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UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEW JERSEY

GEORGE PALLAS Derivatively on Behalf of Nominal Defendant LUCENT TECHNOLOGIES, INC., Plaintiff, v. HENRY B. SCHACHT, PAUL A. ALLAIRE CARLA A. HILLS, DONALD K. PETERSON, FRANKLIN A. THOMAS, JOHN A. YOUNG, DEBORAH C. HOPKINS and RICHARD A. MCGINN, Defendants, -and- LUCENT TECHNOLOGIES, INC., a Delaware Corporation, Nominal Defendant.	:	CASE NO.: JURY TRIAL DEMANDED

VERIFIED DERIVATIVE COMPLAINT

Plaintiff, George Pallas ("Plaintiff"), by his undersigned counsel, brings the following stockholder derivative complaint upon knowledge as to his own acts and, as to all other matters, upon the investigation made by and through his counsel, against Henry

B. Schacht ("Schacht"), Paul A. Allaire ("Allaire"), Carla A. Hills ("Hills"), Franklin A. Thomas ("Thomas"), John. A. Young ("Young"), collectively ("Director Defendants"); and Richard A. McGinn ("McGinn"), Donald K. Peterson ("Peterson") and Deborah C. Hopkins ("Hopkins"), collectively ("Management Defendants"), and nominal defendant Lucent Technologies, Inc. ("Lucent" or the "Company"). The investigation by Plaintiff's counsel included a review of Lucent's filings with the U.S. Securities and Exchange Commission ("SEC"), press releases issued and other public statements made by the Company, demands served upon the board, securities analysts' reports and advisories about the Company, and court files, news articles, and other reports concerning Lucent, Xerox and other companies with which members of Lucent's Board of Directors were or are affiliated.

NATURE OF THE ACTION

1. This is a stockholder's derivative action brought pursuant to Rule 23.1 of the Federal Rules of Civil Procedure and state law, on behalf of nominal defendant Lucent Technologies, Inc. ("Lucent"), against present and former executive officers and directors of the Company, for wrongful refusal of demand, breaches of fiduciary duty, breaches of the fiduciary duties of good faith, loyalty and full disclosure, gross mismanagement, waste of corporate assets and abuse of control.

2. In addition, plaintiff alleges direct proxy violations by the Director Defendants because the 1999, 2000 and 2001 proxy statements, issued in the name of Lucent, were materially misleading. Each of these proxy solicitations failed to disclose that the Director Defendants and the Management Defendants were aware of and even authorized senior management's undisclosed policy decision to "ship now, fix later"

products that were not ready for delivery so the Company could inflate reported sales and meet guidance and analyst expectations that senior management had provided or affirmed to Wall Street and the market in general. These omissions were important to voting shareholders because they would have assumed actual significance in shareholder voting decisions concerning a shareholder proposal in each year to eliminate the staggered terms of Lucent's directors so they were more accountable to the shareholders.

3. These omissions were also material because they reflected on the qualifications of and suitability for reelection of each of the directors nominated for three-year terms in each of the elections in 2000, 2001 and 2002. Had the shareholders known that the directors had been advised of accounting policy changes that potentially would (and actually did) lead to restatements of the Company's financial reports, the shareholders would not have elected the nominated directors for additional three year terms and instead would have rejected the board's recommendations against the shareholder proposal and approved the proposed elimination of the staggered terms so that the directors were more accountable to the shareholders.

4. From 1999 through 2000, Management Defendants – McGinn, Peterson and Hopkins – intentionally breached their fiduciary duties of care, loyalty and full disclosure by grossly mismanaging Lucent, wasting its assets, disguising its true operating performance through undisclosed and improper accounting maneuvers that accelerated the recognition of billions of dollars in revenue, failed to write-off hundreds of millions of uncollectible accounts receivable and increased earnings by over $1 billion. These accounting schemes, policies and practices were carried out so that (i) the Management Defendants and the Director Defendants could conceal their failure to

prudently manage the Company; (ii) they could maintain Lucent's ability to use its stock as currency for acquisitions; (iii) they could maintain the Company's credit rating and access to essential debt financing and off-balance sheet financing opportunities; (iv) they could continue benefiting from salaries, bonuses, options and other compensation to which they were not entitled; (v) they could ensure their reelection to Lucent's board while fending off approval of a shareholder proposal to eliminate the staggered terms of the directors; and (vi) they could secure shareholder approval of a proposal to increase the number of authorized but unissued shares so that Lucent could continue to use such shares as currency for further acquisitions.

5. The scheme was directed or approved by each of the Defendants and relied on off-balance sheet financings, "accounting tricks," manipulations of internal controls, conscious redatings of receivables, conscious failures to write-off uncollectible receivables, premature shipments of incompletely developed or tested products, deferred billings coupled with internal recognition of revenue which, in fact, was unbilled, purported "sales" with undisclosed "rights of return" or side agreements permitting rescission, and other accounting machinations, all of which violated stated Lucent policies and principles and established standards of generally accepted accounting principles ("GAAP"). As a result, Lucent's business and growth was portrayed as far more robust and reliable than it in fact was. In fact, Lucent was an operating nightmare. Moreover, by accelerating future revenues and profits, the Defendants made the prospect of Lucent achieving future expectations (provided as guidance by senior management to Wall Street analysts) even more difficult and increased the Company's vulnerability to future business downturns, all of which happened.

6. The Director Defendants have perpetuated their attempt to cover up their breaches of fiduciary duty and those of Lucent's former management by failing to timely respond candidly and effectively to legitimate demands by the owners of the Company, the shareholders, that Lucent institute suits against the former management to recover the losses suffered by the Company from their misconduct.

7. On February 14, 2001 plaintiff George Pallas served one such demand on the board, attached hereto, to commence an action against former Lucent executives, specifically, Richard A. McGinn, Deborah C. Hopkins, and others. On March 16, 2001 Lucent responded that "the matter will receive our attention." Over fifteen months have passed without **any** further action from the board. This, despite the fact the board has been on notice of meritorious claims since at least October 2000. In addition, the Company has answered securities complaints filed in the action captioned In Re Lucent Technologies Inc., Securities Litigation, further indicating that the claims alleged herein are meritorious. Despite these legitimate demands from the owners of the Company, the Director Defendants have instead taken steps to have shareholder derivative actions filed in Delaware Chancery Court dismissed on the alleged basis that the shareholders did not first serve a demand on the board. In short, the Director Defendants are engaging in corporate gamesmanship, and are unable or unwilling to exercise disinterested business judgment to protect and prosecute the interests of the shareholders who own the Company.

8. In particular, Plaintiff alleges that the Management Defendants caused Lucent to falsely inflate its financial projections and issue knowingly incorrect statements in order to delay or reduce the inroads made by competitors into the market for optical

networking products, to maintain Lucent's market position and long-term strategy, and to ensure that Lucent remained one of the darlings of Wall Street until Lucent's OC–192 product line was finally developed and ready to ship on a large scale. In summary, Plaintiff alleges that Defendants:

a. Created and acquiesced to an environment where lower level sales forces were engaged in improper revenue recognition and sales practices designed to falsely raise the Company's sales volume.

b. Disabled or disregarded systems that would identify illegal practices so the Director Defendants could create a level of plausible deniability.

c. Attempted to create a placeholder for the delayed OC-192 product line by allowing incomplete and defective units to be marketed and sold to traditional customers of Lucent. This action led directly to the damage of Lucent's goodwill and a multi-million dollar write off to cover returned products.

d. Furthered their scheme by eliminating or negligently disregarding employees who attempted to blow the whistle on the false statements and unsound business decisions by the defendants.

9. By late October of 1999, Defendants knew or recklessly disregarded many severe and undisclosed problems within the Company. First, Lucent's internal audits had revealed that its accounts receivable represented hundreds of millions and possibly billions in uncollected and phony sales. Second, the Company was falling behind in the production of OC-192 optical networking systems, which were becoming the standard among both customers and competitors. Third, incomplete and untested products were causing significant customer satisfaction problems resulting in returned orders. Fourth, internal control, accounting, and business systems were regularly circumvented and were insufficient to reflect reliably the true financial position of the Company.

10. By December 9, 1999, Lucent was engaged in creating end-of-quarter "miracles" as a result of pressure from the board to continue the Company's streak of

beating profit estimates for 14 consecutive quarters and continuing stock price growth, which had recently hit a trading high of $84.1875 per share.

11. These end-of-quarter miracles, among other things, consisted of lowering the Company's accounts receivable reserve while booking nonexistent sales to raise quarterly income by millions of dollars.

12. These policies were approved either tacitly or affirmatively by the Director Defendants at a 1999 board meeting, where Defendant McGinn and members of senior management presented the decision to ship products they knew were not ready for sale in order to fraudulently inflate the Company's "sales," and make the numbers. This attempt to inflate sales was presented to the board in light of the Company's failure to bring its OC-192 products to market in a timely fashion.

13. Thus, by the approval of Defendant McGinn's and senior management's decision to ship incomplete products, Director Defendants signaled that similar practices designed to increase sales and hold Lucent's place in the market until the OC-192 system was complete were acceptable business practices. Lucent's lower level sales force adopted this corporate culture and shipped Lucent's Wavestar and Pathstar systems with known defects in the chipsets. This resulted in customer complaints and replacement with higher cost systems. Eventually, Lucent even went so far as to ship products still in the testing and design phase in order to book "sales."

14. In the second half of 1999 and thereafter, Lucent further commenced stuffing the channel in order to make the numbers provided as guidance to the investing public. Lucent's sales force, in order to meet the sales targets, strong-armed wholesalers and distributors to temporarily accept products with the understanding they would

warehouse them until Lucent could buy them back. These warehousing transactions were recognized falsely as revenue solely to inflate Lucent's sales figures until its OC-192 products became available. Thus, the investing public was, once again, misled as to Lucent's continued success in meeting its public guidance.

15. Lucent's long-term strategy was to continue expansion by acquiring companies to gain access to, among other things, new markets and technologies. Most of these acquisitions were financed by Lucent stock. Thus, the Defendants created a corporate culture in which the numbers were met "by any means necessary" because the higher the stock price, the lower the cost was to acquire new companies.

16. To maintain the pace of these acquisitions, Lucent needed to maintain its high stock price and thus meet or exceed analysts' expectations. When Lucent misjudged the future market demand for its existing line of 2.5 gigabit networking devices and fell significantly behind in developing an OC-192 product, the Director Defendants either had to announce publicly the mistake of Lucent's management − signaling to investors and competitors alike the Company no longer held the same growth potential − or choose to look the other way. The Company could continue to meet its guidance and continued sales growth only by inflating sales until Lucent's OC-192 product was ready for market and could book real sales. Accordingly, the Director Defendants consciously looked the other way when senior management intentionally pumped up Lucent's financial reports.

17. The Director Defendants realized the necessity of meeting expectations when, despite the Company's manipulation of sales, accounts receivable and earnings, on January 6, 2000 the Company was forced to announce that Lucent would miss analysts

estimates for the first quarter of fiscal 2000. Immediately after this announcement, Lucent's share price declined more than 27% or $20 per share to $52.19.

18. After this announcement, the Company continued falsely to project its dominance in the optical networking industry and indicated the demand for its products was very strong. Investors were misled both by these statements and by numerous Company filings with the SEC falsely indicating that the OC-192 networking devices were on Lucent's list of products. As a result of these announcements, Lucent's share price rose to over $62 per share by July 17, 2000.

19. During this time, Lucent attempted to manage its accounts receivable by tapping Defendant Schacht to become CEO of Lucent's Avaya spin-off, taking $1.5 billion in receivables with him. Additionally, the Company entered into several financing agreements to sell off portions of its accounts receivable to off-balance sheet special purpose entities ("SPEs") and other securitization vehicles. The Company also entered into numerous "sale" transactions in which it failed to disclose that it had extended "rights of return" to "purchasers" or side agreements permitting rescission.

20. Despite these artificial maneuvers, it soon became clear the Lucent's projections for sales of OC-192 products were too optimistic. As OC-192 sales fell short of projections, the Company was left with rising accounts receivable and no offsetting bump in sales. This left Lucent unable to meet its guidance, and the Company was forced to announce on October 10, 2000 that it was increasing its reserves for uncollected accounts receivable by a material amount. Lucent also disseminated data that indicated to analysts that its optical networking business had declined 15% for the quarter. As a

result, Lucent's stock was punished − falling more than $10 dollars per share to close at $21 3/16 on October 11, 2000.

21. Following a board meeting on the weekend of October 22, it was announced that Defendant McGinn was being replaced as CEO by Defendant Schacht. The Company then attempted to restore its shattered stock price by reassuring analysts the Company would meet its revenue expectations with fourth quarter pro forma earnings of $0.18 per share.

22. Only a month later, however, Lucent was forced to announce, on November 21, 2000, that the growth projections reported on October 23, 2000 overstated the Company's revenues, and that the Company would not meet analysts' expectations. The Company announced instead that it would restate its fourth quarter revenues due to a "revenue recognition problem" involving $125 million of reported quarterly revenue.

23. The true extent of the Company's accounts receivable and sales problems came to light on December 21, 2000, when the Company revealed that its improper sales practices were responsible for millions of dollars of booked sales which ended up being returned and for "sales" of products or items never completely shipped.

24. Since then, Lucent shareholders have suffered losses of many billions of dollars in market capitalization, and the Company's stock price has hovered below $10 per share.

