

NOT FOR PUBLICATION

UNITED STATES DISTRICT COURT  
FOR THE DISTRICT OF NEW JERSEY

SANDRA BALABAN, On Behalf of	:	
Herself and All Others Similarly	:	
Situated,	:	Civil Action No. 02-4852 (JAP)
	:	
Plaintiff,	:	
	:	
v.	:	OPINION
	:	
	:	
HENRY B. SCHACHT, RICHARD A.	:	
MCGINN, DEBORAH C. HOPKINS,	:	
PAUL A. ALLAIRE, BETSY S. ATKINS,	:	
CARLA A. HILLS, FRANKLIN A.	:	
THOMAS, JOHN A. YOUNG, and	:	
LUCENT TECHNOLOGIES, INC.,	:	
Defendants.	:	
	:	

APPEARANCES

KAUFMAN GELBERT & BERN, LLP  
Douglas M. Bern, Esq.  
2 Executive Drive  
Fort Lee, NJ 07024

WECHSLER HARWOOD LLP  
Robert I. Harwood, Esq.  
Samuel K. Rosen, Esq.  
488 Madison Avenue  
New York, NY 10022

Attorneys for Plaintiff

PISANO, District Judge.

This is a securities class action filed on behalf of holders (the “Class”) of the following Lucent Technologies, Inc. (“Lucent”) securities at any time between April 13, 1999 and September 13, 2002 (the “Class Period”):(a) 7.7% Notes Due May 19, 2010; (b) 8% Notes Due

May 18, 2015; (c) 8% Redeemable Convertible Preferred Stock; and (d) 7.75% Redeemable Convertible Preferred Stock (collectively the “Securities”). Before the Court is the Class’s motion to approve a settlement of this matter and the plan of allocation. Defendants do not oppose this motion. The parties have resolved this action as part of a global settlement of what were originally fifty-three separate lawsuits against Lucent and various current and former Lucent directors, officers, and employees. A Stipulation and Agreement of Settlement dated September 22, 2003 (the “Stipulation” or “Settlement”) is the outcome of that global settlement and the painstaking efforts made in negotiating it. The Settlement requires Lucent, among other things, to pay or cause to be paid to the Class a cash payment of \$4.6 million plus interest.

On December 12, 2003, this Court held a fairness hearing on the settlements reached in five Lucent actions pending before this Court: *In re Lucent Technologies, Inc. Securities Litigation*, 00-cv-621 (JAP), *Laufer, et. al. v. Lucent Technologies, et. al.*, 01-cv-5229 (JAP), *Pallas v. Schacht, et. al.*, 02-cv-2460 (JAP), *Cooper v. Schacht, et. al.*, 02-cv-4260 (JAP), and *Reinhart & Smith v. Lucent Technologies, Inc., et. al.*, 01-cv-3491 (JAP). In an Order and Final Judgment entered December 15, 2003, the Court approved the Settlement. Though the Court executed a Final Judgment and Order, the Court informed the parties that it would subsequently enter this Opinion on the motion to approve the settlement and plan of allocation.<sup>1</sup> Accordingly, for the reasons explained below, the Court approves the Settlement for the Class under Rule 23(e) of the Federal Rules of Civil Procedure, consistent with this Court’s Order and Final Judgment entered December 15, 2003.

---

<sup>1</sup> At the hearing, the Court reserved on the issues of attorney’s fees and reimbursement of costs and expenses. The Court does not address either of these issues here, but shall rule on fees and costs in a separate, subsequent opinion.

## **I. Background**

The Lead Plaintiff is Sandra Balaban. The Defendants are Lucent and Henry B. Schacht, Richard A. McGinn, Deborah C. Hopkins, Paul A. Allaire, Betsy S. Atkins, Carla A. Hills, Franklin A. Thomas, and John A. Young (collectively the “Individual Defendants”) (Lucent and the Individual Defendants are collectively referred to as the “Defendants”). Lucent is a Delaware corporation that designs, develops, and manufactures communication systems and software products. The Individual Defendants were officers and/or directors of Lucent during the Class Period.

On October 7, 2002, Plaintiff filed a complaint (the “Complaint”) pleading common law causes of action based on Defendants’s alleged breaches of fiduciary duties in disseminating to the public materially misleading statements concerning the status of Lucent’s revenue and earnings. The Complaint alleges that these public statements were materially misleading and inaccurate because the Individual Defendants knew but concealed the fact that Lucent was suffering problems that materially undermined its reported financial health and ability to compete. The Complaint further alleges that these misrepresentations and omissions elevated the price of the Securities, ultimately resulting in damages to the Class when Lucent’s problems were disclosed and the price of the Securities dropped.

