 30, 2003 reflecting the First Restatement. On the same date, these same documents, together with the corresponding filings represented to have been prepared in accordance with Canadian GAAP, were filed with the Commission.

22. In conjunction with the First Restatement, Nortel's external auditors, Deloitte & Touche LLP ("D&T"), informed the Audit Committee that there were two "reportable conditions", each of which constituted a "material weakness" in Nortel's internal control over financial reporting (as such terms were formerly defined under standards established by the American Institute of Certified Public Accountants (the "AICPA"), which were applicable with respect to 2003). These reportable conditions, which were disclosed in NNC's and NNL's Quarterly Reports on Form 10-Q for the quarter ended September 30, 2003 filed with the SEC and the Commission in November 2003, were as follows:

(i) lack of compliance with established Nortel procedures for monitoring and adjusting balances relating to certain accruals and provisions, including restructuring charges; and

(ii) lack of compliance with established Nortel procedures for appropriately applying U.S. GAAP to the initial recording of certain liabilities, including those described in Statement of Financial Accounting Standards ("SFAS") No. 5, "Accounting for Contingencies" ("SFAS No. 5"), and to foreign currency translation as described in SFAS No. 52, "Foreign Currency Translation" ("SFAS No. 52").

These material weaknesses contributed to the need for the First Restatement.

(ii) Independent Review

23. In late October 2003, the Audit Committees of the Boards of Directors of NNC and NNL (collectively, the "Audit Committee") initiated an independent review of the facts and circumstances leading to the First Restatement (the "Independent Review"), and engaged the law firm Wilmer Cutler Pickering Hale and Dorr LLP ("WilmerHale") to advise it in connection with the Independent Review. WilmerHale retained Huron Consulting Services LLC ("Huron") to provide expert accounting assistance.

24. Through the Independent Review, the Audit Committee sought to gain a full understanding of the events that caused significant excess liabilities to be maintained on Nortel's balance sheet that needed to be restated, and to recommend that the Boards of Directors of NNC and NNL (collectively, the "Board") adopt, and direct management to implement, necessary remedial measures to address personnel, controls, compliance and discipline.

25. The Independent Review focused initially on events relating to the establishment and release of contractual liability and other related provisions in the second half of 2002 and the first half of 2003, including the involvement of the Company's senior corporate leadership. As the review evolved, its focus was broadened to include specific provisioning activities in each of the Company's business units and geographic regions and was expanded to include provisioning activities in the third and fourth quarters of 2003.

26. Based on periodic reports by WilmerHale on the progress of the Independent Review, the Audit Committee recommended, and the Board approved, the termination for cause in

April 2004 of Frank Dunn ("Dunn"), the Company's former President and Chief Executive Officer, Douglas Beatty ("Beatty"), the Company's former Chief Financial Officer, and Michael Gollogly ("Gollogly"), the Company's former Controller, and in August 2004 of seven additional senior finance employees with significant responsibility for Nortel's financial reporting as a whole or for their respective business units and geographic regions.

27. In January 2005, the Audit Committee reported to the Board the findings of the Independent Review as set forth in a document entitled "Summary of Findings and of Recommended Remedial Measures of the Independent Review" submitted to the Audit Committee by WilmerHale and Huron (the "Independent Review Summary"). The Audit Committee adopted the findings of the Independent Review and the recommended remedial measures set forth in the Independent Review Summary in their entirety. The Independent Review Summary was appended, in its entirety, to a press release issued by Nortel on January 11, 2005 and filed with the Commission and was reproduced, in its entirety, in NNC's and NNL's Annual Reports on Form 10-K for the year ended December 31, 2003 (collectively, the "2003 Annual Report") filed with the SEC and the Commission in January 2005.

