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UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEW JERSEY

PETER A. RAETSCH, GERALDINE RAETSCH, and CURTIS C. SHIFLETT, individually and on behalf of all others similarly situated,	
Plaintiffs,	CIVIL ACTION NO.
v.	2:05-cv-5134 (PGS)
LUCENT TECHNOLOGIES, INC., LUCENT TECHNOLOGIES, INC. EMPLOYEE BENEFITS COMMITTEE, and LUCENT TECHNOLOGIES, INC. MEDICAL EXPENSE PLAN FOR RETIRED EMPLOYEES,	CLASS ACTION
Defendants.	

PLAINTIFFS' STATEMENT PURSUANT TO LOCAL RULE 56.1
<u>IN SUPPORT OF MOTION FOR PARTIAL SUMMARY JUDGMENT</u>

Plaintiffs submit this Statement Pursuant to Local Rule 56.1 in Support of Motion for Partial Summary Judgment to set forth the material facts as to which there is no genuine issue or dispute.

Plaintiffs respectfully reserve the right to amend and supplement this Statement as circumstances warrant during the further briefing on the Motion and the Court's consideration of it.

I. FACTS PERTINENT TO STANDARD OF REVIEW

1. This action was commenced on October 24, 2005. *See* Complaint, attached as Exhibit 1 to accompanying Affidavit of Alan M. Sandals (Exhibit 1).[1]

2. The undisputed facts of record establish that the Special Committee's Report, dated December 28, 2006 (Exhibit 3), does not warrant any deference by the Court.

[1] This exhibit and all subsequently referenced exhibits are attached to the accompanying Affidavit of Alan M. Sandals. Facts which are derived from documents that have been produced pursuant to the Protective Order, dated January 29, 2007, appear only in the accompanying Confidential Supplement to Plaintiffs' Statement Pursuant to Local Rule 56.1 in Support of Motion for Partial Summary Judgment. The exhibits quoted or cited in the Confidential Supplement to this Statement are attached to the Confidential Supplement to Affidavit of Alan M. Sandals.

A. The Committee Members Were Fatally Conflicted Due to Their Status as Senior Members of Lucent Management and their Significant Financial Ties to the Company.

3. The members of the Special Committee operated under an inherent and fatally disabling conflict of interests. All three members of the Special Committee were senior management employees of Lucent at the time of their appointment to serve members on November 21, 2006 and continuing through the time they reviewed the claims and issued the Report on December 28, 2006. Janet G. Davidson was "President, Corporate Strategy" for Lucent before its merger with Alcatel and "Global Solutions and Technology Leader" Alcatel-Lucent. George White, Jr. was Vice President Human Resources, Global Operations. Stephen R. Rosen was Vice President – Law. *See* Action in Lieu of Meeting [Appointing Members of Special Committee], Lucent Technologies, Inc. Employee Benefits Committee, dated November 21, 2006, LAR 003080-3084 (Exhibit 4); Biographies of Committee Members, LAR 003085-3088 (Exhibit 5); SEC Form 4, Janet G. Davidson, dated November 30, 2006 (Exhibit 6).

4. Special Committee member Janet G. Davidson was one of the highest ranking executives of Lucent. Among senior management, she was reported in contemporaneous SEC filings as having the fifth largest holdings of Lucent stock (2,344,801 shares, including stock options). *See* Schedule 14A Proxy Statement, Lucent Technologies Inc., dated January 3, 2006, at 15 (Exhibit 7). As of November

30, 2006, each of Ms. Davidson's Lucent stock option awards was converted into the right to purchase American Depositary Shares of the successor company, Alcatel-Lucent. Hundreds of thousands of her options will vest (and become exercisable) in equal annual installments pertaining to each of four awards, in November or December of 2007, 2008, 2009 and/or 2010. *See* SEC Form 4 (including footnotes thereto), Janet G. Davidson, dated November 30, 2006 (Exhibit 6).

5. *See* accompanying Confidential Supplement to Plaintiffs' Statement Pursuant to Local Rule 56.1 in Support of Motion for Partial Summary Judgment.

6. *See* accompanying Confidential Supplement to Plaintiffs' Statement Pursuant to Local Rule 56.1 in Support of Motion for Partial Summary Judgment.

7. As members of senior management, each of the three members of the Special Committee participate in Lucent's "Long Term Incentive Program," which makes awards of cash and stock options based on company performance targets. Existing awards will be paid out (in cash) or vest (as stock options) in December 2007 and December 2008. *See* Defendants' [Redacted] Answers to Interrogatories, dated February 1, 2007, at 30-31 (Exhibit 8); Schedule 14A Proxy Statement, Lucent Technologies Inc., dated January 3, 2006, at 38, 45 (Exhibit 7).

8. In connection with the Alcatel merger and the resulting change in control of the company, Ms. Davidson was eligible for "two years of salary continuation" and a "bonus payment at target levels during each of the two Decembers during the [salary]

continuation period." In August 2006, her "aggregate cash severance benefits" were reported as having an estimated value of $ 2,420,000. She also was eligible to receive her performance awards, in the amounts earned for fiscal years completed before the merger and in a pro-rated amount for the fiscal year in which the merger occurred, "subject to the original schedule and terms of these awards." *See* Amendment No. 1 to Form F-4, Alcatel, filed August 4, 2006, at 81-82 (Exhibit 9).

9. Committee members White and Rosen also are qualified for salary continuation and target bonus payments under the Officer Severance Policy. *See* Defendants' Answers to Interrogatories, dated February 1, 2007, at 31 (Exhibit 8).

10. *See* accompanying Confidential Supplement to Plaintiffs' Statement Pursuant to Local Rule 56.1 in Support of Motion for Partial Summary Judgment.

11. *See* accompanying Confidential Supplement to Plaintiffs' Statement Pursuant to Local Rule 56.1 in Support of Motion for Partial Summary Judgment.

12. Committee member George White also served as a member of the defendant Employee Benefits Committee beginning December 2, 2003. *See* Action in Lieu of Meeting [Appointing Members of Special Committee], Lucent Technologies, Inc. Employee Benefits Committee, dated November 21, 2006, at LAR 003084 (Exhibit 4); Defendants' Answers to Interrogatories, dated February 1, 2007, at 24 (Exhibit 8). White thus has potential personal liability on the claims as a fiduciary of the plans during the period of the benefit cutbacks. *See* Complaint ¶¶ 14, 46-50

(Exhibit 1).

13. Committee member Stephen R. Rosen is a working colleague of corporate counsel for benefits Steven R. Kronheim, who "advis[ed] Lucent on compliance with Code § 420's maintenance of effort requirements." Defendants' Answers to Plaintiffs' First Set of Interrogatories, dated February 1 2007, at 22 (Exhibit 8). For example, Mr. Rosen "was present when a litigation report of new matters, which included the Raetsch case [i.e., this action] was made by Steven Kronheim to the Audit and Finance Committee of the Board of Directors of Lucent on December 20, 2005." Mr. Kronheim or another colleague in the legal department, attorney Larry Hurley, "individually and separately requested" each of the three members to serve on the Committee. Mr. Rosen also consulted with Steven Kronheim and Larry Hurley about retaining counsel for the Committee. *See* Defendants' Answers to Plaintiffs' First Set of Interrogatories, at 35-38 (Exhibit 8).

B. Lucent Has Direct Financial Liability on Plaintiffs' Claims.

14. The Lucent Medical Expense Plan for Retired Employees ("Medical Plan") covering plaintiffs and the members of the Class is an unfunded ERISA welfare benefits plan. Historically, Lucent has funded it on a pay-as-you-go basis out of operating funds or other available corporate resources. It has not been pre-funded on any actuarial or other basis, as a pension plan would be funded. The four pension asset transfers were effected by Lucent in order to meet its ongoing funding obligations for

the Medical Plan. *See, e.g.*, Lucent Form 8-K Report, dated Sept. 8, 2003, LAR 000318-326 at LAR 000324 (Exhibit 10) (stating that management retiree medical benefits cuts implemented during 2003-04 "will yield approximately $ 75 million in annual savings to the company"); Presentation, LAR 000185-86 (Exhibit 11) ("Up until now, Lucent has covered the cost of retiree health and pension benefits from available trusts. Lucent has never had to fund these costs from operating cash. Due to a variety of changed circumstances, the Company will need to begin to fund from cash as follows [referring to company funding of management retiree health care costs beginning in fiscal year 2004).