Throughout the third and fourth quarters of fiscal year (“FY”) 1999 (April 1 to September 30, 1999), according to Plaintiffs, Defendants portrayed Lucent as a successful company with healthy revenue and earnings growth. However, the Defendants’s public statements were materially misleading and inaccurate because Defendants knew but failed to disclose Lucent’s serious problems compromising its financial health and ability to compete. The alleged

materially misleading and inaccurate statements were issued on April 13, April 22, July 20, and October 26, 1999. Plaintiff has pleaded that each of these statements was misleading and inaccurate because Defendants knew but failed to disclose that Lucent was mishandling accounting and revenue recognition practices. Beginning no later than the third quarter of FY1999 (April to June 1999), Lucent engaged in a series of improper accounting practices designed to inflate artificially Lucent's financial condition and results including: (I) improperly recording revenue on incomplete and phony sales; (ii) extending massive "vendor financing" loans to customers that Lucent knew were financially shaky and unable to repay the loans or use the products sold to them; and (iii) improperly manipulating accounts receivable.

Additionally, the Complaint alleges that Lucent's undisclosed improper conduct effectively masked Lucent's inability to service its debt, including the Securities held by the Class. Defendants's misconduct caused the Securities to trade at prices higher than they would have had Defendants disclosed the truth regarding Lucent's business and financial condition and caused the Class to suffer damages when Lucent's problems were finally disclosed.

The Complaint also alleges that Lucent engaged in improper revenue recognition by recognizing revenue that Lucent had not earned. In doing so, Defendants materially misled the Class to believe that Lucent was earning revenues sufficient to service its debt, namely, the Securities. In fact, Lucent was struggling to generate sufficient revenue to meet its obligations and routinely recognized revenue that did not exist.

Lucent represented that it recognized revenue on the product sales only after the products were delivered or the service was performed, all significant contractual obligations had been satisfied, and collection of the sales price was reasonably assured. Yet Lucent, through

Defendant McGinn, repeatedly violated its own revenue recognition policies by: (I) prematurely invoicing orders and recognizing revenue before customers had committed to purchasing the product described on the orders and (ii) recognizing as sales a large quantity of “contingent” orders that were not finalized. According to the Complaint, Lucent senior managers confirmed that at the end of each fiscal quarter, “we would ship stuff out to make our [projected revenue] number and then take it back.”

Another means allegedly used by Lucent to prematurely recognize revenue was known as “CNRing” an order. This technique allowed the Company to recognize revenues for products shipped but not installed at the customer’s location and thus not accepted yet by the customer. Lucent generally billed 100% of the order when it shipped the product. Lucent’s recognition of revenue on “CNRing” transactions was improper because Lucent had not yet installed the equipment, and installation was required before the customer could accept the product and Lucent could recognize revenue. Often, sixty days or more elapsed between the shipment date and the installation.

Due to Defendants’s improper revenue recognition practices, Lucent publicly reported hundreds of millions of dollars of phony revenue. Plaintiff alleges that Defendants materially misled the Class to believe that Lucent’s ability to service its debt was strong when, in fact, Lucent was struggling to generate sufficient revenue to meet its obligations. Defendants’s misconduct regarding its revenue recognition practice elevated the price of the Securities, ultimately causing the Class to suffer damages when Lucent’s problems were finally disclosed.

The Complaint further alleges that Lucent engaged in improper vendor financing. Lucent’s receivables, including those booked under Lucent’s “vendor financing” program,

constituted a material portion of the assets allegedly available to service Lucent's debt, including the Securities. Indeed, as of September 30, 2002, receivables constituted 50% of Lucent's reported "current assets".

Lucent's ability to collect its receivables was crucial to its ability to service its debt and therefore was highly material to Securities holders. By the third quarter of FY1999, Lucent was booking hundreds of millions of dollars of receivables on "vendor financed" sales to customers whom Lucent knew were unable to pay for the products. In many instances, Lucent agreed to provide customers with financing to purchase Lucent products, even though Lucent knew that the companies did not have sufficient working capital to continue operating, let alone purchase new products.

Through these vendor financing arrangements, Lucent extended credit terms to customers who had tremendous losses and little, if any, funds to pay Lucent for the equipment or repay the loans. Lucent would lend customers hundreds of millions of dollars to fund operations and buy Lucent products, sometimes even paying for the installation and engineering. Then, Lucent would defer the customers's loan repayments. By the end of 1999, Lucent had provided \$1.85 billion in loans and loan guarantees to its customers to purchase Lucent products on terms that no third-party lender would agree to in an arms-length transaction. By improperly booking billions in vendor financing receivables that they knew could not be collected, Defendants materially misled the Class to believe that Lucent would have sufficient cash flow to service its debt, including the Securities, when Lucent actually had no hope of collecting payment from those customers.

According to the Complaint, Lucent improperly manipulated its accounts receivable.

Having booked billions in receivables that they knew were uncollectible, Defendants further misrepresented Lucent's financial condition by concealing that Lucent was not collecting payments on its receivables, and therefore was not generating sufficient cash flows to service its debt, including the Securities.