JURISDICTION AND VENUE

25. This action is within the federal question jurisdiction of the Court, pursuant to 28 U.S.C. §§ 1331 and 1337, in that Plaintiff's claims alleged in Count I arise under § 27 of the Exchange Act, 15 U.S.C. §78aa.

26. Venue is proper in this District pursuant to 28 U.S.C. § 1391 and Section 27 of the Exchange Act, 15 U.S.C. § 78aa, because Lucent has its corporate headquarters and principal place of business in this District, the acts alleged herein, including the preparation and dissemination of materially false and misleading proxy solicitations, press releases, financial statements, and other documents, occurred in this District, and the individual defendants may be found in this District.

27. In connection with the acts alleged in this complaint, defendants, directly or indirectly, used the means and instrumentalities of interstate commerce, including, but not limited to, the mails, wires, interstate telephone communications, and the facilities of the national securities exchanges and markets.

PARTIES

28. Plaintiff George Pallas is and has been the owner of shares of Lucent common stock at all times relevant to this action.

29. Defendant Schacht has served as Chief Executive Officer and Chairman of Lucent's Board of Directors from October 23, 2000 through the present. Schacht was the Company's CEO from October 1995 through October 1997, and was Chairman from October 1995 through February 1998. He thereafter was employed as a consultant to Lucent from February 1998 through February 1999. From March 2000 until October 22, 2000, Schacht served as Chairman of the Lucent spin-off, Avaya. Schacht was reelected to his board seat in 2002.

30. At times relevant hereto, Defendant McGinn served as Chief Executive Officer and Chairman of the Board of Lucent, which were the positions he held until he was removed from office by the Lucent Board of Directors on or about October 22, 2000.

As CEO, he was responsible for overseeing operations and public financial reporting at Lucent. At times relevant hereto, Mr. McGinn maintained an office and performed his duties at Murray Hill, New Jersey, within the jurisdiction of this Court. Mr. McGinn also maintains his personal residence within the jurisdiction of this Court.

31. At times relevant hereto, Defendant Hopkins served as Executive Vice President and Chief Financial Officer of Lucent, reporting directly to the Chief Executive Officer of Lucent. She held this position since April 21, 2000. Ms. Hopkins maintained an office and performed her duties at Murray Hill, New Jersey, within the jurisdiction of this Court. According to Lucent's press release announcing her hiring as well as her corporate profile appearing on Lucent's web site, Defendant Hopkins was responsible for overseeing all of Lucent's financial operations.

32. At times relevant hereto, Defendant Peterson served as Lucent's Chief Financial Officer, and Executive Vice President. Peterson had served as an executive officer of the Company from February 1996 until March 1, 2000, and was responsible for Lucent's public financial reports during that time. Peterson realized more than $18 million in proceeds from sales of his personal holdings of Lucent shares between October 26, 1999 and December 21, 2000.

33. Defendant Paul A. Allaire, a member of Lucent's board, is the Chief Executive Officer of Xerox Corporation. On April 11, 2002, the SEC charged Xerox with violations of numerous sections of the Securities Act of 1933 and the Exchange Act of 1934, primarily related to improper revenue recognition practices, overstated receivables, and materially misleading financial reports. On that same day, Xerox settled with the SEC, and paid a civil penalty of $10 million. While on Lucent's board, Allaire

has served as the Chairman of the Audit and Finance Committee, which has three areas of responsibility: (i) "the adequacy of the Company's internal controls and financial reporting process and the reliability of the Company's financial statements;" (ii) "the independence and performance of the Company's internal auditors and independent auditors;" and (iii) "the Company's compliance with legal and regulatory requirements." Allaire has been a Lucent director since 1996. He was reelected to his Board seat in 2002.

34. Defendant Franklin A. Thomas has been a Lucent director since 1996. Thomas currently is Chairman of the Corporate Governance and Compensation Committee. According to the 2001 proxy statement, since October 2000 Thomas has been considered a "Senior Director" with "day-to-day contact with company management." He has also taken on additional corporate governance activities for the Board. Thomas was reelected to his board seat in 2001.

35. Defendants Carla A. Hills and John A. Young both have served on Lucent's board of directors since 1996. Hills was reelected to her board seat in 2000. Young was reelected in 2002.

36. Nominal Defendant Lucent is a Delaware corporation with its principal executive offices located at 600 Mountain Avenue, Murray Hill, New Jersey 07974. Lucent was created from the systems and technology units of AT&T Corp., including the research and development capabilities of Bell Laboratories. As of September 30, 1996, Lucent became a stand-alone Company when AT&T distributed to its shareholders all of its Lucent shares.

SUBSTANTIVE ALLEGATIONS

37. Prior to any public dissemination, it was widely recognized throughout Lucent that, at the end of each quarter, sales personnel would engage in a widespread practice of booking sales prematurely to improperly meet the sales projections mandated by senior management. As a result of these improper revenue recognition practices, Lucent's accounts receivable began to swell.

38. In a process that was condoned and encouraged by Lucent management, Lucent employees often reclassified the age of accounts receivable. This practice served two purposes: (1) it helped conceal Lucent's improper revenue recognition; and (2) it reduced the need to reserve for receivables that remained uncollected for an extended period of time. These practices helped maintain the appearance that the Company's financial growth was continuing at historic levels when, in fact, it was not.

39. In addition, hundreds of millions, if not billions, of uncollectible receivables remained improperly on the books, in part because the recorded receivables were false, and in part because Lucent's collections personnel were grossly untrained and inexperienced, and were unable to deal effectively with the numerous problems and issues raised by unsatisfied customers.

40. GAAP provides that revenue should not be recognized until it is realized or realizable and earned. (FASB Concepts Statement No. 5, ¶ 83.) The conditions for revenue recognition ordinarily are met when persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the seller's price is fixed or determinable, collectibility of the sales price is reasonably assured and the entity has substantially performed the obligations which entitle it to the benefits represented by the

revenue. Generally, revenue should not be recognized until an exchange has occurred and the earnings process is complete. A transfer of risk has to occur in order to effect an "exchange" for the purpose of revenue recognition. (FASB Concept Statement Nos. 2 and 5; FASB Statement of Financial Accounting Standards ("SFAS") No. 48; Accounting Research Bulletin ("ARB") No. 43; Accounting Principles Board ("APB") Opinion No. 10; and American Institute of Certified Public Accountants ("AICPA") Statement of Position ("SOP") 97-2.)

41. According to Lucent's publicly stated revenue recognition policy, Lucent recognized revenue on the sale of products when the products were delivered or the service was performed, all significant contractual obligations had been satisfied, and the collection of the sales price was reasonably assured. This public policy statement was knowingly false, however.

42. In 1999 and 2000, the Director Defendants and the Management Defendants knew, or recklessly disregarded the fact, that Lucent was violating its own revenue recognition policy and GAAP.

43. To the detriment of unsuspecting investors and shareholders, Lucent's management directed or knowingly condoned and encouraged the process in which customer service representatives would invoice orders, thereby recognizing and reporting revenue on the order, even though the customer had not yet committed to purchasing the order. In addition, undisclosed and unconditional "rights of return" often had been extended to the customers so that payment was not reasonably assured. In many other instances, undisclosed side-letter agreements permitting unconditional rescission had been given to the customers. As a result, although Lucent had "booked" the revenue,

persuasive evidence of a firm purchase agreement did not exist, the sale price was not fixed or determinable, and the collectibility of the sales price was not reasonably assured. In truth, a transfer of risk had not in fact occurred for purposes of revenue recognition at the time Lucent recognized and reported revenue on such orders. In many instances, invoices on such contingent orders were generated on or near the last day of the quarter so that the sales representatives could meet the quarterly sales performance quotas.

44. Thereafter, Lucent employees pulled the invoices associated with such "orders" to prevent them from being mailed to unsuspecting customers. After the end of the quarter, the "order" often would be reversed.

45. In certain instances, Lucent employees did not reverse and re-invoice a prematurely recognized order. Rather, Lucent employees would manually generate a "dummy" invoice. The "dummy" invoice was issued to Lucent's customers without the transaction being reflected in Lucent's accounting system, because the invoice for the order had previously been recorded. This process was known as "closing out" an order among Lucent's sales force. As a result, when Lucent's customer first received the manual invoice, in many instances, Lucent's system already reflected the customer receivable as being "past due."

46. According to numerous individuals employed by Lucent in Lucent's PCS division, Optical Networking Group, and international businesses, the recognition of revenue on "orders" related to prospective sales of products which had not yet occurred was a widespread practice throughout the Company, including but not limited to those divisions. Lucent's sales force agreed to engage in such conduct because Lucent sales

commissions were paid when revenue was recognized, regardless of whether the customer actually paid for the product.

47. Another tactic employed by Lucent to recognize revenue prematurely was known as “CNRing” an order. This technique allowed the Company to “close out” and invoice the order when the product as shipped but not yet installed. Although Lucent attempted to divide these “sales” into two components – equipment and installation – so that it could recognize revenue related to shipped equipment prior to its installation, in practice, Lucent generally billed 100% of the order at the time the product was shipped. But Lucent’s recognition of revenue on “CNRing” transactions was improper because the installation of Lucent’s equipment was essential to the functionality of the delivered equipment and remained unperformed at the time the revenue was recognized. As such, revenue was not earned and the collectibility of the sale price was not reasonably assured when the revenue was recognized. Indeed, sixty days or more often elapsed before Lucent attempted to install shipped equipment.

48. Although shareholders and the investing public did not understand why Lucent’s receivables were growing, the magnitude of Lucent’s premature revenue recognition practices is evidenced, in part, by its ballooning accounts receivable balance. For example, *during the six months ended September 30, 1999, Lucent’s accounts receivable increased by approximately $1.7 billion, or 19%*, from $9.1 billion to $10.8 billion, but its reserve for uncollectible receivables increased by only 3.7%. Indeed, as a result of Lucent’s premature revenue recognition practices, Lucent’s customer service representatives often ignored outstanding invoices and did not attempt to collect them.

49. Furthermore, in late summer of 1999, the Company essentially abandoned a push by management to clean up the Company's accounts receivable. Area Vice Presidents, among others, stopped getting feedback or being measured by progress on receivable reductions, and compensation was no longer impacted by such measures. Specifically, the Company abandoned a program to link these individuals' remuneration with their success in reducing receivables. Thereafter, uncollectible accounts receivable again trended upwards.

50. Defendants knew or recklessly disregarded that the magnitude of the increase in Lucent's receivables was unprecedented and highly irregular. In furtherance of their scheme to misrepresent the Company's operating results, the defendants compounded Lucent's misleading accounting and reporting of revenues by failing to timely and adequately require reserves for uncollectible receivables.

51. GAAP requires that financial statements account for existing uncertainties as to probable losses. Such loss contingencies should be recognized and reported as a charge to income when: information existing at the date of the financial statements indicates that it is probable (*e.g.*, a likely chance) that an asset has been impaired or a liability has been incurred; and the amount of such loss can be reasonably estimated. SFAS No. 5, ¶ 8.

52. GAAP also requires that financial statements disclose contingencies when it is at least reasonably possible (*e.g.*, a greater than slight chance) that a loss may have been incurred. SFAS No. 5, ¶ 10. The disclosure shall indicate the nature of the contingency and shall give an estimate of the possible loss, a range of loss or state that such an estimate cannot be made. *Id*.

53. The SEC considers disclosure of loss contingencies to be so important to an informed investment decision that it promulgated Regulation S-X [17 C.F.R. § 210.10-01], which provides that disclosures in interim period financial statements may be abbreviated and need not duplicate the disclosure contained in the most recent audited financial statement, *except that*, "where material contingencies exists, disclosure of such matters shall be provided even though a significant change since year end may not have occurred."

54. As noted above, by September 30, 1999, Lucent's accounts receivable had mushroomed to an unprecedented level. In furtherance of their scheme to inflate Lucent's operating results, Lucent management also encouraged and condoned the common practice of improperly reclassifying the age of Lucent's outstanding receivables, if necessary to meet quarterly numbers. For example, receivables that were outstanding for more than 90 days − in part as a result of Lucent's improper revenue recognition practices noted above − were often reclassified at the end of the quarter in Lucent's accounting records as current receivables. These reclassifications reduced the risk that Lucent's premature revenue recognition practices would be detected, and reduced the apparent risk the receivable would go uncollected, thereby avoiding a possible charge to earnings that would result from an increase in the reserve for uncollectible receivables.

55. The defendants knew or recklessly disregarded the fact that Lucent's receivables remained uncollected over an unusually long period of time, and that GAAP required that Lucent establish an adequate reserve in is financial statements to account for probable uncollectible receivables. Nonetheless, in violation of GAAP and the duties of

the Audit and Finance Committee, Lucent's financial statements failed to adequately reserve for uncollectible accounts receivable.

56. Notwithstanding the defendants' awareness of the true age of Lucent's receivables and the growing receivable balance, the defendants consciously failed to adequately reserve for uncollectible receivables. Had Lucent's accounts receivable reserve at September 30, 1999 been maintained at the same level as existed at March 30, 1999, its income during the September 30, 1999 quarter would have been reduced by approximately $53 million, or approximately five percent.