15. Except for certain managed care insurance products it offers to some participants, the Medical Plan is not an insured plan under which an insurer or other third party bears the financial risk for benefits claims. Each payment of benefits under the Medical Plan constitutes a financial liability of employer Lucent.

16. Plaintiffs' claims expose Lucent to significant financial liability, in the hundreds of millions of dollars. The four pension asset transfers totaled $ 888 million. *See* Complaint, ¶ 37 (Exhibit 1) (corrected grand total amount); Answer, ¶ 37 (Exhibit 2); Report of Special Committee, dated December 28, 2006, at 9 (Exhibit 3). Plaintiffs' submission to the Special Committee presented preliminary analyses estimating the claimed financial losses to the Class members as having a value in excess of $ 400 million, exclusive of interest. *See* Plaintiffs' Submission to Special

Committee, dated December 15, 2006, at 31 (Exhibit 12).

17. When it announced some of the challenged cutbacks and terminations of retiree medical benefits it owed to the class members, Lucent publicly admitted that these actions enabled it to avoid benefit obligations in the hundreds of millions of dollars. *See, e.g.*, Lucent Form 8-K Report, dated September 8, 2003, LAR 000318-000326 at LAR 000324 (Exhibit 10) (stating that management retiree medical benefits cuts implemented during 2003-04 "will yield approximately $ 75 million in annual savings to the company").

C. The Claims Are Asserted on Behalf of a Large Group of Retirees

18. Plaintiffs' claims are brought on behalf of a large proposed class, which consists of all persons who are or have been participants or beneficiaries in the Pension Plan and Medical Plan at any time since the first pension asset transfer, on September 29, 1999. *See* Complaint ¶ 16 (Exhibit 1). Actuarial data presented to the Special Committee revealed that there were more than 93,000 members of the Class as of 2002. *See* Data Compilation, Lucent Technologies 420 Maintenance of Effort Analysis, LAR 005196 (Exhibit 13). (Although this compilation is cited here and elsewhere for the limited purposes stated, plaintiffs do not adopt the compilation.)

D. Lucent is Financially Distressed

19. During 2006 and subsequently, while the Special Committee considered and decided plaintiffs' claims, Lucent experienced continuing financial difficulties.

See, e.g., "Its Sales Down 15%, Lucent Cuts Revenue Forecast for Year," *New York Times*, January 14, 2006; "Weak North American Sales Push Lucent Earnings Lower," *New York Times*, July 27, 2006; "Revenue Plunges 16% at Alcatel-Lucent," *New York Times*, January 24, 2007; "Alcatel-Lucent's First Earnings Report Shows Big Loss; More Job Cuts Set," *New York Times*, February 10, 2007; "Alcatel-Lucent Warns of Continued Losses," *New York Times*, April 25, 2007 (collectively Exhibit 14). It can be inferred that, due to their status as members of Lucent's senior management, the Special Committee was aware of these financial circumstances at the time of its review of plaintiffs' claims and also was aware of the fact that the company could not afford the legal and financial consequences of a Committee decision in favor of plaintiffs.

D. The Claimants Are Not Part of Lucent's Active Workforce

20. Plaintiffs and the members of the proposed Class are, by definition, all retired and are not part of Lucent's active workforce. The majority of class members retired before 1996 and never had any employment relationship with Lucent. *See* Complaint, ¶¶ 10-12, 16, 26 (Exhibit 1); Answer, ¶¶ 10-12, 16, 26 (Exhibit 2).

E. The Special Committee Proceedings Were Infected by Procedural Improprieties and Biased Conduct.

21. The Special Committee proceedings were marked by procedural unfairness and improprieties and biased conduct.

22. The Special Committee was established by written action of the defendant

Employee Benefits Committee ("EBC"), dated November 21, 2006. The Action in Lieu of Meeting recited that the Special Committee was vested with "all of the authority and powers of the EBC under the LRIP [Lucent Retirement Income Plan]" and would "serve as the final review committee under LRIP and ERISA" with respect to the matters presented in this case. *See* Action in Lieu of Meeting, dated November 21, 2006, at 1 (Exhibit 4). The Action in Lieu of Meeting made no reference to any authority being granted to the Special Committee under the Medical Plan. *Id.*

23. The Report of the Special Committee also recites that the defendant Employee Benefits Committee "delegated its responsibilities for preparing the report ordered by Judge Sheridan to [the] Special Committee." *See* Report of Special Committee, December 28, 2006, at 1 (Exhibit 3).

24. In an email to her law partner at Steptoe & Johnson, the Special Committee's counsel, Anne E. Moran, commented that, "the Special committee, *a subcommittee of the Employee Benefits Committee* [,] was already established before we came on board, so we can't change that . . .." *See* Email, Anne E. Moran to Eric Serron, dated December 21, 2006, LR 001099 (emphasis added) (Exhibit 15).

25. In an email to fellow Committee members Davidson and White, dated November 30, 2006, Stephen R. Rosen explained the process by which the Committee and its counsel would conduct its deliberations. Rosen noted that "We [the Committee] also could ask for oral argument/presentation should we so choose." *See*

Email, dated November 30, 2006, Stephen R. Rosen to Janet G. Davidson and George White, Jr., LR 000526 (Exhibit 16).

26. The Committee ultimately chose not to take advantage of the opportunity to obtain additional information about the claims presented and rendered its decision solely on the basis of the parties' written submissions. *See* Report of Special Committee, December 28, 2006, at 2 (Exhibit 3). The members of the Special Committee decided to refrain from any independent fact-gathering or investigation as part of its work, or to retain any actuarial or other expert assistance. In an email to fellow Committee members Davidson and White, dated December 6, 2006, Stephen R. Rosen stated that, "The written submissions [by the parties] would serve as the sole basis for the Committee's deliberations unless the Committee after reviewing the submissions believes additional review is required to reach a determination." *See* Email, dated December 6, 2006, Stephen R. Rosen to Janet G. Davidson and George White, Jr., LR 000524 (Exhibit 17).

27. Counsel for the Lucent defendants transmitted their initial submission to the Special Committee by email dated December 15, 2006 at 6:11 P.M. *See* Email, dated December 15, 2006, Robert Rachal to Janet G. Davidson, et al. (Exhibit 18). Counsel for plaintiffs transmitted their initial submission to the Special Committee by email dated December 15, 2006 at 4:36 P.M. *See* Email, dated December 15, 2006, Alan Sandals to Stephen R. Rosen, et al. (Exhibit 19).

28. In an email to Committee members Davidson, White, and Rosen, dated December 15, 2006 at 4:54 P.M., prepared and sent by Committee counsel Anne Moran before she and they had an opportunity to review the parties' submissions, Ms. Moran forwarded to the Committee members "Section 420 Background Materials" including "an outline of the chronological history of the Section 420 maintenance of cost/benefit rule" and "an article I wrote on 420 in 1995." *See* Email, dated December 15, 2006, Anne E. Moran to Stephen R. Rosen, et al., LR 000163-187 (also noting that "we all received an electronic submission from Mr. Sandals just now") (Exhibit 20).

29. The referenced "outline of the chronological history" prepared by Ms. Moran states, under the heading "General Rule for Section 420," that "This maintenance of cost rule was enacted in 1990. It was changed to a maintenance of effort rule (*focusing on benefits, not costs*), in late 1994, and changed back to a maintenance of cost rule in 2000." (emphasis added). Under the heading "Specific Rules Applying as Law Changes" and the subheading "Minimum Benefits – 1994 Change," the outline states, "Rule: Maintain 'substantially the same level' of employer-provided retiree health coverage as provided in the taxable year immediately preceding the transfer for each 5-year benefit maintenance period." *See* Outline, "Section 420" at LR 000164 (Exhibit 20).