For example, Defendants improperly reclassified the age of receivables to make them appear more current. Plaintiff alleges that this practice served a variety of purposes. Namely, it concealed Lucent's improper revenue recognition practices, reduced the need to reserve for receivables that remained uncollected for an extended period of time, and artificially propped up the prices of Lucent debt Securities by inflating Lucent's reported assets with worthless receivables. Thus, the practice of reclassifying the age of receivables helped Lucent maintain the false appearance of a strong ability to service its debt.

Toward the end of each quarter, Lucent employees often reclassified receivables that were outstanding for more than ninety days, re-recording them as current receivables. These reclassifications reduced the risk that Lucent's premature revenue recognition practices would be detected and avoided the need to increase the reserve for uncollectible receivables, which would have necessitated a charge to earnings. In reality, a material portion of Lucent's reported receivables was pure fiction, and Defendants's misconduct artificially elevated the price of the Securities.

When Lucent finally disclosed the truth about its financial status and business practices, the prices of the securities collapsed by as much as 40%. Lucent's improprieties allegedly continued even after this disclosure in an effort to stave off bankruptcy.

Throughout the Class Period, according to Plaintiff, Defendants breached their fiduciary

duties by disseminating to the Class materially misleading and inaccurate information and concealing from the Class material information. As a result of the Defendants's breaches of fiduciary duties, The Class Members purchased at inflated prices the Securities here and ultimately suffered hundreds of millions of dollars in damages.

In September 2002, the Court stayed all further proceedings in this action and in related cases against Lucent and commenced, with each party's consent and voluntary participation, a global mediation involving several securities fraud litigations against Lucent and/or its officers and directors: *In re Lucent Technologies, Inc. Securities Litigation*, 00-cv-621 (JAP), *Laufer, et. al. v. Lucent Technologies, et. al.*, 01-cv-5229 (JAP), *Pallas v. Schacht, et. al.*, 02-cv-2460 (JAP), *Cooper v. Schacht*, 02-cv-4260 (JAP), *Preferred Life Ins. of New York, et. al., v. Lucent Technologies, Inc.*, MRS-L-1306-02 (N.J. Super.); *Reinhart & Smith v. Lucent Technologies, Inc., et. al.*, 01-cv-3491 (JAP); *In re Winstar Communications Sec. Litig.*, 01-cv3014 (S.D.N.Y.) (Daniels, J.) and *In re Lucent Technologies, Inc., Derivative Litig.*, Civ. Action 18608 (Chancery Ct., DE) (Lamb, V.C.) Counsel participated in the mediation and all related settlement conferences that the Court conducted.

Given Lucent's precarious financial condition at all times relevant to the negotiations, the Company's actual ability to pay was a vital consideration for any settlement. Critical to the negotiations as well, Lucent agreed to settle this matter only if it could settle several related actions then pending against Lucent. To evaluate Lucent's financial status, the Court created an "Ability to Pay Committee," which retained experts to study and provide opinions on Lucent's financial capabilities. That Committee worked closely with their experts and learned the limits and constraints on any possible settlement.

On September 22, 2003, the parties entered into a Stipulation (the “Stipulation”) and Agreement of Settlement (collectively referred to as the “Settlement”). The Stipulation, its exhibits, and the Cover Agreement reflects the entire agreement regarding settlement among the parties. *See* Stipulation ¶ 33. The Settlement provides, among other things, that the Defendants will pay or cause to be paid to the Class \$4.6 million cash, and this amount shall be allocated to the Plaintiffs from the global settlement fund. (*See* Sept. 24, 2003 Order (“Preliminary Approval Order”).

## **II. Discussion**

### **A. Class Certification**

By its Preliminary Approval Order, this Court preliminarily certified this litigation to proceed as a class action for settlement purposes. Class actions created for the purpose of settlement are well recognized under Rule 23 of the Federal Rules of Civil Procedure. *See, e.g., In re Prudential Ins. Co. Am. Sales Practices Litig.*, 962 F. Supp. 450 (D.N.J. 1997) (“*Prudential I*”), *aff’d*, 148 F.3d 283 (3d Cir. 1998) (“*Prudential II*”). This Court finds that class certification remains appropriate.

Rule 23(a)(1) requires that the class be so numerous that joinder of all class members is impracticable. A party need not precisely enumerate the class members to proceed as a class action. “Impracticability” does not mean “impossibility”. *See, e.g., Zinberg v. Washington Bancorp, Inc.*, 138 F.R.D. 397, 405 (D.N.J. 1990); *Vargas v. Calabrese*, 634 F. Supp. 910, 918 (D.N.J. 1986). Here, joinder of all Class Members is impracticable because more than \$15,000 potential class members exist. By definition, the Class is broad-encompassing: it includes persons who purchased the following Securities at any time between April 13, 1999 and

September 13, 2002: (a) 7.7% Notes Due May 19, 2010; (b) 8% Notes Due May 18, 2015; (c) 8% Redeemable Convertible Preferred Stock; and (d) 7.75% Redeemable Convertible Preferred Stock. The Class is thus so numerous that joinder is impracticable, and Rule 23(a)(1) is satisfied.