57. That the Director Defendants and the Management Defendants were aware of these accounting shenanigans is evident in Lucent's reaction to internal auditor recommendations. An internal audit conducted during September/October 1999, revealed that accounts receivable were overstated in an international division. The audit team determined that the proper course would be to take an immediate write-off. However, the division's management team reversed the audit team's recommendation, stating that the division "could not afford to do so at th[e] time." The decision in this regard was made at the top level of Lucent management, and specifically involved Lucent's head of internal audits and the Company's board of directors.

58. During mid-1999, Lucent headquarters issued a directive, communicated through a Company-wide e-mail, that Lucent would no longer allow manual adjusting entries at the end of the quarter unless they were approved by the head of the respective division. The e-mail explained that the reason for the policy change was that a continuation of the practice might get the Company "into trouble." However, the Company did nothing to revise or reverse the tens of thousands of manual adjusting

entries previously reflected on the books, nor did it disclose the previous internal policies and the fact that it was now being changed because it was unlawful.

59. The Director Defendants and the Management Defendants found another way to perpetuate the charade of growth and the illusion of real earnings and revenues. During the quarter ended September 30, 1999, Lucent disclosed that it sold $625 million of its accounts receivable to a non-consolidated qualified special purpose entity. This had the intended effect of reducing Lucent's accounts receivable by $600 million at September 30, 1999. In addition, during the summer of 2000, Lucent announced that it would spin-off its enterprise networks division to its shareholders by forming a new Company named Avaya. Indeed, $1.5 billion in total assets that were spun-off were accounts receivable.

60. In September 2000, Lucent and a financial institution arranged for the creation of another non-consolidated special purpose trust for the purpose of allowing Lucent to sell up to $970 million in customer finance loans and receivables. The Lucent Board and its management thus used these combined techniques of SPEs and spinoffs to hide bad debt and doubtful accounts receivable.

61. Although Nortel, Lucent's closest competitor in the optical networking business, had brought its OC-192 product to the market in 1997, by the fall of 1999, Lucent's OC-192 product was still not ready for sale. As a result, Lucent's 24% share of the growing optical networks market was quickly declining as customers chose to buy OC-192 products produced by Lucent's competitors. The Company nonetheless represented that it had such a product for sale by, among other things, including the 10G product in its Annual Report filed with the SEC on September 30, 1999.

62. In response to the growing pressure on the Company from its inability to market the OC-192 product, Defendants made a high-level policy decision to ship the product even though they knew it was not ready for sale. The Director Defendants participated in this decision because the Management Defendants presented the policy at a 1999 board meeting. The Director Defendants thus tacitly or affirmatively approved management's strategy of shipping products with serious defects in order to meet external revenue estimates.

63. This policy was implemented. On several occasions during 1999, division directors ordered that the product be shipped despite the existence of major flaws in the circuit pack portion of the product. For example, Lucent began shipping its Pathstar product as it was still being tested and designed. When Lucent was unable to get the product to work to the customer's satisfaction, Lucent replaced the product with one that was much more expensive but without increasing the price. Lucent employed this strategy with other customers who complained about Pathstar's performance.

64. Moreover, quality assurance auditors at the North Andover facility were instructed to ship products that had failed to meet Lucent's quality assurance standards so that the Company could meet its numbers.

65. Beginning in at least November 1999, Lucent shipped products from throughout its product line, which were not ready for sale because installation, engineering, and maintenance manuals for such products were not yet ready. As a result, Lucent's customers were unable effectively to use the products they had purchased.

66. During 1999, the end-of-quarter pushes to meet earnings estimates "by whatever means necessary" became regular practice. For example, in August or

September 1999, Lucent's China Business Unit falsely recognized revenue on WaveStar product that was never sold. The circumstances of this false WaveStar "sale" were discussed on a conference call that included, among others, Ron Smith, an executive in the division, and other Lucent employees based in Shanghai. The order for approximately $66 million was placed "just to book revenue" and the product, which was an obsolete model, was supposed to be stored in a warehouse near JFK rather than be shipped to the joint venture "customer" who did not want to be saddled with the product.

67. As another example, during the fourth quarter of 1999, the director of Lucent's Power Systems Division loaded Lucent's distributors with products they did not yet require so that Lucent could report the sales. These Lucent distributors were to warehouse the product until such time as Lucent bought it back. Lucent's recognition of revenue on these shipments was improper because the distributors did not agree to purchase or accept the risks of ownership of such products when they were shipped. To the contrary, Lucent agreed that such products could be returned at a later date. The distributors involved in the foregoing scheme included Pioneer Standard, Marshall Industries, Gates/Arrow Electronics and Avnet.

68. Similarly, Lucent's Internet Service Provider Division "strong-armed" re-sellers to take products. By this method, the Internet Service Provider Division "sold" $59 million worth of product to Westcon, Inc. on the last day of Lucent's 1999 Fourth Quarter, so that revenues from that sale could be reported falsely as realized during that quarter.

69. As part of this continuing scheme, customers with credit problems often were released from "credit hold" status near the end of fiscal quarters so that revenue

could be recognized on their orders. Although this practice enabled Lucent to meet quarterly analyst revenue estimates, it violated GAAP and Lucent's own stated policy not to accept orders from customers on "credit hold." For example, Patagonica, a South American Company, had a $5 million receivable outstanding for more than 90 days but was nevertheless released from credit hold and allowed to place new orders for $1 to $2 million.

70. As yet another part of their scheme to artificially boost the apparent demand for the Company's products, at the end of 1999, Lucent began offering generous lines of credit to CLECs and other companies, including many companies of questionable creditworthiness, to purchase its products and report sales. For example, according to a report published in TheStreet.com, Lucent entered into a $250 million credit agreement with ICG Communications ("ICG") to enable ICG to purchase Lucent products. As a result of that agreement, ICG committed to buying at least $175 million of equipment from Lucent. However, the value of the accounts receivable associated with the ICG purchases was doubtful at the time, and ICG has since sought bankruptcy protection.

71. By the end of 1999, according to a report published in Barrons on September 4, 2000, Lucent had provided $1.85 billion in loans and loan guarantees to its customers to finance purchases of Lucent products.

72. Lucent issued a press release on July 20, 2000, announcing results of its fiscal third quarter, which ended June 30, 2000. In that announcement, Defendant McGinn was quoted as saying:

> We've completed the quarter with strong growth in our data networking, wireless, professional services, optoelectronics and optical fiber businesses. With today's announcement of our spinoff of the microelectronics

> business, we will create two vibrant new companies positioned to lead in the Internet infrastructure and communications semiconductor markets. The fact is, we are dividing Lucent in order to accelerate growth.
>
> The communications components business will now be given the opportunity to achieve its full potential as it becomes freed from the strategic conflict it faced as part of Lucent. And, Lucent will now be totally focused on the largest network buildout in history, a $225 billion market opportunity this year. With a more focused Lucent, we will be able to streamline our operations, increase investments in the market for broadband and wireless Internet infrastructure, and deliver strong, consistent growth.

73. Lucent also chose this opportunity to, in the words of its press release, "Set[ ] Expectations for Fourth Fiscal Quarter 2000 and Fiscal 2001." In this regard McGinn said: "Lucent expects that pro forma revenues from continuing operations will grow about 15 percent for the fourth fiscal quarter of 2000, which ends Sept. 30, and pro forma earnings per share from continuing operations will be roughly in line with revenue growth. For fiscal year 2001, the Company said it expects to return to 20 percent revenue growth and 20 percent growth in pro forma earnings per share."

74. Defendant Hopkins added: "We see our way clearly to 20 percent top line [revenue] and bottom line [profit] growth for fiscal 2001. . . The market opportunities are vast, and so too are the opportunities to sharpen our execution, reduce the operations that were built for a more complex Company and increase our efficiencies in the way we go to market. All of this gives us the chance to create more leverage to the bottom line."

75. At the time that defendants made the statements set forth in paragraphs 69 – 71 above, defendants knew them to be false and misleading.

76. On December 20, 2000, The Wall Street Journal reported the filing of a lawsuit under New Jersey's Conscientious Employee Protection Act ("CEPA"), *Nina*

Aversano v. Lucent Technologies, Inc., No. L-10004-00 (NJ Super., Law Div., Middlesex), alleging that Ms. Aversano, the President of Lucent's North American operations, was ousted by defendant McGinn in retaliation for her objecting to the use of false and misleading financial projections by Lucent.

77. Ms. Aversano's lawsuit details her advice, and that of other senior Lucent managers, that the guidance defendants gave to Wall Street as to expected financial results was unachievable. As early as the first quarter of fiscal 2000 (October 1999), Ms. Aversano was telling Lucent senior managers that Lucent's networking technology was growing obsolete, that Lucent was having trouble finding customers for it, and that revenues were going to decrease drastically unless Lucent switched to optical networking. *Aversano Complaint* ¶¶ 31, 32, 33 and 34.

78. As regards the July 20, 2000 projections, Ms. Aversano's complaint avers:

> 36. In July 2000, [Aversano], along with her supervisor, Patricia Russo, were convinced that [Lucent] would be unable to make its guidance for the fourth quarter of fiscal 2000 [ending September 30, 2000].
>
> 37. [Aversano] provided information to Ms. Russo for her use in meetings in July 2000 between Mr. McGinn and Ms. Russo in which Ms. Russo objected to [Lucent's] guidance for the fourth quarter of fiscal 2000 and insisted that the guidance be reduced. In response to, and retaliation for, Ms. Russo's demands, Mr. McGinn eliminated Ms. Russo's position, in effect ousting her from [Lucent's] employ.
>
> 38. Lucent continued to give optimistic guidance as to the fourth quarter. Moreover, [Lucent] adopted an aggressive approach to 2001 targets. For example, [Lucent's] CFO, Deborah Hopkins, in announcing third quarter fiscal 2000 results, articulated [Lucent's] expectations as follows: "We see our way clearly to 20 percent top line [revenue] and bottom line [earnings] growth for fiscal 2001." [Lucent] also issued guidance

> that revenues were expected to grow by 15 percent for the fourth quarter.

Aversano Complaint ¶¶ 36-38.

79. Given the fact that Lucent already knew that its technology was becoming obsolete and that it was well behind its competitors in developing optical networking products, as well as the information provided to defendant McGinn by Ms. Russo objecting to the guidance that Lucent intended to provide to the market for the fiscal fourth quarter 2000 and for fiscal 2001, the statements concerning Lucent's ability to be a player in "the largest network buildout in history" and its revenue projections for the fourth fiscal quarter and for fiscal 2001 lacked a reasonable basis and were false and misleading.

80. Defendant McGinn was under tremendous pressure from the board to get Lucent back on track and to raise the price of Lucent's stock. From its creation in September 1996 through the end of 1999, Lucent was one of the darlings of Wall Street, and was among the most widely held stocks in the United States. Lucent beat profit estimates 15 quarters in a row and rose to a high of $84.1875 per share on December 9, 1999.

81. However, beginning in January of 2000, Lucent was forced to admit, in a series of announcements to the market, that it had made a number of missteps and that its previous guidance to the market was flawed. Lucent announced it would earn only $0.36 per share for the quarter, and would have yearly earnings of only $1.40. Compared with analysts' mean estimates of $.54 per share and $1.53, the restatement represented a reduction of $0.18 and $.13 per share, respectively. As a result, the market punished

Lucent and by the end of July 2000 its stock price had declined to under $50 per share, a loss of $35 per share and tens of billions of dollars in market capitalization.

82. The Company falsely attributed these shocking results to several factors, including:

a. Faster than expected shifts in customers' purchases to Lucent's newest 80-channel DWDM optical product line and greater expected demand for OC-192 capability on the 80- channel systems, which resulted in near-term manufacturing capacity and deployment constraints;

b. Changes in implementation plans by a number of customers inside and outside the United States, which led to delays in network deployments by enterprises and service providers;

c. Lower software revenues, reflecting acceleration in the continuing trend by service providers to acquire more evenly throughout the year. In past years, these purchases occurred primarily in the quarter ending December 31; and

d. Preliminary results showing lower than anticipated gross margins this quarter from ramp-up costs associated with introducing and implementing new products and lower software revenues.

83. The defendants, however, had not revealed the REAL reasons for the shortfall, which included:

b. The shift in customer demand to OC-192 was not "faster" or "greater" than anticipated. Lucent was very much aware that the decline in sales was due to a decline in customer demand for Lucent's existing optical products which was in part because of customer dissatisfaction with poor product quality and continued delays with the DWDM OC-192 line.

c. Customers shifted demand to a OC-192 capable product line that Lucent was not even ready yet to manufacture since it was seriously behind its competitors, including Nortel, Ciena and Cisco, in that area.

d. Lucent was not experiencing "near-term manufacturing capacity and deployment constraints." The North Andover facility where Lucent manufacturing optical networking equipment frequently lay dormant.

e. Lucent's lower revenues were the result of Lucent's sales policies, which "stuffed the channel" with unwanted merchandise as authorized by the Nuremberg meeting.

f. The sales of optical networking products were in many cases the result of Lucent offering discounts, loans and "vendor financing" to potential customers with questionable credit.

84. Wall Street, the investing public, and the Lucent Board of Directors all measured McGinn's performance as CEO on the basis of the Company's stock price. The stock price, in turn, was driven by meeting current revenue and profit expectations and by perceptions of future revenues.