30. The article forwarded to the Committee by Ms. Moran is "Use of Excess Pension Assets to Pay Retiree Medical Costs – Section 420 at Midlife," 8 *Benefits Law*

Journal 91 (Summer 1995). At page 102 of the article, Ms. Moran wrote, regarding the 1994 change in Section 420 to adopt a benefit maintenance rule, "Thus under the new test, it is the level of *benefits*, and not their *costs*, which count." (emphasis in original). *See* Article, Anne E. Moran, "Use of Excess Pension Assets to Pay Retiree Medical Costs – Section 420 at Midlife," 8 *Benefits Law Journal* 91, 102-03 (Summer 1995), LR 000167, 000178-79 (Exhibit 20). The above-quoted statements by Ms. Moran about the meaning of the Section 420 benefit maintenance requirement, spanning an 11-year period that ended 13 days before the Special Committee issued its Report, are not acknowledged, either directly or indirectly, in the Report that Ms. Moran drafted on behalf of the Committee. *See* Report of Special Committee (Exhibit 3).

31. In a portion of a presentation to the Lucent Benefits Committee dated October 2002, Lucent management set forth its contemporaneous understanding of the benefit maintenance requirement as follows:

> The Maintenance of Effort requirement associated with Section 420 transfers and Lucent's Labor Contract impact its ability to make changes for 1/1/2003 – particularly for health benefits for Retirees and Occupational Actives.
>
> ***
>
> - Transfers made in FY 1999 or before are subject to "Maintenance of Benefit."
>
>   In Lucent's particular circumstances, "Maintenance of Benefit" essentially means that *the types and levels of health benefits that*

were being provided for retirees at the time of the Section 420 Transfers must be maintained until the end of FY 2003.

- Transfers made in FY 2000 or after are subject to "Maintenance of Cost."

  The average per capita postretirement health costs for of [sic] the group of individuals that was receiving postretirement health benefits at the time of the Section 420 Transfer must be maintained during the taxable year of the Section 420 Transfer and the following four years.

- Some flexibility exists in meeting these requirements (i.e. relatively insubstantial or incremental changes could be considered although some risk would still exist).

***
Highest impact changes (i.e. those that generate the most savings) generally carry the greatest risk.

Certain actions are likely to generate participant lawsuits, while others may generate adverse tax or other governmental actions.

See Executive Summary – Key Findings, LR 001412 (Exhibit 21) (emphasis added); *see also* Benefits Analysis, Benefit Committee, October 2002, LR 001576-84 (Exhibit 22). These documents were not produced to plaintiffs' counsel until March 30, 2007. *See* Letter, dated March 30, 2007, Robert Rachal to Alan Sandals (Exhibit 23). These documents also were not provided by defendants to the Special Committee as part of the "administrative record" and the Committee apparently was unaware of them.

32. *See* accompanying Confidential Supplement to Plaintiffs' Statement Pursuant to Local Rule 56.1 in Support of Motion for Partial Summary Judgment.

33. On one copy of Plaintiffs' Submission to the Committee, dated December 15, 2006, Committee counsel Anne Moran wrote the following note on the cover page: "To Ds: How can you argue [that] an increase from [$] 75/yr to 500/yr is not signif[icant]." *See* Annotated copy of Plaintiffs' Submission to Special Committee, dated December 15, 2006, at LR 000730 (Exhibit 24). Ms. Moran's note is based on the fact that defendants' own December 13, 2006 data compilation (Exhibit 13), which was the basis for the table on page 14 of the Committee's Report (Exhibit 3), showed that from fiscal year 1998 to fiscal year 2003, Lucent increased the contributions it charged to the retirees by 660%, from an average per capita contribution of $ 75.03 in 1998 to $ 495.63 in 2003. The Report refrained from presenting the 1998-2003 headcount data. Nor did it mention Ms. Moran's own observation that *during the benefit maintenance period* Lucent had dramatically increased the contributions it charged the retirees. *See* Report of Special Committee (Exhibit 3).

34. On another copy of Plaintiffs' Submission to the Committee, dated December 15, 2006, Ms. Moran wrote the following note on the cover page: "See fn. 29 – Avg OOP [out-of-pocket expenses to retirees] increased [$] 777 – 1217 [;] 1120 to – 2195." *See* Annotated copy of Plaintiffs' Submission to Special Committee, dated December 15, 2006, at LR 000700 (Exhibit 25). These facts are not acknowledged in the Report. *See* Report of Special Committee (Exhibit 3).

35. On a separate copy of page 29 of Plaintiffs' Submission, Ms. Moran circled the same footnote on page 29, containing the quotation from Lucent documents reciting the increase from 2002 to 2003 in average retiree out-of-pocket expenditures, from $ 777 to 1,217 for pre-65 retirees and $ 1,120 to 2,195 for post-65 retirees. Her handwritten note in the margin calculates the magnitude of these increases as "500 pre [and] 1000 post-65." *See* Annotated copy of page 29 of Plaintiffs' Submission to Special Committee, dated December 15, 2006, at LR 001091 (Exhibit 26). These facts are not acknowledged in the Report. *See* Report of Special Committee (Exhibit 3).

36. On Monday, December 18, 2006, Committee counsel Moran forwarded to the Committee members a document she had prepared entitled, "Maintenance of Benefit Defined." This document included excerpts from the legislative history of Section 420, including this passage from the 1999 Senate Report explaining the benefit maintenance requirement: "The minimum benefit requirement requires each group health plan to provide substantially the same level of applicable health benefits for the taxable year of the transfer and the following 4 years. The level of benefits that must be maintained is based on the benefits provided in the year immediately preceding the taxable year of the transfer." *See* Email, dated December 18, 2006, Anne Moran to Stephen R. Rosen, et al., at LR 000191 (Exhibit 27). This legislative history was not cited or quoted in the Report. *See* Report of Special Committee (Exhibit 3).

37. On Friday, December 22, 2006, Ms. Moran circulated a draft of the Report to the Committee members. Page 14 of the draft included this bracketed passage:

> [As shown in the above chart, the percentage of the total contributions to the health plan borne by Lucent was about 97% in 1998, and in 2003 was still over 88%. Merely because the employees pay a part of the cost increase that have occurred with respect to the Plan benefits does not mean that the employer-provided benefits is not substantially the same or greater than as previously provided.] [2]
>
> [2] Need to discuss whether to make this *argument*.

See Email, dated December 22, 2006, Anne Moran to Stephen R. Rosen, et al. and attached draft of Report, LR 000267-85, 000281 (Exhibit 28) (italicized emphasis added). This passage does not appear in the final Report issued by the Committee. *See* Report of Special Committee (Exhibit 3).

38. On the morning of Tuesday, December 26, 2006, two days before the Report was issued, Committee counsel Moran sent an email to the Committee members addressing several drafting issues. The email includes the following statement by Ms. Moran:

> Attached below in email form is a substitute for the *argument* on whether the amounts changed in the MEPRE [Medical Plan] were substantial. I believe we need to address the point made by Plaintiffs that the $137 million is a significant amount. The discussion below would replace the *argument* on page 14 of the draft [Report] I sent on Friday.

(emphasis added). *See* Email, dated December 26, 2006, Anne Moran to Stephen R.

Rosen, et al., at LR 000286 (Exhibit 29).

39. On the afternoon of Tuesday, December 26, 2006, two days before the Report was issued, Ms. Moran sent another email to the Committee members addressing several drafting revisions to the Report. The email includes the following statement by Ms. Moran:

> I am providing you with two revised section[s]. . . . The second part is the discuss[ion] of the alternative *argument* that I rewrote and sent you this morning. In particular, I want you to focus on the footnote marked as such. *I do not think we should try to apply the 10%/20% rule to the maintenance of benefit standard – I don't think that's correct legally, and plaintiffs could redo the numbers and get them to flunk the specific rule*. Therefore I take the position (which I actually believe is correct) that the new regulations [are] just a general guide to Congress' thinking but don't specifically apply. *Another thing I need you to consider is whether we should keep the Plaintiffs' chart in our response. It emphasizes plaintiffs' point of view and their numbers,* but on the other hand, I think it is hard to explain plaintiffs' position unless a chart is there.

See Email, dated December 26, 2006, Anne Moran to Stephen R. Rosen, et al., at LR 000288 (Exhibit 30).