Rule 23(a)(2) requires that questions of law or fact common to the class exist. Rule 23 does not require that all class members be identically situated, just that substantial, common questions of either law or fact exist. *See Prudential II*, 148 F.3d at 310; *Hassine v. Jeffes*, 846 F.2d 169, 177 (3d Cir. 1988). The Class Members share the same issues. The allegations in this case involve Defendants's breaches of fiduciary duties in disseminating to the public materially misleading statements concerning the status of Lucent's revenues and earnings. According to the Plaintiff, these public statements were materially misleading and inaccurate because the Individual Defendants knew but concealed the fact that the Company was experiencing significant problems that materially undermined Lucent's reported financial health and ability to compete. Defendants's material misrepresentations and omissions increased the price of the Securities and caused the Class to suffer damages when Lucent's problems were finally disclosed. This focus is pertinent to all Class Members.

Further, Rule 23(b)(3) requires that common questions predominate over individual questions. Courts look to the "common nucleus of operative facts" to determine predominance of common questions. *Safran v. United Steelworkers of Am., AFL-CIO*, 132 F.R.D. 397, 401 (W.D. Pa. 1989). In so determining, the Court recognizes that predominance is "readily met" in certain cases alleging securities fraud. *Amchem Prods., Inc. v. Windsor*, 521 U.S. 591, 625 (1997). The common questions in this case involve whether Defendants breached fiduciary duties in disseminating materially misleading statements about the status of Lucent's revenue and

earnings. These questions are at the heart of the litigation and thus predominate over any individual questions that may exist. The operative, material facts are also common to the Class Members. They touch on, for example, what the Defendants knew or should have known about the Company's financial health. The material facts also involve Defendants's responsibility for misstatements or omissions relevant to Lucent's Securities, reliance on Defendants's misconduct, and damages suffered as a result of that misconduct. Moreover, the Court need not dwell on a predominance analysis because this is a securities fraud case. *See Amchem Prods., Inc.*, 521 U.S. at 625. The predominance requirement is thus satisfied.

Additionally, Rule 23(a)(3) requires that the class representatives's claims be typical of each class member's claims. The "typicality" requirement is satisfied as long as the Lead Plaintiffs, the other representatives, and the Class "point to the same broad course of alleged fraudulent conduct to support a claim for relief." *Zinberg*, 138 F.R.D. at 401 (quotation marks omitted). Factual differences between the class representatives and other class members do not preclude a finding of typicality. *See Prudential II*, 148 F.3d at 310. The Lead Plaintiff stands in the same position as other Class Members here. The allegations and the claims arising from them are the same for class representatives and the entire Class. Thus, the typicality requirement of Rule 23(a)(3) is satisfied.

Rule 23(a)(4) requires adequacy of representation. This is met if (1) the class representatives's interests are not antagonistic to those of other class members whom they seek to represent and (2) the class representatives's attorneys are qualified, experienced, and generally able to conduct the litigation. *See Wetzel v. Liberty Mut. Ins. Co.*, 508 F.2d 239, 247 (3d Cir. 1975). These requirements are satisfied here. As a threshold matter, in appointing the Lead

Plaintiff in this Action, the Court made a preliminary determination that Rule 23's adequacy and typicality requirements are satisfied. *See* 15 U.S.C. § 78u-4(a)(3)(B)(iii). That determination is accurate. The Lead Plaintiff does not possess interests antagonistic to those of the other Class Members. Furthermore, the attorneys involved here are highly experienced in handling complex, sophisticated securities litigation. Thus, the Rule 23(a)(4) standard is met.

Rule 23(b)(3) also requires that a class action be superior to other available methods for the fair and efficient adjudication of the controversy. The class mechanism is the best way of resolving all class members's claims and sparing the judicial system the expense and burden of dealing with duplicative lawsuits. *Zinberg*, 138 F.R.D. at 402. "[C]lass actions are a particularly appropriate and desirable means to resolve claims based on the securities laws, 'since the effectiveness of the securities laws may depend in large measure on the application of the class action device.'" *Eisenberg v. Gagnon*, 766 F.2d 770, 785 (3d Cir. 1985) (citation omitted). In this case, a class action is the preferable means of resolving fairly and efficiently this matter. Individual lawsuits filed on behalf of each of the claimants would surely pose for the Court hefty challenges in managing the caseload, in properly allocating judicial resources, and in swiftly providing justice to the claimants. Because the case here involves a great number of class members who have relatively small individual claims, the class action mechanism is proper. Thus, the superiority requirement of Rule 23(b)(3) is met.

Accordingly, the Court grants class certification under Rule 23(a) and 23(b)(3). All persons or entities who satisfy the Class definition, except the single person who requested exclusion on or before December 12, 2003, are members of the Class bound by the terms of the Settlement and the Order and Final Judgment and are entitled to share the benefits of the

Settlement, subject to the terms and conditions of the Order and Final Judgment.