85. Due to the downturn of Lucent's stock price, it was widely reported that McGinn would be fired if he could not turn things around quickly. McGinn could not afford more bad news. He thus turned to finding ways to create quarter-end "miracles" and to managing the price of the Company's stock by providing aggressive guidance on future revenues with the intent and purpose of manipulating the price of Lucent's stock price. Increasingly, those inside Lucent came to believe that the revenue guidance lacked any reasonable basis, and that the quarter-end "miracles" were mortgaging Lucent's future.

86. Specifically, by July 2000, Aversano, through her supervisor, Patricia Russo, directly expressed to McGinn that the expectations Lucent conveyed to the market for future performance were not achievable. *Aversano* Complaint ¶¶ 36, 37. In addition, in a weekly internal conference call of Lucent executives, including McGinn and Aversano, Aversano continued to express her belief that Lucent could not meet its fourth quarter revenue targets. *Aversano* Complaint ¶ 40. By August 15, 2000, Lucent had completed half of its fourth fiscal quarter, which would end on September 30, 2000, and

Aversano had concluded that her division, which accounted for more than half of all of Lucent's revenues, *Aversano* Complaint ¶ 29, would miss its earnings targets by at least half a billion dollars. *Id*. at ¶ 40.

87. Rather than deal with the reality of the situation, as it directly contradicted the guidance he had given shareholders, "McGinn became extremely agitated and angry, yelling that she [Aversano] was going to take down the whole business if she didn't 'make the numbers.'" *Id.*

88. As the quarter drew to a close, Aversano was becoming more concerned that the "ambitious revenue target" for fiscal 2001 was going to be impossible to meet. Aversano thus decided to meet with McGinn directly to express her objections. She assembled "a mass of data and other information" for a presentation focusing on the prospects for fiscal 2001.

> 3. On October 9, 2000, plaintiff Nina Aversano – the President of [Lucent's] North American operations – met with Richard McGinn, [Lucent's] Chairman and Chief Executive Officer. Armed with dozens of power point slides, [Aversano] methodically delivered a message that was clear and grim: [Lucent's] $25.5 billion revenue target for North America for fiscal year 2001 was hopelessly unrealistic. [Lucent] would fall several billion dollars short of the target, in part because it had mortgaged the future with deals and arrangements that would cost about $1.8 billion in potential revenue for fiscal 2001. In fiscal year 2000, which had ended September 30, the focus on targets had required quarter-end 'miracles' that were adversely affecting ongoing business. [Aversano] objected to and refused to support the use of this misleading financial target.
>
> * * *
>
> 42. . . . [Aversano] then reviewed a series of transactions and arrangements that were estimated to cause an additional shortfall of about $3 billion. This figure

> included the impact of the buildup of inventory in distribution channels, the use of non-recurring credits to customers who bought products in fiscal 2000, the impact of reduced financing by [Lucent] of customers, and other factors.
>
> 43. The bottom line was that [Lucent] could be expected to fall roughly $5 billion short of its revenue target. This would mean that estimated revenues for fiscal 2001 would be only about 5% more than revenues in fiscal 2000.
>
> 44. [Aversano] objected and refused to support the use of the misleading revenue target of $25.5 billion, just as she had previously objected to the use of guidance based upon unsupportable revenue targets.
>
> 45. [Aversano] reasonably believed, among other things, that [Lucent's] reliance upon unsupportable targets in October 2000 would mislead the investing public, and would, at a minimum, be fraudulent and a violation of federal securities laws. The investing public clearly placed weight upon [Lucent's] guidance; each time it had been revised downward, the stock price had dropped. McGinn had demonstrated by his actions that he would continue to provide guidance, even when it was wildly optimistic, and [Aversano] reasonably believed that for [Lucent] to do so after her clear presentation of the true facts would be fraudulent and/or illegal.
>
> 46. Based on [Aversano's] objections to use of such misleading projections, and in retaliation therefore, McGinn told [Aversano] that he had "lost confidence in her' and that she would "retire" at the end of December 2000.

Aversano Complaint ¶¶ 3, 42 – 46.

89. On October 10, 2000, after the close of the market, Lucent announced that "based on preliminary estimates, it expects earnings for its fourth fiscal quarter of 2000 to be lower than the Company's previously announced guidance." The Company announced that it expected pro forma earnings per share from continuing operations for

the quarter, which ended September 30, 2000, to fall short of prior guidance and to be in the range of 17 cents to 18 cents per share compared to 24 cents for the year-ago quarter. The Company also revised downward its pro forma revenue projections from continuing operations to the range of $9.3 billion to $9.4 billion for the quarter, a 14 percent to 15 percent increase over the prior year period.

90. The October 10th release further stated that: "The Company indicated that the expected fourth quarter revenue and earnings would result in an increase in fiscal year 2000 pro forma revenue from continuing operations of approximately 14 percent and a decline in pro forma earnings per share from continuing operations of approximately 10 percent to 11 percent. Lucent said that its fourth quarter results would impact and lower its guidance for fiscal year 2001."

91. The Company announced that the lower-than-expected earnings for the quarter could be almost equally attributed to three factors:

i. Less than expected revenues and gross margins in the Company's optical systems business;

ii. Credit concerns in the emerging service provider market that led to increasing reserves for bad debt; and

iii. Greater than anticipated decline in circuit switching sales and margins. The Company indicated that gross margin this quarter would be in the range of 39 percent to 40 percent.

92. In an attempt to soften the blow, Lucent announced that it had strong overall growth in wireless businesses, and saw strong revenue growth in several areas. Defendants stated:

> "[t]he Company's Microelectronics and Communications Technologies group's revenues grew more than 50 percent for the quarter. In addition, revenues in the Internet infrastructure business grew more than 40 percent for the quarter. This marks the fourth quarter in a row that this business showed growth over 40 percent. Lucent's services business grew about 18 percent for the quarter."

93. In an article appearing the same day on The Street.com, defendant McGinn, in response to a question as to whether he was seeing a decline in demand for products, was quoted as saying: "You should not equate this to a decline in carrier spending . . . The market overall for the building blocks of the broadband and mobile Internet remains strong." Further: "We experienced some situations in this quarter with certain customers that fall in the category of doubtful accounts."

94. In response, Lucent shares tumbled, from a close of \$32.3125 on October 9th to \$21.125 by the close of the market on October 11th.

95. At the time defendants made the statements set forth in paragraphs 86 – 90, defendants knew that they were false and misleading or omitted to disclose material information necessary to make such statements not false and misleading. Although Lucent announced that revenues would not be in line with the earlier provided guidance, defendants still failed, despite their knowledge or in reckless disregard thereof, to reveal the true state of affairs within Lucent.

96. Although Lucent lowered its guidance, it failed to disclose fully the magnitude of the shortfall. Rather than disclose the full impact of the revenue shortfalls Ms. Aversano had demonstrated, McGinn eliminated Aversano's supervisor, Patricia Russo, and continued to mislead the market.

97. On Friday evening, October 21, 2000, defendants McGinn and Hopkins attended the annual Lucent Board of Directors retreat in New York City prepared to discuss their plans to reverse Lucent's downturn. By the end of the weekend, McGinn would no longer be Lucent CEO.

98. As reported by The Wall Street Journal, on Saturday afternoon, October 22, 2000, McGinn and Hopkins "outlined the fourth financial forecasting failure since January. This time it was bleak prospects for the current fiscal first quarter, typically Lucent's strongest. Instead of the revenue growth and roughly 23 cents in profit that McGinn had suggested back in July, he and Ms. Hopkins disclosed there would be a 7% decline in revenue from the year-earlier period and a break-even bottom line, excluding one-time items. The board was shocked, according to people familiar with the discussions. They began grilling Mr. McGinn on his forecasts, demanding to know why he was missing so many earnings targets." By Sunday afternoon, McGinn was asked to resign immediately.

99. On October 23, 2000, less than two weeks after adjusting its July guidance, defendants issued a press release yet again revising the guidance for fiscal 2001. Lucent also announced results for the fourth fiscal quarter, ended September 30, 2000, that were in line with the revised expectations announced on October 10th. On that day the Company also announced that:

- Chairman and CEO Richard McGinn had been relieved of all duties by the Board of Directors over the weekend;

- former Chairman Henry Schacht, who was then CEO of Lucent spin-off Avaya, had been re-hired as interim Chairman and CEO, effective that day, until a replacement for McGinn could be found; and

- Lucent was again revising expectations downward for the first fiscal quarter of 2001.

100. The October 23rd press release noted that Lucent "expects pro forma revenue from continuing operations for the current quarter to decline about 7 percent and pro forma earnings per share from continuing operations to break even. The Company also said it expects sequential improvement in results from operations each quarter for the rest of the fiscal year."

101. Again, to soften the blow, the October 23, 2000 press release held out hope and promise for the future, indicating that Lucent's financial troubles were behind it. The press release quoted new CEO Schacht as stating: "We are clearly disappointed in our results for fiscal 2000 . . . We are looking at fiscal year 2001 as a transition and rebuilding year for Lucent. Lucent remains a Company with world-class products, people and knowledge of networks, and we are fortunate to compete in one of the world's leading growth markets."

102. The October 23, 2000 press release further quotes Deborah Hopkins as stating: "We have already begun a number of initiatives to sharpen our execution, reduce complexity and increase our efficiencies."

103. The press release continued:

> Hopkins said that these initiatives include an intense review of Lucent's product portfolio to align resources against the highest value opportunities. Additionally, these initiatives also include consolidating Lucent's corporate

> infrastructure, re-deploying the Company's marketing and sales resources to align them with the highest growth opportunities, improving supply chain management and implementing a new customer ordering system. As previously announced, the Company expects to take a restructuring charge in the quarter ending Dec. 31, 2000, to cover these activities.

104. Hopkins continued: "We intend to create a new Lucent – a dynamic Company that, in the long term, will be stronger, more focused and better positioned to capitalize on the opportunities that exist in this robust and growing market."

105. Following-up on the press release announcing fiscal fourth quarter results, the Company conducted a conference call with analysts on October 23, 2000. During that call, new CEO Henry Schacht stated:

- "[We're] taking actions intended to create the new Lucent. This is a transition year, and we'll make progress quarter after quarter and make timely decisions that are going to create a healthy Company."
- "We intend to turn the Company [over] to a new CEO on a new track and . . . in the condition it's expected to be in."

106. Defendant Hopkins also stated during the analyst conference call that: "We will come back to you in January with guidance for the new Lucent for the remainder of the fiscal year. However, we do expect sequential improvement in each quarter of 2001."

107. These statements (¶¶97-103) were false and misleading because they omitted to disclose the extremely material facts set out in the Aversano presentation to McGinn in early October and their probable impact on Lucent's future growth prospects.

Despite their knowledge, defendants still failed to disclose the magnitude of the problems that Lucent was experiencing both as to the fiscal fourth quarter of 2000 and as to fiscal 2001. Defendants continued to insist that there would be sequential improvement in each quarter of 2001 when there was no reasonable basis from which such guidance could be given. Indeed, the facts then known to defendants were to the contrary.

108. On November 21, 2000, less than one month later, defendants announced that Lucent's financial results for the fiscal fourth-quarter ended September 30, 2000, were faulty, and that the Company would restate its fiscal fourth-quarter results. Defendants announced they would be reducing Lucent's reported revenue for the quarter by $125 million, and further announced that they could no longer vouch for their earlier financial projections for the current fiscal first quarter ending December 31, 2000. This was an extraordinary admission about the state of affairs within the Company, and the reliability of any projections it had made, given that defendants could offer no guidance whatsoever for a quarter that was -- as of the date of this press release -- nearly two-thirds concluded.

109. Defendants stated that the Company:

> has identified a revenue recognition issue impacting approximately $125 million of revenue in its fourth fiscal quarter ended Sept. 30, 2000. The Company estimates that the reduction in revenue could have an approximately 2 cent impact on earnings per share for the quarter and the year. The Company previously reported $9.4 billion in revenues and 18 cents a share on continuing operations for the quarter.

110. Defendant Schacht, now acting as chairman and chief executive officer stated that: "We wanted to make this public as soon as we discovered the issue," and that "I have asked our outside auditor and our outside counsel to assist us in doing a complete

review of this and any related issues. We have also informed the Securities and Exchange Commission of our efforts."

111. These statements were false and misleading. This was not, as defendant Schacht stated, newly discovered information. Rather, defendants already knew, as early as October 9, 2000, based upon the information provided by Aversano, that its revenues for the fiscal fourth quarter were incorrect. Indeed, the $125 million "revenue recognition issue" was only one of the $1.8 billion of transactions that [Aversano] had presented to McGinn. *Aversano* Complaint ¶ 8.

112. As a result of this announcement, the Company's shares plunged, trading down $3.25 or 15.5% at $17.69 midday on November 21, 2000. The stock was then trading 75% below its 52-week high reached on December 9, 1999.

113. Shares of Lucent stock continued to fall on November 22, 2000, as a result of the announcement of Lucent's improper revenue recognition and that it may restate its fourth-quarter results. The stock dropped to a low of $16 3/8, a level unseen since May of 1997.

114. On December 21, 2000, defendants issued a press release announcing that Lucent would again restate its financial results for fiscal fourth quarter 2000, ended September 30, 2000, and announced that it now expected a significant loss for the first fiscal quarter of 2001, ending December 31, 2000.