40. On the morning of Wednesday, December 27, 2006, the day before the Report was issued, Ms. Moran sent an email to the Committee members, reciting that "all of you have approved the report" but that she had made two changes "that I believe are not substantive." In order to explain the second change, Ms. Moran wrote to the Committee members as follows:

> Second, in the alternative argument using Plaintiffs' numbers, I stated in the last draft that [*sic* - omit] the percentage of the so-called "shortfall"

> calculated by plaintiffs to the overall actual costs incurred by Defendants. I believe that the proper measure should be the ratio of the shortfall over the expected costs (that is more like comparing apples to apples). So I changed that percentage. I also rounded up the $137.8 million "shortfall" to $138 million to match Plaintiff's submission. The changed sections are below:
>
> OLD WORDING:
> The amount of the so-called shortfall of expected/additional employer expenses that Plaintiffs argued were "shifted" to participants represents about 10.2% of the total actual costs for the MEPRE for that period incurred by Lucent ($137 million "shortfall" / $1.342 billion in actual costs).
>
> NEW WORDING:
> The amount of the so-called shortfall of expected/additional employer expenses that Plaintiffs argued were "shifted" to participants represents about 9.3% of the total additional/expected costs for retiree health benefits that plaintiffs argued should have been incurred by Lucent for that 5-year period ($138 million shortfall / $1.472 billion in "expected" costs).

See Email, dated December 27, 2006, Anne Moran to Janet G. Davidson, et al., LR 000291-92 (Exhibit 31). The Report does not acknowledge the point made in the "Old Wording." *See* Report of Special Committee (Exhibit 3).

41. Additional documents pertinent to the claims reviewed by the Special Committee were produced by defense counsel only after the Committee completed its Report, during the period February 1, 2007 to June 18, 2007. Plaintiffs could not review or submit, and the Committee never saw or considered, any of these documents. *See* Letters, dated February 1, 2007, February 15, 2007, February 23, 2007, March 30,

2007, June 5, 2007 and June 18, 2007, Robert Rachal to Alan Sandals (collectively Exhibit 32).

F. The Special Committee Had No Experience or Expertise to Apply to the Claims. Its Views on the Issues, Principally Questions of Statutory Construction, Are Not of the Type Accorded Deference by the Courts.

42. The permanent Employee Benefits Committee had never considered any question of the type presented by plaintiffs, even under the guise of "interpreting" any of the plans while the benefit maintenance and cost maintenance requirements were in force from September 1999 to September 2006. "The Employee Benefits Committee has not previously considered the interpretation, application or implementation of the plan provisions imposing maintenance of effort [requirements] to a claim arising under a Lucent plan." *See* Defendants' Answers to Interrogatories, dated February 1, 2007, at 25 (Exhibit 8). In fact, no fiduciary of the Lucent plans had done so. "[P]rior to Judge Sheridan's remand order, plan fiduciaries had not previously interpreted or applied Lucent plan provisions imposing maintenance of effort requirements to resolve any claim under the plans." *See* Defendants' Answers to Interrogatories, dated February 1, 2007, at 38, 39 (Exhibit 8).

43. In response to an interrogatory requesting defendants and each Committee member to "state the qualifications, by training, experience, or otherwise, of each member of the Special Committee to interpret, apply or implement the benefit

maintenance or cost maintenance requirements of Internal Revenue Code section 420 as applicable to any benefits plan sponsored by Lucent, and/or plan provisions incorporating such statutory provisions," defendants only cited "the resumes of the Special Committee members" produced at LAR 003085-3088. *See* Defendants' Answers to Interrogatories, dated February 1, 2007, at 23-24 (Exhibit 8). The cited statements of experience for the Committee members do not reveal that any of them has had any such training or experience. *See* Biographical Information for Special Committee members, LAR 003085-3088 (Exhibit 5).

44. As reflected in the Report, the Committee did not seek the advice or assistance of an actuary in order to assist them in evaluating the factual issues presented. *See* Report of Special Committee at 2 (Exhibit 3).

45. As reflected in the Report, the Committee did not engage in any fact-finding on actuarial or financial issues, investigate or discuss the analyses submitted by plaintiffs, or attempt to resolve the factual disputes presented by the parties. *See* Report of Special Committee (Exhibit 3).

46. Only litigation counsel for defendants had full access to the facts and consulted with and asked Lucent's outside actuary at Aon to compile and produce "data on actual plan expenses and headcounts." Some time after November 29, 2006, "counsel for Lucent requested Aon to compile this data, which compilations were provided Plaintiffs and included in the administrative record at LAR 005196 & 5197."

See Defendants' Answers to Plaintiffs' First Set of Interrogatories, dated February 1 2007, at 22 (Exhibit 8). This data, in the form of a one-page summary table without backup data, was sent by overnight mail to counsel for plaintiffs and received on December 14, 2006, *one day* before the parties' submissions to the Committee were due. *See* Letter, dated December 13, 2006, Robert Rachal to Alan Sandals (Exhibit 33). Counsel for Plaintiffs had first requested production of such actuarial data on November 1, 2006. *See* Letter, dated November 1, 2006, Alan Sandals to Howard Shapiro (Exhibit 34).

47. The Lucent Technologies Inc. Retirement Income Plan ("Pension Plan") and the Medical Plan expressly incorporate statutory provisions set forth in Sections 401(h) and 420 of the Internal Revenue Code. Pension Plan § 5.2 directs that "The segregated 'Health Care Fund' described in Section 5.3 shall *meet the requirements of Code § 401(h)*," LAR 0518 (emphasis added), which statutory provision in turn incorporates the requirements of Code § 420. Pension Plan § 5.3 directs that the Health Care Fund shall be credited with "transfers of excess assets under the Plan, *to the extent and as defined and permitted by Code § 420*." LAR 0519 (emphasis added). Pension Plan § 5.9(a) restricts transfers of pension assets to "Qualified Transfers of 'excess pension assets' *as defined in Code § 420(e)(2)*." LAR 0521 (emphasis added). Pension Plan § 5.11(e) defines "Qualified Transfer" as "a 'qualified transfer' *within the meaning of Code § 420(b)(1)*." LAR 0523 (emphasis added). *See* Lucent Retirement

Income Plan (excerpts) (Exhibit 35). The Medical Plan at § 17.11 directs that "*Pursuant to Sections 401(h) and 420 of the Code*, Lucent Technologies, Inc. shall comply with all cost maintenance period requirements and benefit maintenance period requirements that may be applicable to this Plan for any Code Section 420 pension asset transfer [etc.]." LAR 0621, 0760 (emphasis added). *See* Lucent Medical Expense Plan for Retired Employees (excerpts) (Exhibit 36).

48. In its Report, the Special Committee repeatedly engaged in matters of statutory interpretation and construction and repeatedly expressed its "belief" about the requirements of Internal Revenue Code Section 420 that are incorporated in the Pension Plan and Medical Plan. *See, e.g.*, Report of Special Committee at 3 ("Section 420 of the Code requires . . ."), 7 ("Based on the clear reading of the statute . . ."), 12 ("The Special Committee believes that the statute contemplates . . ."), 14 ("the Special Committee believes that the statute contemplates . . ."), 16 ("we do not believe that the maintenance of benefit rule requires that employers . . ."), 18 ("There is nothing in that statutory language . . .") (Exhibit 3).

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II. BACKGROUND FACTS APPLICABLE TO PLAINTIFFS' CLAIMS

A. The Parties and the History of Lucent and Its Plans.

49. Plaintiffs Peter A. Raetsch and Curtis C. Shiflett were formerly employed by AT& T Corporation and Lucent Technologies, Inc. and retired from Lucent. Answer ¶ 2 (Exhibit 2).

50. Plaintiff Peter A. Raetsch is a participant in and has received benefits from the Pension Plan and the Medical Plan. His spouse, plaintiff Geraldine Raetsch, was a beneficiary of the Medical Plan and Pension Plan. Answer ¶ 10 (Exhibit 2).

51. Plaintiff Shiflett is a participant in and has received benefits from the Pension Plan and the Medical Plan. His spouse, Betty L. Shiflett, was a beneficiary of the Medical Plan and Pension Plan. Answer ¶ 11 (Exhibit 2).