### **B. Approval of the Settlement and Plan of Allocation**

This matter requires the Court to scrutinize the Settlement including the proposed method for allocating monies. A court is obliged to protect class members's interests, *see In re Ikon Office Solutions Inc. Sec. Litig.* (“*In re Ikon*”), 194 F.R.D. 166, 174 (E.D. Pa. 2000), despite that “[t]he law favors settlement, particularly in class actions and other complex cases where substantial judicial resources can be conserved by avoiding formal litigation.” *In re AremisSoft Corp. Secs. Litig.* (“*AremisSoft*”), 210 F.R.D. 109, 119 (D.N.J. 2002) (quoting *In re Gen. Motors Corp. Pick Up Truck Fuel Tank Litig.* (“*In re Gen. Motors Corp.*”), 55 F.3d 768, 784 (3d Cir. 1995)). Federal law requires a court to approve a class action settlement. Under Rule 23(e) of the Federal Rules of Civil Procedure, the Court should approve a class settlement if it is “fair, adequate, and reasonable.” *Eichenholtz v. Brennan*, 52 F.3d 478, 482 (3d Cir. 1995) (citations omitted). A court enjoys considerable discretion to determine whether a proposed settlement satisfies this standard. *See id.* at 482 (citing *Walsh v. Great Atl. & Pac. Tea Co., Inc.*, 726 F.2d 956, 965 (3d Cir. 1983)). A district court must consider a number of factors when evaluating a settlement for its fairness and adequacy:

- (1) the complexity, expense and likely duration of the litigation ...;
- (2) the reaction of the class to the settlement ...;
- (3) the stage of the proceedings and the amount of discovery completed;
- (4) the risks of establishing liability ...;
- (5) the risks of establishing damages ...;
- (6) the risks of maintaining the class action through the trial ...;
- (7) the ability of the defendants to withstand a greater judgment;
- (8) the range of reasonableness of the settlement fund in light of the best possible recovery ...; and
- (9) the range of reasonableness of the settlement fund to a possible recovery in light of all the attendant risks of litigation[.]

*Girsh v. Jepson*, 521 F.2d 153, 156 (3d Cir. 1975) (quotation omitted).

### **1. Complexity, Expense and Duration of the Litigation**

This factor is “intended to capture the probable costs, in both time and money, of continued litigation. *In re Gen. Motors Corp.*, 55 F.3d at 811. Securities class actions are inherently complex, *see In re Ikon*, 194 F.R.D. 166, 179, and this case is no exception. If this case had not settled, the parties could have litigated the claims here for several years. Indeed, Plaintiff recognizes that related actions against Lucent have been litigated for approximately three years. Counsel for Plaintiffs the related actions, respectively, have devoted considerable time to preparing numerous amended complaints, addressing lead plaintiff and lead counsel structure, conducting extensive factual investigation, reviewing and analyzing voluminous discovery, and dissecting Lucent’s financials and its books and records. Plaintiff acknowledges that the trial of this action against the Defendants would have been a lengthy, expensive process. Because of the damages sums and issues involved, Plaintiff wisely anticipates that appeals would be virtually assured - no matter what the verdict.

Even assuming that the Class could recover a larger judgment after trial, the inevitable delay through a trial, post-trial motions, and the appellate process would likely deny the Class any recovery for years, which is undoubtedly an unfavorable result for all parties: “Avoiding this unnecessary and unwarranted expenditure of resources and time benefit[s] all parties.” *In re Computron Software, Inc.* (“*Computron*”), 6 F. Supp. 2d 313, 317 (D.N.J. 1998). Accordingly, the Settlement secures a substantial recovery without further litigation, delay, expense, or uncertainty, and this factor weighs in favor of the Settlement.

## 2. Class Reaction to the Settlement

“This factor attempts to gauge whether members of the class support the settlement.” *Prudential II*, 148 F.3d at 318. Courts construe class members’s failure to object to proposed settlement terms as evidence that the settlement is fair and reasonable. *See Fickinger v. C.I. Planning Corp.*, 646 F. Supp. 622, 631 (E.D. Pa. 1986) (“[U]nanimous approval of the proposed settlement by the class members is entitled to nearly dispositive weight.”). However, courts must be cautious about “inferring support from a small number of objectors to a sophisticated settlement.” *In re Gen. Motors Corp.*, 55 F.3d at 812, particularly in securities cases where shareholders may have such minimal stock holdings that it is unwise to invest the time and resources to contest a settlement. *See id.*; *Bell Atl. Corp. v. Bolger*, 2 F.3d 1304, 1313 n.15 (3d Cir. 1993).

In accordance with the Court’s Order, Plaintiff mailed more than 15,000 Notices to members of the Class. Initially, approximately 880 copies of the Court-approved Notice of Pendency of Class action, Settlement, and Hearing Thereon, Proposed Settlements with Defendants (the “Notice”) were disseminated to Class members on October 7, 2003. After that first mailing, approximately 14,840 Notices were distributed in response to correspondence and inquiries from potential Class Members. In addition, a Summary Notice was published in the National Edition of *The Wall Street Journal* on October 7, 2003. There is no challenge to the contents of the Notice or the manner by which Notice was given. To date, no Class Member has objected, and only one has sought exclusion. *See AremisSoft*, 210 F.R.D. at 124; *see also Stoetznner v. U.S. Steel Corp.*, 897 F.2d 115, 118-19 (3d Cir. 1990) (concluding that, when “only” 29 members of a class of 281 objected, the response of the class as a whole “strongly favors

settlement”).