115. In the December 21st press release, defendants announced that Lucent "expects a pro forma loss of 25 to 30 cents per share on continuing operations in the first fiscal quarter of 2001, ending December 31, 2000 . . . ." Defendants further stated that the Company has "also completed the revenue review it announced on Nov. 21. As a

result, its fourth fiscal quarter 2000 revenue will be $8.7 billion and its pro forma earnings will be 10 cents per share on continuing operations. This is lower than the previously announced $9.4 billion in revenues and pro forma earnings of 18 cents per share on continuing operations for the quarter ended Sept. 30, 2000. For fiscal year 2000, the adjusted results will be $33.6 billion in revenue and pro forma earnings per share of 93 cents on continuing operations."

116. Back on July 20, 2000, defendant McGinn provided guidance for fiscal 2001 of 20 percent revenue growth and 20 percent growth in pro forma earnings per share. Defendant Hopkins seconded this guidance. Specifically as to the first fiscal quarter of 2001, Lucent had stated that revenues from continuing operations for the first fiscal quarter would grow 20 percent while pro forma earnings per share for that quarter would decline about 15%. Lucent now states, on December 21, that "[f]or the first quarter of 2001, Lucent anticipates that pro forma revenues will decline about 20 percent compared to the year-ago quarter, and pro forma earnings per share on continuing operations is expected to show a loss in the range of 25 to 30 cents per share."

117. Although defendant Schacht now blamed this restatement of revenues on "a significant sales decline in North America due to an overall softening in the competitive local exchange carrier (CLEC) market, slowdown in capital spending by established service providers, lower software sales and a more focused use of vendor financing" as if this were some new discovery, these problems are neither recent developments nor new information just learned by defendants. Rather, Aversano expressly warned Lucent senior management of the issues that resulted in the restatement as early as October 9, 2000, and Ms. Russo had objected to the July 20, 2000 revenue

guidance for these very same reasons. Despite repeated warnings from Aversano, Russo and other Lucent executives, defendants failed to disclose or recklessly disregarded these material facts.

118. On December 21, 2000, defendants further announced an additional restatement of more than half a billion dollars in revenues for the fiscal fourth quarter of 2000, bringing the restatement of earnings for the quarter to $679 million. According to defendants, their "investigation" into fourth quarter revenues uncovered improper revenue recognition, sales in the fourth quarter that included significant credits on sales in future quarters, essentially mortgaging the future, and what appear to be either phony sales or, at the very least, consignment sales that were recognized as revenue at the time they were made. Thus, defendants reported:

> - Lucent found that in one case there had been misleading documentation and incomplete communications between a sales team and the financial organization with respect to offering a customer credits in connections with a software license. It was done with disregard for the clear revenue recognition procedures that Lucent has in place. Appropriate disciplinary action, including the dismissal of an employee, is being taken. As a result, Lucent will reduce its fourth fiscal quarter 2000 revenues by $125 million.
>
> - In the course of the review, Lucent identified two other cases in which the sales teams had verbally offered credits to be used at a later date, but that may have been related to transactions in the fourth quarter. Lucent has decided to reflect those credits in the fourth quarter, reducing fourth fiscal quarter revenues by an additional $74 million.
>
> - In one case, Lucent found that revenue had been recognized from the sale of a system that had been incompletely shipped. Accordingly, Lucent reduced its fourth fiscal quarter revenues by an additional $28 million.

- During the course of the review, Lucent decided to take back $452 million in equipment that had previously been sold to certain systems integrators and distributors, but not utilized or passed on to customers due to changes in business strategies and the weakening of the emerging service provider market. In the interest of preserving customer and distributor relationships, and because there was some evidence that there may have been verbal agreements that led them to expect Lucent to do so, Lucent has decided to take the equipment back and resell it in the future. As a result, revenues for the fourth quarter will be reduced by an additional $452 million. Revenue from the resale of this equipment will be recorded as it occurs.

119. In conjunction with the December 21, 2000 earnings warning, defendant Schacht belatedly admitted that Lucent had wrongly emphasized quick revenues over long-term growth, built up an unwieldy internal structure, and missed its opportunity to bring an advanced fiber optic system to market. Schacht admitted to investors in the December 21, 2000 conference call that Lucent "created an organization structure that, again <u>in hindsight</u>, created duplications, excess costs, lack of focus and reduced visibility." Schacht also noted that a growing percentage of its sales was coming from outside of the U.S., which, according to analyst Seth Spalding at Epoch Partners, indicates a lack of confidence in sales in the domestic market.

120. The quoted December 21, 2000 statements made by defendants as detailed above were false and misleading. While Lucent now claims that it made these revelations with the benefit of "hindsight," in fact, Lucent was made aware of these problems prior to July 20, 2000, and well prior to its October 10, 2000, October 23, 2000, November 21, 2000, and December 21, 2000 statements.

121. Indeed, second tier managers at Lucent had objected to and refused to support Lucent's focus on short-term targets that required quarter-end "miracles" which were adversely affecting ongoing business, including market developments that were estimated to cause a shortfall of approximately $1.7 billion in revenue, together with other transactions and arrangements that were estimated to cause an additional shortfall of about $3 billion. Defendants recklessly disregarded these objections and warnings. They also recklessly ignored objections and red flags concerning the buildup of inventory in distribution channels, the use of "consignment" sales, and the use of non-recurring credits to customers who bought products in fiscal 2000, all of which Schacht falsely portrayed as if it were newly discovered information.

122. It was false and misleading for defendants to have stated that they only realized on December 21, 2000 that the Company had emphasized quick revenues over long-term growth and "created an organization structure that . . . created duplications, excess costs, lack of focus and reduced visibility," when in fact they had created and condoned that very corporate culture. Lucent's board and the Management Defendants were already aware of the problems with revenue and sales projections, and knew that the focus on "quarter-end miracles" was adversely affecting long-term business goals.

123. In response to the revelations of December 20, 2000 (the Aversano lawsuit) and the December 21, 2000 restatement of earnings, the price of Lucent's common stock again dropped from $17.375 on December 19, 2000 to close at $13.625 on December 22, 2000. In all, the price of Lucent common stock has plummeted by over $50 per share.

Wrongful Refusal of Demand and Futility of Demand

124. As early as February 14, 2001, shareholders of Lucent, including Plaintiff Pallas, began making formal demands on the Board of directors to commence an action against Richard A. McGinn, Deborah C. Hopkins "and all other individuals responsible for the misconduct of our Company." In addition, at least four (4) shareholder derivative actions were filed in the Delaware Chancery Court against members of the Lucent board of directors, McGinn, Hopkins and others.

125. On March 16, 2001, Lucent acknowledged receipt of the Pallas demand and stated that "the matter will receive our attention." Despite this statement, in the Delaware cases, Lucent's Board has evidently rejected the shareholder demands. Instead of moving to takeover the litigation and pursue the claims on behalf of Lucent against the individual board members and former managers, the Delaware defendants have moved to dismiss the cases on the ground that the shareholders had not first served a demand on the board. In other words, the Lucent board is engaged in gamesmanship by asserting on the one hand that it will turn its "attention" to legitimate shareholder demands while contending, on the other hand, that shareholder demands that were not preceded by a formal demand letter are meritless and should be dismissed.

126. In fact, the current Lucent Board has wrongfully refused Plaintiff's legitimate demand served herein. First, over a year has passed without the Board taking any substantive action, or issuing any report concerning, the subject matter of Plaintiff's demand. This delay is compelling evidence that the Board is not exercising any business judgment in the expeditious and vigorous pursuit of any and all claims Lucent may have against its current and former officers and directors. The delay is also evidence that the

Board, and its consultants, have engaged in a prolonged and mendacious campaign to whitewash the misconduct of upper management at Lucent and to cover-up the utter lack of adequate and effectual Board controls over that management and the information systems necessary to ensure proper Board control of management.

127. Such wrongful refusal of Plaintiff's legitimate demands to institute suit is further evidenced by the following:

a. On February 14, 2001, plaintiff made a "demand" on Lucent's Board of Directors by his letter of such date (Plaintiff's Demand"). Plaintiff's Demand is attached hereto as Exhibit "A."

b. On March 16, 2001, Lucent's in-house Legal counsel, Paul Diczek, Esq. acknowledged the receipt of plaintiff's letter addressed to Lucent's Board of Directors. He said, "that the matter will receive our attention" after taking more than a month to respond.

c. On April 25, 2001, Richard D. Greenfield, Esq., on behalf of his son, Adam D. Greenfield, made demands on Lucent's Board of Directors by letter of such date (Adam's Demand").

d. Once again, Lucent's Board took a month to respond to Adam's Demand, which it did through Joseph V. Ippolito by letter dated May 24, 2001. Mr. Ippolito advised that: "Lucent's Board of Directors will refer your inquiry [sic] to a special committee. That committee will report its conclusions to the Board of Directors."

e. On June 4, 2001, Mr. Greenfield wrote to Mr. Ippolito, asking 12 questions which would assist him in determining the bona fides of Lucent's Board of Directors. These questions were as follows:

i. Was my letter of April 25 promptly disseminated to each of the members of the Board of Directors and, if so, the date of such dissemination?

ii. To what other persons was my letter sent and the identity of the person who sent it?

iii. When did the Board of Directors first consider my letter of April 25 in person, telephonically or otherwise?

iv. What is the identity of the persons who participated in such consideration of my letter? If such consideration was memorialized in Board minutes or otherwise, please send me a copy of such minutes.

v. When and in what manner was a so-called "special committee" appointed?

vi. Is there a resolution of the Board of Directors appointing such "special committee?" If so, I would appreciate receiving a copy of any such resolution.

vii. Who are the members of the "special committee" and what are their business affiliations?

viii. Have the members of the "special committee: met in person, conferred by telephone or otherwise in connection with my letter of April 25? If so, state the date and manner of such communications.

ix. Has the "special committee" retained legal counsel? If so, state the name of the particular lawyers retained by the "special committee: and the date of initial contact between any member of the Board of Directors or of Lucent management with any such lawyers (or their firm) with respect to my letter of April 25.

x. Has the "special committee" developed any timetable in connection with its activities and/or when it will "report its conclusions" to Lucent's Board of Directors?

xi. Has the Board of Directors received any other similar "demand" letters from any Lucent shareholder or representative of a Lucent shareholder? If so, please provide me with a copy of any such letters and advise me of what steps have been taken, if any, by Lucent's Board of Directors in response thereto.

xii. Have any shareholders commenced derivative litigation or otherwise asserted claims derivatively on behalf of Lucent directly or indirectly concerning the subject matter of my letter of April 25? If so, please provide me with a copy of any complaints which assert such claims.

f. After a further letter to Mr. Ippolito on June 4, 2001, on June 13, 2001, he wrote to Mr. Greenfield, unresponsively, and said:

> "Lucent's Board of Directors has formed a special litigation committee that <u>is</u> investigating the issues raised in your demand letter. The board is in no position to disclose any further information <u>at this time</u> regarding the committee or its activities..." [emphasis added]

g. On June 19, 2001, Mr. Greenfield wrote to Mr. Ippolito stating in material part:

> "Unfortunately, your June 13 letter does nothing, even to the slightest degree, to provide any information to me.
>
> "Obviously, you are acting on behalf of someone; the Board of Directors, the so-called "Special Litigation Committee" and/or Lucent Management. Please advise me promptly on whose behalf you are responding. Further, since your letters of June 13 and today amount to a "stonewall," my letter of earlier today will have to stand. Namely, the actions of Lucent's Board of Directors, through you, obviously amount to a *de facto* rejection of the demand letter.

h. On June 20, 2000 Mr. Ippolito responded to Mr. Greenfield:

> "I am not in a position to respond to your earlier or current demands for specific information. We apparently disagree concerning that to which you are entitled. As I previously advised, when the Special Litigation Committee of the Board completes its review, your will be advised of its action."

i. After a further request to Mr. Ippolito of the identity of the members of the so-called "Special Litigation Committee," Mr. Greenfield received a letter dated July 30, 2000 from John S. Siffert, Esq. informing him that the committee consisted of defendants Hills and Thomas and that his firm represented them in such capacity. Mr. Siffert went on to say:

> "The Special Committee is currently considering the demand made in your letter. I invite you to please submit to me, within thirty days, any further information you believe would be helpful in <u>the Special Committee's investigation</u> of this demand." [emphasis added]

j. Mr. Greenfield promptly responded to Mr. Siffert on August 3, 2001, stating:

> "In that regard, please advise me of the precise mandate of Ms. Hills and Mr. Thomas. Additionally, please provide me with a copy of whatever Board resolution or similar directive of the Board resulted in their serving as the so-called "Special Committee". I would also like to know when the Committee was formed and whether it was in response to a shareholder demand and/or some other event.
>
> "You state in your letter that the "Special Committee is currently considering the demand made in [my] letter." In that regard, given the fact that more than three months have passed since the demand letter was sent on our client's behalf, I would like to know precisely what the Committee is doing by way of "consideration" that would demonstrate that they are legitimately acting on the demand and not participating in a sham orchestrated by legal counsel. If you will excuse my skepticism, I find it inconsiderate of you, after a delay of more than three months, to request that I submit to you, "within thirty days, any further information [I] believe would be helpful in the Special Committee's investigation of this demand."

"I would be more than happy to meet with the members of the Special Committee either in New York or in any other convenient location in the United States to provide answers to any questions the members of the Special Committee" have. At the same time, I would hope that either you or the members of the Committee themselves would provide to me whatever information they or you have which possibly indicate that such Committee members are independent and not personally responsible for the wrongdoing alleged in my letter to the Board of April 25, 2001.