52. Plaintiffs Raetsch and Shiflett qualified for pension and retiree medical benefits. Answer, ¶ 23 (Exhibit 2). Plaintiffs Raetsch and Shiflett are receiving service pensions from the Pension Plan. Assets were transferred from their Pension Plan to fund retiree medical benefits under the Medical Plan. Answer ¶ 12 (Exhibit 2).

53. Defendant Lucent Technologies, Inc. is a Delaware corporation having a principal place of business at 600 Mountain Avenue, Murray Hill, NJ. Answer ¶ 13 (Exhibit 2).

54. Defendant Lucent Technologies, Inc. Employee Benefits Committee is a body appointed by Lucent which serves designated plan administration functions under

the Pension Plan. Answer ¶ 14 (Exhibit 2).

55. Defendant Lucent Technologies Inc. Medical Plan for Retired Employees is a successor to certain retiree medical benefit plans sponsored by AT&T, and is established to provide post-retirement medical coverage to eligible plan participants, their spouses, and other eligible dependants. Answer ¶ 15 (Exhibit 2).

56. Lucent Technologies Inc. was incorporated in 1995 and fully divested from AT&T Corporation on September 30, 1996. Certain participants and assets, along with obligations to pay certain benefits, were transferred to new plans at Lucent. Answer ¶ 3 (Exhibit 2).

57. Lucent established its own pension and medical plans, and certain participants and assets, along with obligations to pay certain benefits, were transferred to the new plans at Lucent. Answer ¶ 4 (Exhibit 2). Lucent established the Pension Plan and the Medical Plan. Answer ¶ 32 (Exhibit 2).

58. Plaintiffs and the members of the proposed Class did not consent to the assignment of AT&T's benefits obligations to Lucent. Answer ¶¶ 28-31 (Exhibit 2).

59. On September 30, 1996, Lucent was fully divested from AT&T Corporation. The assets in the Lucent Pension Plan exceeded its liabilities at the time of this spin-off from AT&T. Answer ¶ 27 (Exhibit 2).

60. The AT&T Management Pension Plan and the Lucent Technologies Inc. Management Pension Plan each had assets which exceeded its liabilities. Answer ¶ 36

(Exhibit 2).

61. The Lucent Technologies Inc. Management Pension Plan was re-named the Lucent Retirement Income Plan effective January 1, 2000. Answer ¶ 35 (Exhibit 2).

B. Lucent's Transfers of Pension Assets to Fund Medical Benefits and Its Resulting Benefit Maintenance and Cost Maintenance Obligations

62. Lucent made four Section 420 transfers of pension assets from the Pension Plan to fund retiree medical benefits for plaintiffs and other management retirees and their dependents as follows:

(a) in the amount of $182,993.00 on or about September 29, 1999;

(b) in the amount of $191,169.00 on or about December 31, 1999;

(c) in the amount of $214 million on or about December 27, 2000; and

(d) in the amount of $300 million on or about December 26, 2001.

The total amount of these four transfers was $888,162,000. Answer, ¶ 37 (Exhibit 2); Complaint ¶ 37 (Exhibit 1).

63. Under the terms of the Lucent Technologies Inc. Management Pension Plan, later renamed the Lucent Technologies Inc. Retirement Income Plan, the transfers of excess Pension Plan assets to find health benefits for management retirees and their dependents caused Lucent to be subject to certain maintenance of effort obligations, consisting of a "benefits maintenance" obligation for tax years 1999 through 2003

(ending September 30, 2003), and a "cost maintenance" obligation for tax years 2004 through 2006 (ending September 30, 2006). Answer ¶ 5 (Exhibit 2).

64. In conformity with the requirements of Internal Revenue Code Section 420, the Pension Plan includes provisions that, *inter alia*, a separate account "Health Care Fund" was established within the pension trust to fund a portion of the retiree medical benefits; the Health Care Fund "shall meet the requirements of Code § 401(h)" and any transfers of pension assets would be limited to transfers that were qualified under the Code; and a transfer of pension assets would be permitted only if each Medical Plan "provides that the Applicable Health Benefits for each taxable year during the Benefit Maintenance Period are substantially the same as the Applicable Health Benefits provided by the employer during the taxable year immediately preceding the taxable year of the Qualified Transfer." *See* Pension Plan, LAR 0483, 0518-0523 (Exhibit 35). These provisions incorporating the requirement of the Benefit Maintenance Period also appeared in the predecessor versions of the Pension Plan dated as of October 1, 1996, and January 1, 1998.

65. Lucent also amended the Medical Plan to recite that:

> **17.11 Pension Asset Transfers**
>
> Pursuant to Sections 401(h) and 420 of the Code, Lucent Technologies Inc. shall comply with all cost maintenance period requirements and benefit maintenance period requirements that may be applicable to this Plan for any Code Section 420 pension asset transfer by or on behalf of Lucent Technologies Inc. for

> qualified current retiree health liabilities (as defined under Code Section 420). With respect to any prior asset transfer by AT&T under Code Section 420, Lucent Technologies Inc. agrees to comply with the provisions of Code Section 420 for the applicable cost maintenance or benefit maintenance periods to which this Plan is subject.

See Lucent Technologies Inc. Medical Expense Plan for Retired Employees, § 17.11 at 129 (as amended and restated effective January 1, 2001 and executed September 30, 2002), LAR 0621, 0760 (Exhibit 36).

66. The company has not produced any plan documents for the Dental Plan. Presumably, they also contain the required language.

67. Top management of the company, including plan fiduciaries, were informed and aware that the provisions of Internal Revenue Code Sections 401(h) and 420, which were incorporated in both the Pension Plan and the Medical Plan, required Lucent to observe a five-year "benefit maintenance period" for retiree medical benefits through September 30, 2003. The five-year benefit maintenance requirement was pointed out to top management and Directors of the company at the December 18, 2002 meeting of the Corporate Governance and Compensation Committee Meeting. The agenda and minutes for the meeting were produced in the death benefit litigation at production numbers D-002451 through D-002466 (Exhibit 37).

68. The December 18, 2002 meeting was attended by, inter alia, CEO and Director Patricia Russo; Director Henry Shacht; CFO Frank D'Amelio; General

Counsel Richard Rawson; VP William Carapezzi; Chief Investment Officer Collette Chilton; Sr. VP Human Resources Pamela Kimmet; and Managing Corporate Counsel Steven Kronheim. D-002455 (Exhibit 37). Page 3 of the minutes recites that Ms. Kimmet provided background on pension and healthcare issues and "distributed a binder entitled 'U.S. Healthcare and Retirement Plans Discussion'" to which she referred during her presentation. The minutes also state that Ms. Kimmet "addressed the requirements of Section 420 of the Internal Revenue Code regarding prior transfers of excess pension assets to fund retiree healthcare and cost maintenance requirements." D-002457 (Exhibit 37).

69. The information binder used at the December 18, 2002 Board Committee meeting was produced to the Special Committee at LAR 0202-0251 (Exhibit 38) (non-confidential excerpts). The binder includes materials discussing the requirements of Section 420. Internal page 49 sets forth a chart entitled "Section 420 - Maintenance of 'Benefit/Cost' Expirations." This page has the following note:

> Note: *It appears that, under a Section 420 transition rule, the Maintenance of "Benefit" requirement applies for all years through FYE 2003. This interpretation is reflected in our chart.*

LAR 0234 (emphasis added) (Exhibit 38). The preceding page warned that "Penalties for violating [section 420] requirements include Pension Plan disqualification, excise and income taxes, and possible damages. The risk of challenges and penalties rises with the magnitude of change." LAR 00233 (Exhibit 38).

70. Despite these warnings about the benefit maintenance rule and the serious consequences for both the Pension Plan and the company that would result from its violation, the immediately preceding page lists some of the benefits cutbacks that had been implemented in 2001 and 2002, as well as other cutbacks that would take effect in 2003 – all during the benefit maintenance period. LAR 00232 (Exhibit 38).

C. Lucent Made Substantial Changes in the Level of Medical Benefits During the Benefit Maintenance and Cost Maintenance Periods.