Though the Court has received a number of other letters expressing opinions regarding the Lucent settlement and requesting to opt-out in some cases, these letters are written by individuals who are not Class Members here. Even assuming that these individuals are Class Members, their requests are untimely. Irrespective of this, these letters neither add anything new to the Court’s analysis nor change the Court’s analysis in any way. The Court concludes that the favorable reaction of the Class is strong evidence that the Settlement is indeed fair, reasonable, and adequate, and should be approved. This factor supports the Settlement.

### **3. The Stage of Proceedings and Amount of Discovery Completed**

Parties should have an “adequate appreciation” of the merits in settling a case. *Prudential II*, 148 F.3d at 319 (quoting *In re Gen. Motors Corp.*, 55 F.3d at 813). While the type and extent of discovery taken are relevant to the propriety of a settlement, settlements reached early are still favored. *Computron*, 6 F. Supp. 2d at 318; *see also Weiss v. Mercedes Benz of North Am., Inc.*, 899 F. Supp. 1297, 1301 (D.N.J.) (approving settlement while the “case is still in the early stages of discovery”), *aff’d*, 66 F.3d 314 (3d Cir. 1995).

Here, Plaintiff’s counsel completed substantial work in preparing this case. Counsel conducted extensive investigation and analysis regarding the law and facts relevant to the case. In doing so, Plaintiff gathered and studied relevant publicly-available information. Additionally, Plaintiff’s counsel consulted with a liability and damages expert to assist with the consideration and analysis of the strengths and weaknesses of their claims. Plaintiff also analyzed documents relevant to the global proceedings and settlement.

Thus, the Court finds that Counsel was well informed of the legal and factual issues

involved, the merits of those issues, and the value of the case when the parties ultimately agreed to the Settlement. Moreover, Counsel acted efficiently in handling the discovery and negotiating this Settlement. As a result, this factor favors the Settlement.

#### **4. The Risks of Establishing Liability and Damages**

##### **a. Liability**

A court must also “survey the possible risks of litigation in order to balance the likelihood of success and the potential damage award if the case were taken to trial against the benefits of immediate settlement.” *Prudential II*, 148 F.3d at 319. In doing so, however, a court should not conduct a “mini-trial and must, to a certain extent, give credence to the estimation of the probability of success proffered by class counsel[.]” *In re Ikon*, 194 F.R.D. at 181 (citation omitted).

Plaintiffs faced risks in establishing liability here. Different than in a number of the related actions, this action claims breaches of fiduciary duty on behalf of Securities holders who were induced by material misstatements not to sell the securities. To prove its theory that fiduciaries breached a duty owed to the Securities holders, Plaintiff would have to prove as a threshold matter that Defendants owed a duty. Assuming that Plaintiff could so demonstrate, Plaintiff would also bear the heavy burden of demonstrating that Defendants were responsible for material misstatements or omissions of fact, that the Class justifiably relied upon Defendants’s misconduct, and that the Class suffered damages as a result of this misconduct. Aside from the fact that these proofs are weighty, the Class’s ultimate success was questionable based on the lack of favorable precedent. After this action was filed, in fact, a Delaware court dismissed a complaint on behalf of holders of Rite Aid securities similarly alleging breach of fiduciary duty.

*Manzo v. Rite Aid*, No. 18451-NC, 2002 WL 31926606 at \* 5 (Del. Ch. Dec. 19, 2002), *aff'd*, 825 A.2d 239 (Del. 2003).

Plaintiff, facing potential dismissal of the action, sought settlement on the best terms possible for the Class. This factor thus supports the Settlement.

## **2. Damages**

Even if Plaintiff could establish liability, Plaintiff would also face substantial challenges in proving damages. Defendants would likely argue that influences other than just Lucent's disclosure of the information affected the post-disclosure market price of the stock. Defendants would also likely argue that factors unrelated to the misrepresentations may have had varying impacts on the value of the stock throughout the Class Period. *See Blackie v. Barrack*, 524 F.2d 891, 909 n.25 (9<sup>th</sup> Cir. 1975), *cert. denied*, 429 U.S. 816 (1976) (recognizing in a 10(b) context that the drop after a corrective disclosure will not be conclusive of the amount of original inflation . . . because the prolonged nature of the fraud introduces other market variables which may affect the amount the market reacted to disclosures at different times during the class period.) Moreover, Plaintiff would face the additional hurdle of separating the impact of the misleading statements from that of other potential influences including the economy or inflation.