"To facilitate my making a meaningful presentation to the Committee and to avoid wasting their time and yours, I would like to know whether any other shareholders of Lucent have made demands on its Board of Directors and, if so, the status of any such demands. Similarly, if any shareholder of Lucent has asserted derivative claims in litigation, I would appreciate receiving from you promptly copies of any such complaints or, should there be a consolidated complaint, that document. In the event that a motion to dismiss has been filed in connection with any such complaints, I would also appreciate receiving copies of any such motions and the papers submitted in support thereof.
"I look forward to meeting with you and the Committee members shortly. In the meanwhile, I trust you will provide me with the requested documents and information identified above.

k. In response, Mr. Siffert rejected Mr. Greenfield's offer to meet with the "Special Committee." His letter of August 21, 2001 said:

"If during its consideration of your demand letter, the Special Committee determines it is appropriate that <u>we</u> meet, I will contact you to set up a meeting date."

l. After sporadic communications during the intervening months, Mr. Siffert wrote to Mr. Greenfield on November 8, 2001 (received November 21, 2001) as follows:

"<u>We are continuing to investigate</u> the allegations in your letter of April 25, 2001. <u>We are now</u> at a point where <u>we believe</u> meeting with you would be appropriate.

<u>We are available</u> to meet at our office on December 7, 2001.

m. Mr. Greenfield responded to the offer from Mr. Siffert and his two clients:

“While I am skeptical that the meeting you propose is anything but a sham to be used in an attempt to defeat a shareholder derivative suit, I am willing to travel to New York. However, to assure me that a meeting will not be a waste of time, I would appreciate receiving from you by return fax a candid response to my letter to you of August 3 which, to date, has gone unanswered.”

“Regrettably, following a court appearance in Oakland, California on December 6, I will be flying trans-Pacific on December 7. I will not be returning to the United States until December 20. However, because the meeting with you and the members of the so-called “Special Committee” may be useful, I am willing to try to adjust my schedule. In that regard, I may be able to have my co-counsel cover for me on December 6 and delay my trip if I believe the meeting with you and the “Special Committee” will proceed with mutuality of purpose.”

“As an alternative, I can, however, be in New York on November 30 to meet with you and the “Special Committee.” If this date is not convenient for you or the Committee members, I will do my best to adjust my schedule accordingly for a meeting on December 7.”

“For a meeting to be worthwhile, I anticipate that I will require four to five hours to make my presentation to the “Special Committee” and I will expect that they will also be in a position to answer substantive questions I anticipate asking them. Their responses, assuming a level of knowledge they should have by now, may well shorten my own presentation since I do not want to waster their time imparting information that they already have.

“Further, I expect that they will share with me, subject to whatever reasonable confidentiality agreement you wish me to enter into, the scope and product of <u>their</u> own “investigation” so that I can evaluate their <u>bona fides</u> including the extent of their own responsibility for the underlying wrongdoing. After all, it makes no sense to go through this process if their “investigation” is a sham. I should point out that I am not seeking any of your legitimate work product or the non-factual content of privileged communications – just facts.”

“I look forward to our meeting and to its being <u>mutually</u> productive. I trust that you will convey this letter to your clients so that we can have a universal agreement as to what will transpire and so that there are no surprises.”

“Given the tightness of the timing of a meeting, please get back to me by tomorrow at the latest, one way or the other as to the possibility of a meeting this Friday. I can be reached by phone at (561) 653-9921, by fax at (561) 653-9977 or by e-mail at the address indicated above."

n. On November 29, 2001, Mr. Siffert responded:

"... The meeting I propose will be with counsel for the Committee. The Committee members themselves will not be present.

In response to your earlier inquiry, the Special Committee is tasked with investigating your demand and is taking appropriate actions to do so. At this time, the Committee and we, as counsel, are not in a position to provide you with a status report..."

o. The foregoing letter was the first time that Mr. Siffert gave any inkling that he was not permitting his clients, who were purportedly "investigating" the demand, from learning first-hand what plaintiff's counsel had to say.

p. On December 5, 2001, Mr. Greenfield once again wrote to Mr. Siffert requesting a fact-to-face meeting with the "Special Committee" and offered substantial flexibility as to the date and place of such a meeting. Mr. Greenfield wrote:

"In response to your letter of November 29, 2001, I would be pleased to meet with you in New York on January 9th in anticipation of a meeting with the so-called "Special Committee" along with the lines set forth in my letter of November 26th."

"I presume, as a matter of courtesy, you will provide me either today or after December 20th with several alternative dates to meet with the "Special Committee" members, either in New York or at any other reasonable location.

"I assume that, as well, you will provide me with the answers to the questions raised in my letter to you on August 3, 2001, sent to you again on November 26th. Not even receiving any responses from you – even as to matters of public record – puts your own bona fides in question. I trust that your response will be awaiting my return on December 20th. "

q. Mr. Siffert wrote back on December 7, 2001, setting a date for a meeting on January 9, 2002 but refusing, once again, a meeting between Mr. Greenfield and his clients. He stated:

> "I remind you that you will be meeting with counsel for the Special Committee. We have not yet determined if and when it will be appropriate for you to also meet with the Special Committee members.
>
> ... we are assisting the Special Committee in doing its job."

r. On December 20, 2001, Mr. Greenfield wrote to Mr. Siffert as follows:

> "While I am prepared to meet with you as scheduled, I will only do so if it is productive. In that regard, please forward to me by no later than December 31, answers to the questions I have previously asked you .... going back to August ... as well as copies of those documents I have requested."

s. On December 21, 2001, Mr. Siffert rejected Mr. Greenfield's renewed request.

t. On January 7, 2002, Mr. Greenfield informed Mr. Siffert that he would not attend a meeting with him for, inter alia, the following reason:

> "By continuously avoiding the provision of even basic information to make any meeting mutually productive, you and your colleagues clearly reveal your collective motives; i.e. to use a meeting as a further pretext for filing a motion to dismiss one or more shareholder derivative suits that may be filed (or which may have already been filed)."

u. After a response from Mr. Siffert on January 15, 2002, Mr. Greenfield dealt with the de facto rejection of the Plaintiff's Demand and Adam's Demand in his letter of January 21, 2002:

> "As you know, I initially expected to meet with the "Special Committee" members directly since it was my understanding that they were performing the factual aspects of the "investigation" themselves. I also anticipated that the dialogue with the Committee members would be just that, a dialogue rather than a one-way dissemination of information from me to them."
>
> "Additionally, I requested from you repeatedly as a matter of good faith and to allow me to fulfill my professional responsibilities, copies of certain documents, some of them public and some not, as well as certain information bearing upon the existence of other shareholder demands

> and/or litigation. Despite my repeated requests, you provided me with nothing. Notwithstanding the fact that a meeting was scheduled ultimately with you alone, your continued “stonewalling” with respect to my repeated requests demonstrated to me the lack of good faith in your position and in that of the Committee members. Further, on reflection, it also appeared to me that you personally and, presumably, along with members of your firm, are personally and deeply involved in the fact-gathering process and participating in a cover-up. You are not merely acting as legal counsel to the “Special Committee.” You and its members are and will be material witnesses in the ultimate derivative litigation, particularly with respect to the activities of the Special Committee and its counsel, their independence or lack thereof and their potential complicity in a “whitewash” effort. “
>
> ”While you now argue that neither the “Special Committee” nor your firm has rejected the demands made by our clients, the facts indicate otherwise. Actions speak louder than words and your actions speak clearly. It will be up to a court to determine whether the actions of the Committee and its counsel amount to a rejection of the shareholder demands or not.”

v. On January 23, 2002, Mr. Siffert stated in a letter to Mr. Greenfield:

> “... <u>we are proceeding</u> with <u>our</u> investigation in good faith” [emphasis added]

w. Not having heard from Mr. Siffert for approximately three months, Mr. Greenfield wrote to him on May 1, 2002 as follows:

> “It has been three months since I have heard from you. You have not advised me of the status of <u>your investigation</u> nor when I might meet personally with Ms. Hills and Mr. Thomas.”
>
> “It has been over one year since George Pallas made demands upon Lucent’s Board (on March 16, 2001) and since the demand I made on behalf of my son, Adam Greenfield, on April 25, 2001. There may have been other shareholders who have made substantially similar demands on Lucent’s Board, but you refuse to let me know whether or not they have been made or by whom.”
>
> “I believe that you and your clients are proceeding in bad faith. You have had unfettered access to all of Lucent’s documents and personnel and, if you had been legitimately “investigating” the shareholder demands, your

task should and would have been completed within several months. This is particularly so since you have had the benefit of the "road maps" created for you by Plaintiff's counsel in the federal securities fraud cases and by the numerous articles in the business press which have dissected the gross mismanagement by Lucent's Board and senior executives. See, e.g., Bloomberg Markets, October 2000, p.35 et seq.; The New York Times, January 21, 2001, Money & Business Section, p.1 et seq."

"Please advise me by the close of business on May 3, 2002 as to the status of the purported "investigation" and when I might meet with your clients for the dialogue I have described in previous correspondence."

x. Mr. Siffert responded on May 2, 2002 in relevant part:

"Contrary to the assertions in your most recent letter, we actively have continued to investigate the allegations raised in your original demand letter and that of Mr. Pallas. The allegations in the original demand letters are extremely broad, encompass various different and complex issues (not to mention millions of pages of company documents), and claim that in addition to the Board, McGinn and Hopkins unspecified "others" have participated in the alleged wrongdoing. We previously offered to have you meet with us to discuss in a productive and more focused manner the allegations being raised by your client and Mr. Pallas. You have thus far refused our offer.

Nevertheless, we have continued our investigation in good faith. We expect to be concluding our work and making a recommendation to the Special Committee in due course. If you change your mind and wish to meet with us as counsel to the Special Committee before we conclude our investigation, you should contact us by May 31. Thereafter, the Special Committee will determine whether it is appropriate to meet with you."

125. The foregoing amounts to a de facto rejection of plaintiff's and Adam's demands on Lucent's Board of Directors to commence this litigation. The manner in which Lucent's Board, its "Special Litigation Committee" and Counsel to such Committee have acted demonstrates the futility of shareholder demands under the circumstances described herein.

126. No legitimate investigation of the shareholder demands is taking place and the Lucent directors appointed to the Committee are themselves guilty of the very

wrongdoing they are purportedly investigating. They and their counsel, Mr. Siffert and his colleagues, are prolonging and worsening the very cover-up of wrongdoing that resulted in the foregoing shareholder lawsuits and the shareholder demands described above.

127. In practical terms, Lucent's Board would not cause Lucent to sue its own members and a suit by Lucent against its directors would eliminate any ability of Lucent to recover the proceeds of the various officers' and directors' liability insurance coverage, which Lucent purchased. Such coverage and the proceeds thereof are the primary financial means by which Lucent can recover its damages from the individual defendants.

128. The actions and failures to act by the members of Lucent's Board amount to a waste of corporate assets. Such waste of assets cannot be blessed by the Board or by any committee thereof and, as such, these activities are not capable of ratification in the context of either "investigating" the Lucent shareholder demands and/or deciding what the appropriate course of action is with respect to any previously commenced derivative litigation filed without shareholder demands upon Lucent's Board.

129. Just as the members of Lucent's Board cannot be expected to have Lucent sue themselves, they are also co-conspirators with the "auditor" of Lucent's financial statements, Price Waterhouse Coopers ("PWC"). It and the Director Defendants have a common interest in defending against claims of securities law violations and the misfeasance and malfeasance referred to above.

130. For the foregoing reasons, Lucent's Board has relinquished any right to exercise the business judgment normally accorded to a board of directors and this litigation should be allowed to proceed on behalf of Lucent and for its benefit.

131. In addition to the effective and wrongful refusal of Plaintiff's demands by the Lucent Board, it is clear that demand is excused in this case because it is futile. The Lucent Board has continually demonstrated a conscious disregard for the interests of Lucent's stockholders and has shown a gross unwillingness to protect Lucent's interests by recovering monies from its current and former officers and directors.

132. It is futile to assume the board of directors will agree to commence action against itself given the prior business judgment in abdicating its required oversight of the Company's statements to the public, filings with the SEC and external revenue projections.

133. The Director Defendants, by bringing an action, would jeopardize their own financial and professional well-being since each director of Lucent also serves on the boards for various other companies, including American International Group, Inc.; Chevron Corp.; Oracle Corp.; American Express Company; and Xerox. To the extent the Directors here agreed there were sufficient allegations and evidence of mismanagement to warrant suit, those directors would most certainly be removed from their directorial positions at the other companies that are confronting similar allegations of mismanagement, fraud and waste.

134. The Director Defendants cannot be expected to exercise disinterested independence in evaluating a demand to institute suit for Lucent, because their own defense to that suit will be the concession that the Board was unaware of the goings on at

Lucent, which alone establishes a gross breach of fiduciary duty. The authorization of a suit which defendants know would require an ignorance defense would not be logical given the risks such an admission would have on the Directors' suitability to serve on other corporate boards or to engage in other activities requiring the exercise of fiduciary responsibilities.