71. After the first Section 420 pension asset transfer in September 1999, Lucent made changes to the benefits provided under the Medical Plan.

72. Defendants made a series of cuts in the program of retiree medical benefits, either by reducing levels of coverage, increasing co-payments and deductibles, and/or imposing contribution requirements on plaintiffs and their spouses and the members of the Class. Beginning October 1, 2003, the company continued to reduce benefits and also began to exclude participants.

73. These benefit reductions were as follows:

(a) Effective January 1, 2001, Lucent acted to (1) impose contribution requirements for participation in the Medical Plan by certain retirees (and their spouses) who retired on or after March 1, 1990; (2) increase office visit co-payment amounts and out of pocket individual and family maximums for medical services covered under the Medical Plan; and (3) increase co-pays for retail and mail order

prescription drugs covered under the Medical Plan. *See* information binder used at the December 18, 2002 Board Committee meeting at LAR 00231 (Exhibit 38); "2001 Benefit Elections" booklet at LAR 04976 (Exhibit 39).

(b) Effective January 1, 2002, Lucent acted to further increase co-pays for retail and mail order prescription drugs covered under the Medical Plan by adding a "third tier" of coverage, for "non-preferred" branded prescription drugs with higher co-pay requirements. *See* LAR 0231 (Exhibit 38).

(c) Effective January 1, 2003, Lucent acted to (1) impose contribution requirements for participation in the Medical Plan by all retirees who retired on or after March 1, 1990; (2) increase co-pays, individual and family annual deductibles, and individual and family out of pocket maximums for medical services covered under the Medical Plan for all retirees and dependents; (3) increase co-pays and annual out-of-pocket maximums for retail and mail order prescription drugs covered under the Medical Plan for all retirees and dependents; and (4) impose co-insurance and co-pays for retail and mail order prescription drugs prescribed for outpatient chemotherapy covered under the Medical Plan for all retirees and dependents. *See* LAR 00231 (Exhibit 38); "Your Guide to Open Enrollment" at LAR 4948-56 (Exhibit 40).

(d) Effective October 1, 2003, Lucent acted to (1) eliminate company reimbursements of Medicare Part B premiums paid by all Medicare-eligible

management retirees and dependents. *See* Employee enrollment kit at LAR 5013, 5021 (Exhibit 41).

(e) Effective January 1, 2004, after the cost maintenance requirement took effect, Lucent acted to (1) eliminate company-paid coverage for dependents of all management retirees who retired on or after March 1, 1990 and whose base salary at retirement was $ 87,000 or more; (2) eliminate company-paid dental coverage for all management retirees and their dependents and reduce healthcare contribution caps by a commensurate amount; (3) increase co-pays for hospitalization and emergency room visits, reduce the quantity of medication covered by the retail prescription drug program, and increase the annual out-of-pocket maximum for prescription drugs. *See* LAR 05014, 05022-5023, 05055 (Exhibit 41).

(f) Effective January 1, 2005, Lucent acted to (1) eliminate company-paid coverage for dependents of management retirees who retired on or after March 1, 1990 and whose base salary at retirement was $ 65,000 or more; (2) reduce allowable "reasonable and customary" charges under the POS out-of-network, traditional indemnity, and mental health coverages; and (3) change the "coordination of benefit" provision where another plan also covers a charge, so that Lucent would pay only the incremental difference between what its plan would have paid and what the other plan would pay. *See* "Benefits 2005" booklet at LAR 00158-160 (Exhibit 42).

(g) Effective January 1, 2006, Lucent acted to (1) impose new contribution requirements for participation in the Medical Plan for retirees who retired on or after March 1, 1990 and their spouses. *See* "Important Information About Your Benefits" at LAR 3011 (Exhibit 43). *See also*, Answer ¶ 41 (Exhibit 2).

74. During the benefit maintenance period, the level of retiree medical and dental benefits (including retiree contribution, co-payment, and out-of-pocket maximum provisions) that were specified by the Medical Plan and Dental Plan for management retirees was not "substantially the same as" the level of benefits provided by Lucent during the year immediately preceding the September 1999 transfer.

D. Lucent's Benefit Cutbacks and Cost-Shifting Were Substantial.

75. During the benefit maintenance period from October 1, 1999 to September 30, 2003, defendants did not maintain substantially the same level and program of retiree medical and dental benefits for plaintiffs and the Class.

76. During the benefit maintenance period, the level and program of benefits was substantially cut back and reduced by defendants' actions to shift costs of the benefits away from the company and onto the retirees. For example, the company reported the fact that its "per capita cost [for retiree medical coverage] for 2003 vs. 2002 was **flat**" (emphasis in original) and that "This is mainly attributable to cost shifting under the medical plan. The average out-of-pocket expenses (excluding contributions [which also were increased]) have increased from: . . . $ 777 [2002] to $

1,217 [2003] for pre-65 retirees [and] $ 1,120 [2002] to $ 2,195 [2003] for post-65 retirees." *See* "U.S. Management Employees/Retirees Benefits Proposal for 2005 at LAR 0290 (Exhibit 44). The company also increased the contributions it charged the retirees by 660%. *See* ¶ 33 above.

77. The significance of these changes in the level of benefits is demonstrated by the financial effects of the changes. An estimate of the financial effects can be calculated by first projecting the costs to the company of providing the fiscal year 1998/1999 program of benefits[2] during each remaining year of the five-year benefit maintenance period, and then comparing these expected company costs to the actual costs paid by the company during the benefit maintenance period.

78. The expected cost to the company of providing throughout the benefit maintenance period substantially the same level of benefits that was in force during fiscal year 1999 is a function of the following factors:

(a) the population covered by the Medical Plan (retirees, spouses and other eligible dependents);

(b) the expected plan utilization and claims experience for the covered

[2] Lucent did not produce any documents indicating that there was any material change or difference in the plan of medical/dental benefits that was in force during fiscal year 1998 as compared to fiscal year 1999, so these calculations use fiscal year 1999 (with the same program of benefits as 1998) as the benchmark year for the benefit maintenance analysis.

population under the coverage terms of the plan as of fiscal year 1999;

(c) "medical trend", i.e., the rate of increase in the cost of providing the healthcare services, procedures and products (including prescription drugs) covered by the plan, which rate of increase reflects not only increases in the costs of particular services, procedures and products, but also increases in costs due to advances in medical practice standards, technology and utilization; and

(d) general inflation trends in the economy as a whole.

These points are illustrated in the Health Care Trend Survey reports, prepared by employee benefits consulting firm Aon Consulting, which together with predecessor firm ASA/Actuarial Sciences Associates, Inc. served as Lucent's healthcare benefits consultant during the period in question. *See* Aon News Release, "Health Care Costs Increase at the Lowest Rate in Five Years, Says Aon" (November 15, 2006) (including table of medical trends from Fall 2001 to Fall 2006) (Exhibit 45); Aon Spring 2006 Health Care Trend Survey (Spring 2006) (Exhibit 46).

79. Due to the changes in the medical and dental benefits that were implemented by defendants, Lucent's actual, reported expenditures for the Medical Plan during the benefit maintenance period do not reflect the full expected costs of continuing to provide and maintain the 1999 level and program of benefits throughout the benefit maintenance period.

80. Cost-shifting to the retirees that was in a form other than contribution increases does not appear in the company's tabulations of company and retiree costs (LAR 5196, Exhibit 13). Costs paid by the retirees due to increased co-payment requirements, increased deductibles and out of pocket maximum requirements, and exclusions from coverage, are not reflected in the company's data compilation of company and retiree expenditures. The only costs paid by retirees that are reflected in the data compilation are the monthly contributions they paid. LAR 005196 (Exhibit 13).

81. Within a week of the Court's ruling on the motion to dismiss, counsel for plaintiffs requested defendants to produce the data needed to make a full projection of the financial effects of the changes. *See* Letter, dated November 1, 2006, Alan M. Sandals to Howard Shapiro (Exhibit 34). By letter dated November 3, 2006, Lucent's counsel refused to provide this data either to plaintiffs' counsel or the Special Committee). *See* Letter, dated November 3, 2006, Howard Shapiro to Alan M. Sandals (Exhibit 47).