Inevitably, the damages question would spark sharp disagreement between the parties's respective experts. Counsel recognizes that substantial disagreement among the experts would likely involve the critical issues including the stock value at each point when the stock was purchased. Because the outcome of such expert "battles" is never predictable, the Court recognizes the very real possibility that a jury could be swayed by defense experts, who would seek to minimize the Class Members's losses or to show that the losses were attributable to

factors other than the alleged misstatements and omissions. *See also Robbins v. Kroger Props. Inc.*, 116 F.3d 1441 (11<sup>th</sup> Cir.), *reh'g en banc denied*, (11th Cir. 1997) (finding no loss causation and overturning \$81 million jury verdict); *Prudential I*, 962 F. Supp. at 539 (noting that divergent expert testimony leads inevitably to a battle of the experts). As a result, defense experts conceivably might have persuaded a jury that damages should be reduced or that losses are attributable to factors unrelated to the alleged fraudulent conduct. *See In re Cendant Corp. Litig.*, 264 F.3d 201, 239 (3d Cir. 2001) (recognizing risks associated with jury being confronted with competing damage expert opinions). Because the Settlement thus eliminates the inherent, unavoidable risks of litigation of this nature, this factor supports the Settlement.

#### **5. The Risks of Maintaining the Class Action Through Trial**

This factor is relevant because class certification influences the value of a class action. “[N]ot only does the aggregation of the claims enlarge the value of the suit, but often the combination of the individual cases also pools litigation resources and may facilitate proof on the merits. Thus, the prospects for obtaining certification have a great impact on the range of recovery one can expect to reap from the action.” *In re Gen. Motors Corp.*, 55 F.3d at 817; *see also In re Ikon*, 194 F.R.D. at 180-81. “Because the district court always possesses the authority to decertify or modify a class that proves unmanageable, examination of this factor in the standard class action would appear to be perfunctory.” *Prudential II*, 148 F.3d at 321.

No facts or circumstances suggest a particular risk of decertification. Thus, consideration of this factor neither favors nor discourages the Settlement. *See In re Ikon*, 164 F.R.D. at 183.

#### **6. The Ability of the Defendants to Withstand a Greater Judgment**

Given that Lucent is unable to withstand a greater judgment, this factor supports the

Settlement. *See In re Ikon*, 194 F.R.D. at 183 (noting that the defendant's inability to pay a greater sum favored settlement). There is no question here that Lucent could not withstand a judgment of the magnitude of the damages in this Action. A judgment based purely on damages that did not account for Lucent's ability to pay easily could have reached hundreds of millions of dollars, assuming that a jury found credible the damages experts for Plaintiffs. Lucent's financial condition substantially deteriorated during this litigation, and it simply could not have satisfied a judgment of this magnitude.

When settlement negotiations began, the Plaintiffs faced a slowly degenerating Company. The Company's underlying weakness and deteriorating financial condition of the Company was reflected in the stock price and the financial press. By October 2002, the stock price hit an all-time low of \$0.58 per share. News articles in late 2002 reported that it was increasingly likely that Lucent would be forced into bankruptcy or reorganization, to the detriment of shareholders. *In re PaineWebber Ltd. P'ships Litig.*, 171 F.R.D. 104, 129 (S.D.N.Y.), *aff'd*, 117 F.3d 721 (2d Cir. 1997) (citation omitted) ("The "prospect of a bankrupt judgment debtor down at the end of the road does not satisfy anyone involved in the use of class action procedures.")

To evaluate Lucent's financial status, the Court created an "Ability to Pay Committee," which retained experts to study and provide opinions on Lucent's financial capabilities. Counsel for Plaintiffs served on that Committee. They worked closely with their experts and fully understood the limits and constraints on any possible settlement. Ultimately, the Settlement provides, among other things, that Lucent will pay or cause to be paid to the Class \$4.6 million in cash.

The efforts and ingenuity of the Plaintiffs, through their counsel, resulted in an extremely

valuable Settlement for the benefit of the Class. No doubt, this factor strongly supports approval of the Settlement

#### **7. The Range of Reasonableness of the Settlement Fund in Light of the Best Possible Recovery**

The Court also must consider how the Settlement compares to the best possible recovery for the Class. “[T]he present value of the damages the plaintiffs would likely recover if successful, appropriately discounted for the risks of not prevailing, should be compared with the amount of the proposed settlement.” *Prudential II*, 148 F.3d at 322 (quoting *In re Gen. Motors Corp.*, 55 F.3d at 806); see also *In re Ikon*, 194 F.R.D. at 183-84 (same). The Settlement is reasonable in light of the best possible recovery and the attendant risks of litigation. It provides Class Members with a certain recovery - a significant benefit given that this action might have been the subject of a credible defense motion for dismissal. Particularly when compared to the risks associated with litigation of this matter, the Settlement is reasonable. This factor thus weighs heavily in favor of the Settlement.

Overall, the Court concludes that the *Girsh* factors, on balance, favor the Settlement. The Settlement is fair and reasonable and is thus approved.