135. The Director Defendants are also unwilling to authorize such a lawsuit, because it would be tantamount to self-incrimination. It is likely, if not virtually certain, that the Management Defendants will contend and show that the Board was fully advised of all of the unlawful, misleading and fraudulent practices engaged in by the Company. In short, the suit will reveal that the Board was a participant in the manipulation of earnings, thereby damaging the directors personally, professionally and financially.

136. Given the potential for conflicts of interest it is unlikely the board will authorize an action. As head of the Audit and Finance Committee, director Paul Allaire either consciously disregarded his duties as a director or so woefully failed to fulfill them that it is apparent that the board did not establish, implement or follow basic systems required to ensure it had sufficient competent information to perform its fiduciary duties to the Company and its shareholders. The other Lucent directors all have personal and professional relationships with Mr. Allaire that clearly prevent them from exercising sound judgment as to the merits of a suit by Lucent against the Management Defendants. Indeed, some members of the board presently sit with Mr. Allaire on the board of SmithKline Beecham PLC.

137. Given the intermisticity of relationships of Lucent's current and former board members and the level of recklessness shown to the discharge of their duties as

members of the board or as committee chairs it is futile to expect any legitimate action to be forthcoming from the board of directors to protect the interests of the Company and its shareholders.

First Claim For Relief

Violation Of Section 14(a) Of The Securities Exchange Act

138. At all relevant times, the Director Defendants were and/or are Lucent's directors. Such Defendants were and are controlling persons of Lucent pursuant to section 20 of the Exchange Act in that they dominated and controlled the Company, oversaw its public pronouncements and, with respect to Lucent's proxy statements at issue, were elected and re-elected pursuant thereto and approved the contents thereof before they were disseminated to Lucent's shareholders. As such, they directly controlled Lucent's corporate suffrage process.

139. The Company's proxy statements dated December 21, 1999, January 8, 2001 and December 28, 2001 were issued and disseminated to Lucent's shareholders for the purposes of, inter alia, inducing them to vote on the following matters:

(a) "To elect members of the Board of Directors..."

(b) "To approve the Lucent Technologies, Inc. 2001 Employee Stock Purchase Plan"

(c) "To transact other business"

140. In order to induce Lucent shareholders to elect and re-elect the Director Defendants to the Board of Directors, Lucent enclosed with the respective Proxy Statements the Annual Reports of the Company for the most recent fiscal year. Although the Director Defendants take the position that such Annual Reports were "not a part of the proxy soliciting material" with which they were mailed, in fact, the Company's

Annual Reports, when taken together with the Proxy Statements, were the means the Defendants utilized to influence and obtain shareholder votes for themselves and for the other proposals voted upon.

141. The foregoing Annual Reports materially misrepresented the assets, earnings and net worth of Lucent as indicated above. Each of the Director Defendants, as Lucent Directors and control persons of the Company, was responsible for the content of such Annual Reports, filings with the SEC and public dissemination of information in the Company's name. As such, they are responsible to the Company for any damages caused to it flowing from the foregoing shareholder litigation and from their other conduct as referred to above.

142. The Lucent Proxy Statements referred to above touted the Board's apparent corporate governance procedures and highlighted its various committees and the attendance record of the Directors. The Proxy Statements identified each Director Defendant and set forth his or her respective service with other businesses and on other corporate boards. In doing so, the Director Defendants concealed the fact that because of the multiplicity of their corporate and other responsibilities they could not and were not devoting ample attention to Lucent, its business and its massive operational problems referred to herein. Indeed, as indicated above, the Director Defendants effectively abdicated their corporate governance responsibilities and thereby relinquished the right to exercise freely the business judgment normally possessed by a board of directors, either as a whole or through any committee thereof.

143. Each of the proxy statements at issue states prominently and falsely under the heading "Governance of the Company" that: "Members of the Board are kept

informed of the Company's business through discussions with the chairman and key members of management, by reviewing materials provided to them and by participating in meetings of the Board and its committees." In fact, the chairman (Schacht) concealed from the members of Lucent's Board many of the material facts referred to above relating to Lucent's gross mismanagement and the Board, even when informed of the deterioration of Lucent's operations, failed to obtain for themselves from defendant Schacht or otherwise sufficient information to keep themselves informed enough to take remedial action.

144. Each of the proxy statements at issue proclaimed the very high (e.g. 94%) "average attendance at Board and committee meetings" when, in fact, much of such attendance was pro forma, without adequate preparation, knowledge of material information and/or meaningful contribution to the decision-making ("Committee Report") process. For example, with respect to the "Report of the Audit and Finance Committee" contained in the Lucent proxy statements, the defendants including, in particular, the members of the Audit and Finance Committee ("Audit Committee"), failed to disclose that they did not have ample time or expertise to review the audits of Lucent's financial statements or the performance of its purportedly independent auditor, PWC. For example, defendant Allaire, the chairman of the Audit Committee, was, at all relevant times, involved in dealing with the near-collapse and financial deterioration of Xerox Corporation, of which he was chairman and Chief Executive Officer while also serving as a member of the boards of directors (and various committees thereof) of inter alia, SmithKline Beecham; Priceline.com, Inc.; and Sara Lee Corp. Similarly, defendant Thomas, during the period on which he served as a member of the Audit Committee,

concurrently served on the boards of directors of numerous corporations and non-profit entities and committees thereof, all of which prevented him from devoting sufficient time to Lucent's affairs, particularly to their falsely stated and exaggerated activities as referred to in the Committee Report which appeared in each of Lucent's proxy statements. In addition, defendants Allaire and Thomas were members of the Corporate Governance and Compensation Committee ("Governance Committee") of Lucent's Board and attended meetings thereof.

145. Neither in any of the Committee Reports nor elsewhere in any of the relevant proxy statements was it disclosed that although the Audit Committee had stated "audit functions," its members were not adequately trained, prepared and/or had devoted sufficient time to properly carry out such functions. Although committee members periodically attended meetings with PWC and internal staff members, they failed to detect and/or concealed from the Committee Reports the fact that Lucent's financial statements were not prepared in conformity with generally accepted accounting principles or that PWC's audits thereof were not performed pursuant to appropriate auditing standards and practice.

146. Neither in any of the Committee Reports nor elsewhere in any of the relevant proxy statements was it disclosed that the Audit Committee did not adequately explore the extent to which PWC's conflicts of interest interfered with its ability to perform audits and reviews of Lucent's financial statements while, concurrently, reaping massive sums (e.g. more than $63 million in fiscal year 2001 as fees for "consulting' and other non-audit services rendered to Lucent, (including audit fees of discontinued or sold operations, and providing "non-financial systems design and implementation")). In fact,

PWC failed to adequately staff and aggressively conduct its audits of Lucent's financial statements or take any steps to "rock the boat" for fear of jeopardizing the flow of consulting and other fees generated each year by Lucent, which fees in fiscal year 2001 vastly exceeded (by nearly nine (9) times) the audit and review fees paid to PWC in such year.

147. Had PWC conducted its audit and review functions independently and devoted the time and manpower resources to such function necessitated by Lucent's deteriorating condition, it was more likely than not that Lucent's true financial circumstances would have been revealed publicly in a more timely manner, thereby avoiding Lucent's exposure to a material amount of the damages alleged in the Shareholder Class Actions referred to above.

148. By "rubber stamping" the audit and other services performed for Lucent by PWC, the members of the Audit Committee aided and abetted the failure of PWC's audits and the internal audit process. The Committee Reports' representation that it "reviewed" PWC's independence was false and/or misleading for the foregoing reasons and because such "reviews" were conducted in a pro forma manner pursuant to a checklist rather than substantively as necessitated by PWC's conflicts and the requirements of proper auditing procedures in Lucent's circumstances.

149. In Lucent's 2001 proxy statement the Committee Report stated that based upon its [pro forma] reviews and discussions with PWC, it "recommended to the Board that the Company's audited financial statements be included in the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2000." By acting as such, the Audit Committee during the period relevant to this litigation, accepted personal

responsibility for the content of Lucent's false and misleading financial statements referred to herein.

150. Appended to Lucent's 2001 proxy statement was "a written charter setting out the audit related functions the [Audit] Committee is to perform." Such "charter" is an integral part of the 2001 proxy statement and, notwithstanding the laudable functions and objectives set forth therein, Lucent's 2001 and 2002 proxy statements failed to disclose the extent to which the Audit Committee failed to properly perform such functions as set forth above and otherwise.

151. Lucent's proxy statements disclose the functions of the Governance Committee as follows:

> The functions of the Corporate Governance and Compensation Committee include: recommending to the full Board nominees for election as Directors of the company, making recommendations to the Board from time to time as to matters of corporate governance, administering management incentive compensation plans, establishing the compensation of officers and reviewing the compensation of Directors. The committee will also consider qualified candidates for Director suggested by shareowners in written submissions to Lucent's corporate Secretary.

152. Each of the 2000, 2001 and 2002 proxy statements of Lucent failed to disclose that the Governance Committee in making its "nominations" for Lucent directorships, failed to consider whether the nominee had the time, training and/or experience to fulfill properly the responsibilities of serving as a director of Lucent, and only selected (or re-nominated) persons not likely to act independently of defendant Schacht.

153. In determining the compensation of defendant Schacht and each of the other director defendants, the Governance Committee failed to adequately take into account Lucent's deteriorated performance (for which defendants were and are

responsible). The foregoing proxy statements failed to disclose that in determining their own compensation, the Governance Committee and, indeed, all the defendants, failed to consider their own performance and the profitability of Lucent.

154. In this regard, each of the Proxy statements mailed or delivered to Lucent shareholders since at least December 1999 has included the following shareholder proposal:

> RESOLVED:
> "That the stockholders of Lucent Technologies recommend that the Board of Directors take the necessary steps to instate the election of directors ANNUALLY, instead of the stagger system which was recently adopted."
>
> REASONS:
> "The great majority of New York Stock Exchange listed corporations elect all their directors each year."
>
> "This insures that ALL directors will be more accountable to ALL shareholders each year and to a certain extent prevents the self-perpetuation of the Board."
>
> "Last year the owners of 365,298,827 shares, representing approximately 41.4% of shares voting, voted FOR this proposal."
>
> "If you AGREE, please mark your proxy FOR this resolution."

155. Each of the Proxy statements mailed or delivered to Lucent shareholders since at least December 1999 has included, in substance, the following recommendation from the Lucent directors in response to this shareholder proposal:

> YOUR DIRECTORS RECOMMEND A VOTE AGAINST THIS PROPOSAL.
>
> The Board of Directors continues to believe that this proposal is not in the best interest of Lucent or its shareowners.
>
> The proponent believes that the Board should be more accountable to shareowners. The board continues to believe that Directors who are

elected to three-year terms are just as accountable to shareowners as Directors who are elected on an annual basis. We have fiduciary duties that do not depend on how often we are elected. During the past year, we took the following actions to further the accountability of the Board to the shareowners:

We implemented a performance evaluation process, through which Directors candidly assess the effectiveness of the Board and identify areas requiring improvement or change.

We implemented a new compensation program that directly aligns the Directors' interests with those of the shareowners by requiring that a substantial portion of each Director's retainer be paid in stock or an option to purchase Lucent stock. In fiscal 1999, the majority of the eligible Directors elected to take their entire retainer in stock or an option to purchase stock.

We amended the company's by-laws to provide that a Director who is appointed by the board must stand for election by the shareowners at the next annual meeting, regardless of whether that Director's class would otherwise be standing for elections.

The Board also continues to believe that having a staggered board assures continuity and stability of the company's business strategies and policies. This is especially important in light of the fast-paced, competitive industry in which Lucent operates. Because at least two shareowner meetings would be required to effect a change in control of the Board, a majority of directors at any given time will be familiar with the company's business strategy through service as a Director. In addition, in the event of an unfriendly or unsolicited takeover proposal, the staggered system gives the Board the greatest opportunity to negotiate with a third party or to consider other alternatives that would maximize shareowner value.

THE BOARD OF DIRECTORS RECOMMENDS A VOTE AGAINST THE ADOPTION OF THIS SHAREOWNER PROPOSAL. PROXIES SOLICITED BY THE BOARD OF DIRECTORS WILL BE SO VOTED UNLESS SHAREOWNERS SPECIFY OTHERWISE IN THEIR PROXIES.

156. The Directors' response to this shareholder proposal is and has been materially misleading because it has omitted the following material facts:

a. that the Director Defendants and the Management Defendants were aware of and even authorized senior management's undisclosed policy decision to "ship now, fix later" products that were not ready for delivery so the Company could inflate reported sales and meet guidance and analyst expectations that senior management had provided or affirmed to Wall Street and the market in general;

b. that the Director Defendants and the Management Defendants were aware of and even authorized senior management's undisclosed policy decisions (i) to use off-balance sheet financing vehicles to hide uncollectible accounts receivable; (ii) to make end-of-quarter sales "by any means necessary," including taking bad credits off "credit hold," extending undisclosed and unconditional "rights of return" to customers; permitting "side agreements" allowing for rescission, and permitting manual adjusting entries to delay billing while recording sales on the Company's books before an actual transfer of risk had occurred;

c. that the Director Defendants and the Management Defendants were aware of and even authorized senior management's policy decision to maintain Lucent's stock price by "whatever means necessary" so the Company could continue its strategy of acquiring other companies by using Lucent stock as currency;

d. that the Director Defendants had abdicated their responsibility for ensuring the independence of the internal and external audit functions by permitting division management to override internal audit recommendations and allowing the external auditor to be retained to provide non-audit services that provided over nine (9) times the remuneration it received for providing audit services; and

e. that the Director Defendants had not, in fact, "implemented a performance evaluation process through which Directors candidly assess the effectiveness of the Board and identify areas requiring improvement or change," because the Board has not taken any timely or meaningful steps to recover for Lucent the vast sums of money lost as a result of the accounting manipulations and "end-of-quarter" practices engaged in by former senior management, and because the Board has failed to hold accountable those members of former senior management and Board committees directly responsible for the fraudulent reporting and wasteful corporate practices engaged in by the Company.