82. As a result of defendants' refusal to provide the data, it was not possible for plaintiffs or the Special Committee to make a full projection of the company costs of providing the fiscal year 1999 level and program of benefits throughout the remainder of the five-year benefit maintenance period, and to compare those costs to the actual costs paid by the company during the benefit maintenance period. This

analysis will illustrate the magnitude and significance of the reductions in benefits during the benefit maintenance period. It also was not possible for plaintiffs and the Special Committee to make a full projection of the costs of providing the fiscal year 1999 program of benefits and thus to determine the baseline per capita cost and required minimum per capita expenditure for the cost maintenance period ending September 30, 2006.

83. Despite the lack of detailed data, some basic data were available to counsel for plaintiffs to enable them to present to the Special Committee estimates of the magnitude of the financial harm resulting from the changes in the benefit program during the benefit maintenance period.

1. <u>Growth in Population Covered by the Medical Plan</u>

84. The covered population of retirees, spouses and other eligible dependents who were covered by the Medical Plan grew considerably during the benefit maintenance period, from September 1999 to September 2003. On December 13, 2006, defendants' counsel produced to plaintiffs' counsel a data compilation, entitled "Lucent Technologies 420 Maintenance of Effort Analysis" setting forth on an annual, fiscal year basis the annual expenditures and numbers of "Retired Management" participants ("members") in the Medical Plan. *See* Data Compilation produced at LAR 5196 (Exhibit 13). (Plaintiffs were not supplied with underlying business records from which this data compilation was prepared, and therefore were not able to test the

accuracy of this compilation and therefore have reserved all rights to explore these issues in further proceedings. As stated in the footnotes to the data compilation, much of the data on "members" participating in the Medical Plan were extrapolated.)

85. Defendants' December 13, 2006 data compilation shows that:

(a) from fiscal year 1999 to fiscal year 2000, the retiree population increased by 4.14% (74,621 participants in 2000 vs. 71, 652 in 1999);

(b) from fiscal year 2000 to fiscal year 2001, the retiree population increased by 5.91% (79,032 participants in 2001 vs. 74,621 participants in 2000);

(c) from fiscal year 2001 to fiscal year 2002, the retiree population increased by 18.17% (93,393 participants in 2002 vs. 79,032 in 2001); and

(d) from fiscal year 2002 to fiscal year 2003, the retiree population declined by 2.42% (91,231 participants in 2003 vs. 93,393 in 2002). *See* Data Compilation, LAR 005169 (Exhibit 13).

Assuming for current purposes only that the population data in the compilation are correct, a simple calculation shows that from fiscal year 1999 to fiscal year 2003, the aggregate population increase in the Medical Plan was 27.32% (91,231 in 2003 vs. 71,652 in 1999).

86. Defendants' data compilation made no attempt to adjust the population data to account for decreases in the number of Medical Plan participants based on the affects of the benefits cuts imposed by the company. The population headcounts

reported in the data compilation do not include the number of participants who would have been covered by the plan if defendants had maintained substantially the same level and program of benefits during the 1999-2003 benefit maintenance period.

87. A more precise basis to calculate the increase in the population eligible to be covered by the Medical Plan is found in another document produced by Lucent, which Lucent used in May 2003 to evaluate various alternatives to reduce the covered population. The charts in this document reveal that as of May 2003, the Medical Plan covered 47,500 retirees and 45,000 spouses, for a total of 92,500 lives. *See* LAR 0064, Chart for "Alternative 4a" (boxes for total population at all income and pension levels) (Exhibit 48). The same document reveals that this total included 8,527 people (4,048 retirees and 4,479 dependents) added during the year 2000, and another 21,832 people (10,252 retirees and 11,580 dependents) added during the year 2001. *See* LAR 0065 (this chart only covers the subset of "Post [19]90 Retiree Group") (Exhibit 48).

88. Using these reported year-by-year increases in covered lives, and adding in the 36,498 lives from retirements before 1990 which are not differentiated on the chart, the following participant population trends can be derived:

YEAR	RETIREES ADDED	DEPENDENTS ADDED	TOTAL	CUM. TOTAL	YR OVER YR %
1990 and earlier	36,498	0	36,498	36,498	
Before 1991	275	258	533	37,031	1.46
1991	523	487	1,010	38,041	2.73

1992	719	677	1,396	39,437	3.67
1993	498	429	927	40,364	2.35
1994	1,110	975	2,085	42,449	5.17
1995	1,222	1,120	2,342	44,791	5.52
1996	3,339	3,449	6,788	51,579	15.15
1997	883	948	1,831	53,410	3.55
1998	1,030	1,121	2,151	55,561	4.03
1999	2,333	2,558	4,891	**60,452**	8.80
2000	4,048	4,479	8,527	68,979	14.11
2001	10,252	11,580	21,832	90,811	31.65
2002	769	920	1,689	92,500	1.86
2003	0	0	0	**92,500**	0
				2003 vs. 1999	**53.01**

This calculation was presented in plaintiffs' submission to the Committee. Defendants did not challenge this calculation, but the Committee did not acknowledge it. The historic data in Lucent's 2003 document establish a higher rate of population increase from 1999 to 2003 (53.01%) than is indicated by defendants' December 13, 2006 data compilation (27.32%) (Exhibit 13).

89. The Special Committee did not acknowledge this significant discrepancy in the population data presented by the parties, investigate it, or attempt to resolve it. It accepted defendants' December 13, 2006 data compilation without question. *See* Report at 14 (Exhibit 3) (chart based solely on defendants' data compilation).

90. Even if one uses the more conservative retiree population increase percentage derived from defendants' data compilation, the cost to Lucent of providing the fiscal year 1999 level and plan of benefits during fiscal year 2003 should have increased by approximately 27.32% based on retiree population growth alone, ignoring the factor of medical inflation. If, in the alternative, the data presented in Lucent's 2003 document were used, the cost to Lucent of providing the fiscal year 1999 level and plan of benefits during fiscal year 2003 should have increased by approximately 53% based on retiree population growth alone.

2. <u>Medical Costs Inflation Experienced by the Plan</u>

91. The limited data produced by the company also provide information indicating the degree of medical cost inflation experienced by the Medical Plan. In the background book for the December 18, 2002 review of pension and healthcare costs by the Corporate Governance and Compensation Committee of the Lucent Board of Directors, Lucent's benefits staff pointed out that "health care costs have increased substantially since 1999, from 10% [annual increase] to as high as 15% [annual increase] in 2002" and that "medical [costs] increased by approximately 12% in 2002 [and] pharmacy costs increased by over 20% in 2002." *See* LAR 0186 (Exhibit 11). The same document went on to state that, for the forthcoming year, "2003 costs are expected to continue to increase at approximately 15%." *Id.*

3. <u>Expected Plan Costs If Benefits Had Been Maintained</u>

92. As noted in ¶¶ 81-82 above, Lucent did not provide the detailed data needed to make a full projection of expected company costs associated with maintaining the same level and program of benefits that the Medical Plan provided during fiscal year 1999. However, the significance of the changes in these benefits can be estimated from available data.

93. The costs paid by the company for medical coverage for management retirees and their spouses and other eligible dependents during fiscal year 1999 are recorded in the December 13, 2006 data compilation. The document sets forth on an annual, fiscal year basis the annual expenditures and numbers of participants ("members") in the medical plan. *See* LAR 5196 (Exhibit 13).

94. The December 13, 2006 data compilation reports that the company's fiscal year 1999 expenditures for "Retired Management" retirees, for both medical and dental coverage, and net of retiree contributions and other credits, were $ 200,954,193. According to the same data compilation, the fiscal year 2003 company expenditures for the Medical Plan and Dental Plan were $ 340,645,758. *See* Exhibit 13.

95. Using the expenditures for fiscal year 1999 reported in defendants' data compilation (Exhibit 13), it is possible to estimate the amount that the company would be expected to spend during fiscal year 2003 if it had maintained and provided substantially the same level of benefits throughout the benefit maintenance period.