28. The Independent Review concluded that former corporate management (who had been terminated for cause) and former finance management in Nortel's Finance organization (who had also been terminated for cause) endorsed, and employees carried out, accounting practices relating to the recording and release of provisions that were not in compliance with U.S. GAAP in at least four quarters, including the third and fourth quarters of 2002 and the first and second quarters of 2003. In three of those four quarters – when Nortel was at, or close to, break even – these practices were undertaken to meet internally imposed pro forma earnings before taxes ("EBT") targets. While the dollar value of most of the individual provisions was relatively small, the aggregate value of the provisions made the difference between a profit and a reported loss, on a pro forma basis, in the fourth quarter of 2002 and the difference between a loss and a reported profit, on a pro forma basis, in the first and second quarters of 2003. This conduct caused Nortel to report a loss in the fourth quarter of 2002 and to pay no employee bonuses, and to

achieve and maintain profitability in the first and second quarters of 2003, which, in turn, caused it to pay bonuses to all Nortel employees and significant bonuses to senior management under bonus plans tied to a pro forma profitability metric.

29. The inappropriate accounting practices listed above related to the recording and release of provisions, also were not in compliance with Canadian GAAP.

30. At the request of the Audit Committee, the Independent Review Summary also set forth governing principles for remedial measures recommended by WilmerHale. The recommendations were directed at:

(i) establishing standards of conduct to be enforced through appropriate discipline;

(ii) infusing strong technical skills and experience into the Finance organization;

(iii) requiring comprehensive, on-going training on increasingly complex accounting standards;

(iv) strengthening and improving internal controls and processes;

(v) establishing a compliance program throughout the Company which is appropriately staffed and funded;

(vi) requiring management to provide clear and concise information, in a timely manner, to the Board to facilitate its decision-making; and

(vii) implementing an information technology platform that improves the reliability of financial reporting and reduces opportunities for manipulation of results.

31. The Audit Committee recommended, and the Board approved, the adoption of all of the recommendations contained in the Independent Review Summary.

(iii) Second Restatement

32. As the Independent Review progressed, the Audit Committee directed Nortel's new corporate management to examine in depth the concerns identified by WilmerHale

regarding provisioning activity. That examination, and other errors identified by management including errors relating to revenue recognition, led to the restatement of Nortel's financial statements for the years ended December 31, 2002 and 2001 and the quarters ended March 31, 2003 and 2002, June 30, 2003 and 2002 and September 30, 2003 and 2002 (the "Second Restatement"), and the revision of NNC's previously announced unaudited results for the year ended December 31, 2003.

33. Overall in the Second Restatement, as a result of adjustments to correct errors related to revenue recognition, NNC increased revenues by an aggregate of $1.492 billion in 2001 and $439 million in 2002. NNC also increased previously announced 2003 revenues by an aggregate of $386 million. Most of these adjustments constituted the recognition of revenue that had previously been improperly recognized in prior years and should have been deferred (often over a number of years). This also had the effect of reducing previously reported revenues in 1998, 1999 and 2000 by approximately $158 million, $355 million and $2.866 billion, respectively. Of these adjustments identified in the Second Restatement, approximately $750 million of revenues was deferred to years after 2003, while approximately $250 million of revenues was permanently reversed.

34. Some of the adjustments related to errors involving issues in connection with arrangements known as "bill and hold" transactions, in which revenue is recognized before actual delivery of the product. During the Second Restatement process, Nortel management determined that the relevant U.S. GAAP accounting policy had been incorrectly applied to a number of contracts, and revenues had been recognized where the relevant criteria had not been fully met, and therefore deferred all revenues associated with bill and hold arrangements to subsequent periods. With respect to the fourth quarter of 2000, approximately $1 billion of revenue was recognized incorrectly from bill and hold transactions which failed to meet the appropriate accounting guidance as set out in the SEC's Staff Accounting Bulletin 101, "Revenue Recognition in Financial Statements" ("SAB 101"). Subsequently, in the course of the Revenue Independent Review (as defined below), it was determined that former senior finance management, contrary to earlier advice received from D&T as to the criteria that should be met pursuant to SAB 101 in order to recognize revenue when delivery of product has not

occurred, failed to ensure that bill and hold transactions be requested by the buyer in accordance with the guidance set out in SAB 101.