157. The foregoing omissions and misrepresentations of material facts resulted in Lucent's 2000, 2001 and 2002 proxy statements impacting upon the corporate suffrage process in each of such years including the election of the defendants as directors. In particular, although the shareholder proposal to eliminate the staggered terms of board members garnered a near or absolute majority of all shares voted in 2000, 2001, and 2002, the proposal was not implemented by the Board because a majority of all outstanding shares had not voted to approve the proposal and because the Director Defendants elevated their personal self-interest in retaining their board seats and covering-up their prior misconduct above their fiduciary responsibilities to be responsive and accountable to the owners of the Company. Had the proxy statements disclosed the above-mentioned facts, including the Audit Committee's failure to comply with its own purported "charter" and its failure to properly oversee the financial reporting systems and internal and external audits of the Company, such facts would have assumed actual

significance in shareholder decisions about approving the shareholder proposal or reelecting Audit Committee chair Paul Allaire.

158. In this respect, the 2000 proxy statement was particularly misleading when it requested shareholder approval of an amendment to the Company's certificate of incorporation to increase the number of authorized shares from 6 billion to 10 billion. In recommending the amendment the Board stated, misleadingly, as follows:

> During 1998 and 1999, we effected 2-for-1 stock splits following significant increases in the market price for Lucent stock. In the event the Board determined that it would again be appropriate to effect a stock split, the current number of authorized shares of common stock that are not outstanding or reserved is not sufficient to enable the company to complete another 2-for-1 stock split. Although we cannot guarantee that Lucent's stock price will continue to rise or that the Board would declare a stock split at any specific price or at all, the Board believes that the increase in the number of authorized shares will provide us with the flexibility necessary to maintain a reasonable stock price through future stock splits (effected in the form of a stock dividend) without the expense of a special shareowner meeting or having to wait until the nest annual meeting.
>
> During fiscal 1999, Lucent continued to acquire companies as part of its strategy to broaden its portfolio of product offerings, to augment its technological capabilities and to expand its geographic markets and distribution channels. As part of this strategy, we may acquire additional companies for these and other business reasons. From time to time, we pay for acquisitions with Lucent stock. The Board believes that the proposed increase in the number of authorized shares is desirable to maintain the company's flexibility in choosing how to pay for acquisitions and other corporate actions such as equity offerings to raise capital and adoption of additional benefit plans. * * *

159. In making this recommendation, the Board took primary responsibility for the corporate strategy of using Lucent's stock as currency to acquire other companies. The Board also took responsibility for generating the corporate culture in which "any means necessary" were used to demonstrate sequential improvements in quarter to quarter performance so as to meet Wall Street and market expectations and maintain the

Company's increasing stock price. What the Board failed to disclose, however, was that this strategy was resulting in and had resulted in undisclosed changes in sound business practices so that uncollectible receivables were being booked, phantom revenues were being recognized, "ship now, fix later" policies were being adopted and approved, and the long term health, prosperity and viability of the Company was being mortgaged and jeopardized. Indeed, the Board's recommendation of the certificate amendment first portrayed the proposal as necessary for another stock split. In fact, the Board was well aware that Lucent could not continue to meet its revenue forecasts without significant and costly acquisitions. Had shareholders been told the problems resulting from the Board's corporate strategy, such facts would have assumed actual significance in their decision to approve the certificate amendment.

160. As such, by issuing and disseminating Lucent's 2000, 2001 and 2002 proxy statements, the defendants each violated Section 14(a) of the Exchange Act and Rule 14a-1 promulgated thereunder.

Second Claim For Relief

Breach of Fiduciary Duty by Management Defendants

161. Plaintiff incorporates herein by reference all of the foregoing allegations as if fully set forth herein.

162. By reason of their positions and ability to control the business and corporate affairs of Lucent, at all relevant times, each Management Defendant owed Lucent and its shareholders fiduciary duties of loyalty, due care and full disclosure and was required to control Lucent in a fair, just and equitable manner and to act in furtherance of the best interest of Lucent and its shareholders.

163. Each Management Defendant also owed Lucent and its shareholders a fiduciary duty to exercise due care and diligence in the management and administration of the affairs of Lucent and in the use and preservation of its property and assets.

164. Each Management Defendant further owed Lucent and its shareholders a fiduciary duty to insure that Lucent operated in compliance with all applicable federal and state laws, rules and regulations, that Lucent did not engage in any unsafe or unsound practices, and that Lucent did not waste its corporate assets.

165. To discharge their fiduciary duties, each Management Defendant was required to exercise reasonable and prudent supervision over the management, policies, practices, controls and financial and corporate affairs of Lucent. Among other things, each Management Defendant was required to:

a. manage, conduct, supervise and direct the employees, business and affairs of Lucent in accordance with applicable laws, rules and regulations;

b. not violate or permit any officer, director or employee of Lucent to violate applicable laws, rules or regulations;

c. exercise reasonable control and supervision over Lucent's officers and employees;

d. insure the prudence and soundness of policies and practices undertaken or proposed to be undertaken by Lucent and its officers and employees;

e. remain informed as to how Lucent was, in fact, operating, and, upon receiving notice or information of unsafe, imprudent or unsound practices, make reasonable investigation of such practices and take steps to correct such practices;

f. supervise the preparation, filing and dissemination of any SEC filings, press releases, audits, reports or other information disseminated by Lucent;

g. maintain and implement an adequate system of internal controls at Lucent, including financial, accounting and management information systems;

h. supervise the preparation and filing of any audits, reports or other information disseminated by Lucent to make full and accurate disclosure of all material facts; and

i. preserve and enhance Lucent's reputation as a global public corporation and maintain public trust and confidence in Lucent as a prudently managed institution fully capable of meeting its duties and obligations.

166. As described above, the Management Defendants maliciously, wantonly and willfully in bad faith intentionally breached their fiduciary duties to protect the rights and interests of Lucent and its shareholders.

167. As described above, the Management Defendants maliciously, wantonly and willfully in bad faith intentionally failed in their fiduciary duties to Lucent and its shareholders to prudently supervise, manage and control Lucent's operations and prudently manage the business and assets of Lucent.

168. By subjecting Lucent to the unreasonable risk of substantial losses by intentionally failing responsibly and with due care to oversee and implement proper accounting practices at Lucent, the Defendants maliciously, wantonly and willfully in bad faith intentionally breached their duties of due care and diligence in the management and administration of Lucent's affairs and in the use and preservation of Lucent's assets.

169. During the course of the discharge of their duties, the Management Defendants knew the unreasonable risks associated with the wrongful conduct described in the complaint, and either participated in or approved those activities or failed to supervise such activities in accordance with their duties to both Lucent and its shareholders. As a result, the Management Defendants intentionally grossly mismanaged or aided and abetted the gross mismanagement of Lucent and its assets.

170. As a proximate result of the Management Defendants' intentional breaches of fiduciary duties, Lucent has been damaged and will continue to suffer damages.

Third Claim For Relief

Breach of Fiduciary Duty By Director Defendants

171. Plaintiff incorporates herein by reference all of the foregoing allegations as if fully set forth herein.

172. By reason of their positions and ability to control the business and corporate affairs of Lucent, at all relevant times, each Director Defendant owed Lucent and its shareholders fiduciary duties of loyalty, due care and full disclosure and was required to control Lucent in a fair, just and equitable manner and to act in furtherance of the best interest of Lucent and its shareholders.

173. Each Director Defendant also owed Lucent and its shareholders a fiduciary duty to exercise due care and diligence in the management and administration of the affairs of Lucent and in the use and preservation of its property and assets.

174. Each Director Defendant further owed Lucent and its shareholders a fiduciary duty to insure that Lucent operated in compliance with all applicable federal

and state laws, rules and regulations, that Lucent did not engage in any unsafe or unsound practices, and that Lucent did not waste its corporate assets.

175. To discharge their fiduciary duties, each Director Defendant was required to exercise reasonable and prudent supervision over the management, policies, practices, controls and financial and corporate affairs of Lucent. Among other things, each Director Defendant was required to:

a. manage, conduct, supervise and direct the employees, business and affairs of Lucent in accordance with applicable laws, rules and regulations;

b. not violate or permit any officer, director or employee of Lucent to violate applicable laws, rules or regulations;

c. exercise reasonable control and supervision over Lucent's officers and employees;

d. insure the prudence and soundness of policies and practices undertaken or proposed to be undertaken by Lucent and its officers and employees;

e. remain informed as to how Lucent was, in fact, operating, and, upon receiving notice or information of unsafe, imprudent or unsound practices, make reasonable investigation of such practices and take steps to correct such practices;

f. supervise the preparation, filing and dissemination of any SEC filings, press releases, audits, reports or other information disseminated by Lucent;

g. maintain and implement an adequate system of internal controls at Lucent, including financial, accounting and management information systems;

h. supervise the preparation and filing of any audits, reports or other information disseminated by Lucent to make full and accurate disclosure of all material facts; and

i. preserve and enhance Lucent's reputation as a global public corporation and maintain public trust and confidence in Lucent as a prudently managed institution fully capable of meeting its duties and obligations.

176. As described above, the Director Defendants maliciously, wantonly and willfully in bad faith intentionally breached their fiduciary duties to protect the rights and interests of Lucent and its shareholders.

177. As described above, the Director Defendants maliciously, wantonly and willfully in bad faith intentionally failed in their fiduciary duties to Lucent and its shareholders to prudently supervise, manage and control Lucent's operations and prudently manage the business and assets of Lucent.

178. By subjecting Lucent to the unreasonable risk of substantial losses by intentionally failing responsibly and with due care to oversee and implement proper accounting practices at Lucent, the Director Defendants maliciously, wantonly and willfully in bad faith intentionally breached their duties of due care and diligence in the management and administration of Lucent's affairs and in the use and preservation of Lucent's assets.

179. During the course of the discharge of their duties, the Director Defendants knew the unreasonable risks associated with the wrongful conduct described in the complaint, and either participated in or approved those activities or failed to supervise such activities in accordance with their duties to both Lucent and its shareholders. As a

result, the Director Defendants intentionally grossly mismanaged or aided and abetted the gross mismanagement of Lucent and its assets.

180. As a proximate result of the Director Defendants' intentional breaches of fiduciary duties, Lucent has been damaged and will continue to suffer damages.

Fourth Claim For Relief

Waste of Corporate Assets Against All Defendants

181. Plaintiff incorporates herein by reference all of the foregoing allegations as if fully set forth herein.

182. This claim is asserted derivatively on behalf of Lucent against all the defendants.

183. Each of the defendants owes and owed to Lucent the obligation to protect the Company's assets from undue loss or waste.

184. Defendants tacitly or explicitly wasted Company resources by "stuffing the channel" with product which they knew or should have know would have to be recalled or bought back, in order to improve "sales," and by shipping incomplete products.

185. By shipping knowingly faulty products and replacing them with more expensive Company products at no additional cost defendants tacitly or explicitly wasted corporate assets.

186. By allowing sales to be made to uncreditworthy companies, taking customers off "credit hold," permitting side agreements for unconditional rescission, and otherwise allowing unconditional returns, defendants committed corporate waste.

187. The Company received nothing of value in exchange for the products, services and funds it expended and actually suffered significant revenue loss as a result of defendants' misconduct.

188. In addition, the Director Defendants have committed waste by failing to pursue in a timely and aggressive manner legitimate and valuable claims against the Management Defendants for breach of fiduciary duty and waste.

189. As a direct result of the foregoing, the Company has sustained and will continue to sustain serious damage, for which relief is sought herein.

DEMAND FOR JURY TRIAL

Plaintiff demands a trial by jury on all claims, issues or factual disputes subject to trial by jury.

PRAYER FOR RELIEF

Wherefore, Plaintiff demands judgment as follows:

A. A declaration that the 2000, 2001 and 2002 proxy solicitations violated Section 14(a) of the Exchange Act and Rule 14a-1, promulgated thereunder;

B. A declaration that the elections of directors and the other actions taken at the 2000, 2001 and 2002 shareholder meetings are void;

C. An Order directing the Director Defendants to conduct a proxy solicitation of Lucent shareholders to consider the election of directors, the approval of the shareholder proposal and to transact other business;

D. A judgment finding that defendants have violated their fiduciary duties to the Company and its shareholders and have wasted the Company's assets;

E. An judgment against all defendants and in favor of the Company for the amount of damages sustained by the Company as a result of the breaches of fiduciary duty by each Defendant jointly and severally in an amount to be determined at trial, together with prejudgment interest at the maximum rate allowable by law;

F. An order awarding Plaintiff the costs and disbursements incurred in this action, including reasonable allowances for Plaintiff's attorneys' and experts' fees and expenses; and

G. Granting such other or further relief as the Court may deem just and proper.

Dated: October 15, 2003

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