Taking the fiscal year 1999 expenditures and adjusting them to reflect both medical inflation and plan population increases revealed in Lucent's documents, the following are the estimated expected costs to Lucent of providing the same level of benefits during the benefit maintenance period:

FISCAL YEAR	EXP. COSTS	FOLLOWING YEAR INCREASE BASIS	INCREASE[3]
[1999]	[$ 200,954,193]	4.1% pop incr., 12% medical inflation	1.166
2000	$ 234,312,589	5.9% pop. incr., 12% medical inflation	1.186
2001	$ 277,894,731	18.2% pop. incr., 15% medical inflation	1.359
2002	$ 377,658,939	.977 (headcount reduced), 13% medical inflation	1.104
2003	$ 416,935,469	--	--

These simple calculations use the more conservative population increase factors reflected in defendant's data compilation. They also use conservative, assumed rates of medical inflation for the plan. The trends reported in the Aon surveys (Exhibits 45 and 46) indicate that the actual rates of medical inflation were higher.

96. The above analysis shows expected company expenditures of approximately $ 417,000,000 during fiscal year 2003, ending September 30, 2003, assuming that the substantially the same fiscal year 1999 level of benefits had been

[3] The values reported in this column of the table, which are used to calculate the "Exp. Costs" column, correct a mathematical error in the version of this table submitted to the Special Committee. The table submitted to the Committee erroneously calculated the *sum* of the population increase and medical inflation factors by adding the two together, rather than using the *product* of these two factors. Because the medical inflation applied to all services provided to the plan participants, including the increased population, the two factors operated in tandem to increase costs.

provided. According to defendants' data compilation, the actual company expenditures during fiscal year 2003 were $ 340,645,758, representing a difference from the expected level of approximately $ 76.3 million in fiscal year 2003 alone. The differences in expected versus actual company expenditures during earlier years that were subject to the benefit maintenance requirement (fiscal years 2000, 2001 and 2002) can also be readily calculated by comparing the expected annual company costs shown in the previous table to the actual expenditures by Lucent reported in the December 13, 2006 data compilation (LAR 5196, Exhibit 13):

FISCAL YEAR	EXP. COSTS	ACTUAL COSTS	SHORTFALL
1999	$ 200,954,193	$ 200,954,193	$ -
2000	$ 234,312,589	$ 211,188,578	$ 23,124,011
2001	$ 277,894,731	$ 247,427,466	$ 30,467,265
2002	$ 377,658,939	$ 342,109,003	$ 35,549,936
2003	$ 416,935,469	$ 340,645,758	$ 76,289,711
		Total Shortfall	**$ 165,430,923**

97. These calculations show that the estimated total shortfall (i.e., the dollar difference between the company's expected and actual expenditures to provide the same level of benefits) equals $ 165,430,923 exclusive of interest.

98. Defendants did not maintain substantially the same level and program of retiree medical and dental benefits during the benefit maintenance period ended September 30, 2003. Conservative estimates of the financial effects of defendants' benefit cutbacks show that this failure to maintain substantially the same level and program of benefits was significant.

4. Shortfalls During the Cost Maintenance Period

99. According to the above calculations, if defendants had maintained substantially the same level of retiree medical and dental benefits that was in force in fiscal year 1999 through the end of fiscal year 2003, then company expenditures during fiscal year 2003 would have been approximately $ 416.9 million. This level of expenditure also serves as the baseline for purposes of implementing the per capita cost maintenance requirement that applied during fiscal years 2004-2006.

100. The following table shows the expected costs for the company to maintain the average per capita cost during fiscal years 2004-2006, even assuming that the company made a permissible 10% reduction of headcount in fiscal year 2004, and a second 10% reduction in headcount in that reduced population in fiscal year 2005.[4]

FISCAL YEAR	EXPECTED COSTS	ACTUAL COSTS	SHORTFALL
2003	$ 416,935,469	$ 340,645,758	$ -
2004	$ 375,241,922	$ 255,637,571	$ 119,604,351
2005	$ 337,717,729	$ 217,067,000	$ 120,650,729
2006	$ 337,717,729	$ 209,322,185	$ 128,395,544
		Total Shortfall	**$ 368,650,624**

(These calculations assume that a 10% reduction in headcount actually resulted in a full 10% reduction in plan cost. This is a conservative assumption working in

[4] These calculations apply the 10% reduction factor to the cost in each immediately preceding year, i.e., 2003 expected costs times 0.9 equals 2004 expected costs, and 2004 expected costs times 0.9 equals 2005 expected costs.

defendants' favor, because it is not necessarily true that a 10% headcount reduction would result in a 10% cost reduction.)

101. Using the appropriate *corrected* level of benefits and costs for fiscal year 2003, and factoring in the maximum headcount reductions and resulting reductions in costs that would be permitted under the Section 420 cost maintenance regulations issued by the Treasury Department, this analysis shows that there was a cumulative shortfall in the per capita benefit expenditures by the company, having an estimated value of $ 368,650,624 exclusive of interest.

102. Defendants did not maintain the average per capita cost of the program of retiree medical and dental benefits during the cost maintenance period beginning October 1, 2003 and ending September 30, 2006. The above analysis of the financial effects of defendants' conduct establishes that this failure to maintain costs was significant.

103. As calculated in ¶¶ 95-96 above, the expected total costs for fiscal year 2003 under the benefit maintenance requirement equal $ 416,935,469. When that value is divided by the actual number of fiscal year 2003 plan participants reported by the company in the December 13, 2006 data compilation (91,231 participants), the result is an average per capita cost of $ 4,570 per participant.

104. The differences between the expected annual per capita company expenditures of $ 4,570 for fiscal year 2003 and the actual per capita expenditures

reported in defendants' December 13, 2006 data compilation, i.e., $ 3,358 in fiscal year 2004, $ 3,246 in 2005, and $ 3,389 in 2006, are also significant.

105. An alternative analysis of compliance with the cost maintenance requirement, which does not take into account the pre-existing benefit maintenance requirement and instead uses only the actual, reported level of company costs in fiscal year 2003, also can be performed.

106. Fiscal year 2004 was the first year in which the cost maintenance requirement was applicable to Lucent. The two taxable years immediately preceding fiscal year 2004 were fiscal year 2003 and fiscal year 2002.

107. According to the December 13, 2006 data compilation provided by the company (Exhibit 13), the average per capita cost in fiscal 2003 was $ 3,768, and that was the higher per capita value of the two fiscal years, 2002 and 2003. The same chart shows that, using the average per capita cost figure from fiscal 2003 and not taking into account any other issues, in each succeeding year the company provided benefits that had a per capita average cost considerably less than $ 3,768. The per capita difference was $ 410 ($ 3,768 – 3,358) in fiscal year 2004, equal to a total shortfall of $ 32,353,920 for the listed 78,912 participants. The difference was $ 522 ($ 3,768 – 3,246) in fiscal year 2005, equal to a total shortfall of $ 35,280,936 for the listed 67,588 participants. The difference was $ 379 ($ 3,768 – 3,389) in fiscal year 2006, equal to a total shortfall of $ 23,632,166 for the listed 62,354 participants. The

combined total of these differences during fiscal years 2004-2006 is $ 91,267,022. These annual per capita and combined total amounts are significant. (Again, these calculations do not utilize the higher expected amount of 2003 per capita costs estimated in ¶¶ 95-96 above, which takes into account the benefit maintenance shortfalls through September 30, 2003).

108. Historic company records show that Lucent treated fiscal year 2001 as the benchmark year for its cost maintenance calculations and used a value of $ 3,255 as the average per capita cost of providing benefits during that year. *See, e.g.*, LAR 0052 (Exhibit 49) (July 2, 2003 analysis using fiscal 2001 costs, reported as $ 3,255 per capita). The December 13, 2006 data compilation uses a lower per capita amount for fiscal year 2001 ($ 3,165 per capita) but does not explain why it uses a lower value than the historic data. Data Compilation (Exhibit 13). The cost maintenance calculations presented by defendants to the Special Committee used the same unadjusted, fiscal year 2001 average per capita cost of $ 3,165. *See* Report of Special Committee at 19 (Exhibit 3).

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Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that the foregoing Plaintiffs' Statement Pursuant to Local Rule 56.1 in Support of Motion for Partial Summary Judgment was served upon counsel listed below on June 28, 2007 by ECF filing and by UPS Overnight Service:

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