35. Over the course of the Second Restatement process, management and D&T identified a number of additional reportable conditions, each constituting a material weakness, in Nortel's internal control over financial reporting as at December 31, 2003. At the time of the Second Restatement, a total of six material weaknesses had been identified. The material weaknesses identified were:

(i) lack of compliance with written Nortel procedures for monitoring and adjusting balances related to certain accruals and provisions, including restructuring charges and contract and customer accruals;

(ii) lack of compliance with Nortel procedures for appropriately applying applicable GAAP to the initial recording of certain liabilities, including those described in SFAS No.5, and to foreign currency translation as described in SFAS No. 52;

(iii) lack of sufficient personnel with appropriate knowledge, experience and training in U.S. GAAP and lack of sufficient analysis and documentation of the application of U.S. GAAP to transactions, including, but not limited to, revenue transactions;

(iv) lack of a clear organization and accountability structure within the accounting function, including insufficient review and supervision, combined with financial reporting systems that are not integrated and which require extensive manual interventions;

(v) lack of sufficient awareness of, and timely and appropriate remediation of, internal control issues by Nortel personnel; and

(vi) an inappropriate "tone at the top", which contributed to the lack of a strong control environment. As reported in the Independent Review Summary, there was a "[m]anagement 'tone at the top' that conveyed the strong leadership message that earnings targets could be met through application of accounting practices that finance managers knew or ought to have known were not in compliance with U.S. GAAP and that questioning these practices was not acceptable”.

These material weaknesses contributed to the need for the Second Restatement.

(iv) Revenue Independent Review

36. In light of the magnitude of the Second Restatement adjustments to previously reported revenues, the Audit Committee directed a review of the facts and circumstances leading to the restatement of these revenues for specific transactions identified in the Second Restatement (the “Revenue Independent Review”), with a particular emphasis on the underlying conduct that led to the initial recognition of these revenues. The Revenue Independent Review also considered any appropriate additional remedial measures, including those involving internal controls and processes.

37. The Audit Committee engaged WilmerHale to advise it in connection with the Revenue Independent Review. WilmerHale retained Huron to provide expert accounting assistance.

38. The Revenue Independent Review focused principally on transactions that accounted for approximately $3.0 billion of the $3.4 billion in restated revenue from the Second Restatement, with a particular emphasis on transactions that accounted for approximately $2.6 billion in the fourth quarter of 2000.

39. The Revenue Independent Review found that, in an effort to meet internal and external targets, Nortel’s senior corporate finance management team changed the Company’s accounting policies several times during 2000, either to defer revenue out to a subsequent period or pull revenue into the current period. After changing internal accounting policies, senior corporate finance management did not understand the relevant U.S. GAAP requirements, misapplied these U.S. GAAP requirements, and in certain circumstances, “turned a blind eye” to these U.S. GAAP requirements. As a result, the Revenue Independent Review concluded that Nortel recognized revenue for numerous transactions with disregard for the proper accounting and this conduct was driven by the need to close revenue and earnings gaps.

40. The findings of the Revenue Independent Review were presented to the Audit Committee and the Board and disclosed in NNC's and NNL's amended Annual Reports on Form 10-K/A for the year ended December 31, 2005 (collectively, the "2005 Annual Report") filed with the SEC and the Commission. As disclosed in the 2005 Annual Report, the first five of the six material weaknesses in Nortel's internal control over financial reporting described in paragraph 35 continued to exist as at December 31, 2005 (as the term "material weakness" is now defined under standards established by the United States Public Company Accounting Oversight Board (the "PCAOB")).

E. Conclusions Respecting Conduct

41. The filing by Nortel with the Commission of financial statements for each of the Relevant Fiscal Periods that did not comply with Canadian GAAP, as set out above, was contrary to sections 77 and 78 of the Act.

42. Nortel's representation in its financial statements filed with the Commission for each of the Relevant Fiscal Periods (and in its other continuous disclosure filings for the Relevant Fiscal Periods containing financial information derived from such financial statements) that such financial statements had been prepared in accordance with Canadian GAAP or U.S. GAAP, as the case may be, was materially misleading or untrue or did not state a fact that was required to be stated or that was necessary to make the statement not misleading, and was contrary to the public interest.

43. During the Material Time, Nortel failed to implement appropriate internal controls and procedures to identify, monitor and to fully disclose the accounting practices related to Provisioning and Revenue Recognition and such failure was contrary to the public interest.

F. Conduct Contrary to the Public Interest

44. Staff alleges that the conduct set out above violates Ontario securities law as specified and constitutes conduct contrary to the public interest.