#### **C. Allocation Plan**

Next, this Court must evaluate the Plan of Allocation (the “Plan”). “Approval of a plan of allocation of a settlement fund in a class action is governed by the same standards of review applicable to approval of the settlement as a whole: the distribution plan must be fair, reasonable, and adequate.” *Computron*, 6 F. Supp. 2d at 321 (citations omitted). A plan of allocation that reimburses class members based on the type and extent of their injuries is generally reasonable.

*See id.*; *see also In re Ikon*, 194 F.R.D. 166, 183-84. The purpose of developing a plan of allocation is to devise a plan that permits the equitable distribution of limited settlement proceeds to eligible Class Members. *Beecher v. Able*, 575 F.2d 1010, 1016 (2d Cir. 1978). A plan of allocation “must be fair, reasonable and adequate.” *In re AremisSoft*, 210 F.R.D. 109, 126 (D.N.J. 2002) (quoting *In re Computron*, 6 F. Supp. 2d at 321). A fair, reasonable, and adequate plan of allocation should be based on the nature and extent of Class members’s provable damages. *See In re Gulf Oil/Cities Serv. Tender Offer Litig.*, 142 F.R.D. 588, 596 (S.D.N.Y. 1992). Thus, plans that allocate more of the settlement to the class members with the most injuries are reasonable. *Id.*

The Notice mailed to Class members contains the terms of the proposed Plan of Allocation. The Plan reflects Class Counsel’s evaluation of the strengths and weaknesses of the claims of the various subsets of Class Members. Counsel prepared the Plan after careful, extensive consideration, which involved detailed analysis by Plaintiff’s damages expert.

The net Settlement Fund will be allocated proportionately among all authorized claimants on the basis of their recognized claims as compared to the aggregate claims of all authorized claimants. For purposes of determining the amount an authorized claimant may recover under the Plan, Plaintiff’s Counsel consulted with a damages expert and determined that the Plan reflects an allocation that counsel believe could have been recovered if Plaintiff was ultimately successful in proving liability. Counsel determined that the allowed claims should vary, proposing that the recognized loss of each claim shall be calculated as follows:

**7.7% Notes due 5/19/2010**

- A. For purchases between May 19, 2000 and September 13, 2002, and:
1. sold prior to the close of business on July 31, 2003 - the greater of the purchase price minus the sales price or \$0.00; or
  2. held as of the close of business July 31, 2003 - the greater of the purchase price

minus \$918 or \$0.00.

**8% Notes due 5/18/2015**

- \_\_\_\_\_ B. For purchases between May 18, 2000 and September 13, 2002, and:
1. sold prior to the close of business on July 31, 2003 - the greater of the purchase price minus the sales price or \$0.00; or
  2. held as of the close of business on July 31, 2003 - the greater of the purchase price minus \$905 or \$0.00.

**7.75% Cumulative Trust Preferred Securities**

- \_\_\_\_\_ C. For purchases between March 17, 2002 and September 13, 2002, and:
1. sold prior to the close of business on July 31, 2003 - the greater of the purchase price minus the sales price or \$0.00; or
  2. held as of the close of business on July 31, 2003 - the greater of the purchase price minus \$719 or \$0.00.

**8% Redeemable Convertible Preferred**

- \_\_\_\_\_ D. For purchases between August 6, 2001 and September 13, 2002, and:
1. sold prior to the close of business on July 31, 2003 - the greater of the purchase price minus the sales price of \$0.00; or
  2. held as of the close of business on July 31, 2003 - the greater of the purchase price minus \$1,003 or \$0.00.

Under the proposed Plan, claimants are reimbursed for their recognized losses based largely on when they held and, in some cases, disposed of their securities. The Plan reflects the variations in the positions of the different Securities holders within the Class and the different amount of maximum damages recoverable under the PSLRA damages provisions. Courts have routinely approved plans of allocation that provide different payments to class members. *See Cendant*, 264 F.3d at 248-49. “[W]hen real and cognizable differences exist between the ‘likelihood of ultimate success’ for different plaintiffs, ‘it is appropriate to weigh ‘distribution of the settlement . . . in favor of plaintiffs whose claims comprise the set’ that was more likely to succeed.” *PaineWebber*, 171 F.R.D. at 132 (citations omitted).

The proposed Plan accomplishes fairness to the class as a whole, contemplates the strength

of the claims based on available facts and evidence, and reflects the size of the fund to be distributed. This Plan was adequately explained in the Notice sent to Class Members, was prepared in consultation with Plaintiffs's damages expert, and tracks the theory of damages asserted. Significantly too, no one has objected to the Plan of Allocation. Thus, the Plan is fair, reasonable, and adequate to the Class as a whole.

### **III. Conclusion**

For the reasons explained above, the Court approves the Settlement as just and reasonable. A Final Judgment and Order has been previously entered. This Opinion shall be read in conjunction with that Final Judgment and Order.

Date: April 23, 2004

---

S/ JOEL A. PISANO, U.S.D.J.