

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

_____	X	
INDIANA ELECTRICAL WORKERS	:	Civil Action No.
PENSION TRUST FUND IBEW, On Behalf	:	
of Itself and All Others Similarly Situated,	:	<u>CLASS ACTION</u>
	:	
Plaintiff,	:	COMPLAINT FOR VIOLATION OF THE
	:	FEDERAL SECURITIES LAWS
vs.	:	
	:	
NORTEL NETWORKS CORPORATION,	:	
FRANK A. DUNN and DOUGLAS BEATTY,	:	
	:	
Defendants.	:	
_____	X	<u>DEMAND FOR JURY TRIAL</u>

INTRODUCTION AND SUMMARY

1. This is an action on behalf of purchasers of Nortel Networks Corporation (“Nortel” or the “Company”) publicly traded securities during the period from December 23, 2003 to March 12, 2004 (the “Class Period”). Nortel supplies products and services that support the Internet and other public and private data, voice and multimedia communications networks using wireline and wireless technologies.

2. During the Class Period, defendants caused Nortel’s shares to trade at artificially inflated levels through the issuance of false and misleading financial statements. Defendants had formulated a plan to have the Company’s credit rating on its \$4.1 billion debt raised from “B3” to “investment grade.” Defendants were advised by Moody’s credit officer, Donald Carter, that if the Company could improve its financials, the Company’s rating would be raised. Not only would this rating change have a positive impact on the Company’s stock price but this would in turn further inflate the Company’s net income (beyond the already falsified accounting). By raising the

Company rating, the Company could refinance its debt at a preferable rate – and increase the Company’s margins. Defendants had hoped that the Company’s positive (albeit false) Q4 2003 report would put pressure on Moody’s to raise its rating. Regardless, by posting the false (but positive) Q4 results and filing the 10-K, defendants and the Company’s top executives were rewarded with \$30 million in bonuses. Then as defendants’ scheme began to unwind, Nortel put Chief Financial Officer Douglas Beatty and controller Michael Gollogly on leave of absence pending completion of an investigation into the circumstances leading to the restatement.

3. On March 15, 2004, Nortel delayed filing an annual report and admitted it may have to restate results for a ***second time in six months*** while the timing of certain accruals and provisions in 2003 and earlier periods are re-examined. This is in addition to an earlier restatement in November of 2003, when Nortel actually reduced accumulated sales and losses back to 2000, saying it had ***overstated*** restructuring costs and revenue in certain periods.

4. In response to the March 15, 2004 delay in filing, the Company’s shares plummeted. Defendants knew that as a result of their actions, Nortel’s lenders could demand ***early*** repayment of ***\$3.6 billion*** of notes and convertibles bonds. As this leaked out into the market the Company’s shares continued their decline.

JURISDICTION AND VENUE

5. The claims asserted arise under §§10(b) and 20(a) of the Securities Exchange Act of 1934 (“1934 Act”) and Rule 10b-5 promulgated thereunder. Jurisdiction is conferred by §27 of the 1934 Act. Venue is proper pursuant to §27 of the 1934 Act as defendant Nortel and/or the Individual Defendants conduct business in and the wrongful conduct took place in this District.

THE PARTIES

6. Plaintiff Indiana Electrical Workers Pension Trust Fund IBEW purchased Nortel publicly traded securities as detailed in the attached Certification and was damaged thereby.

7. Defendant Nortel supplies products and services that support the Internet and other public and private data, voice and multimedia communications networks using wireline and wireless technologies.

8. Defendant Frank A. Dunn (“Dunn”) was Chairman, President and CEO of Nortel. Dunn assisted in the preparation of the false financial statements and repeated the contents therein to the market.

9. Defendant Douglas Beatty (“Beatty”) was CFO of Nortel. Beatty assisted in the preparation of the false financial statements and repeated the contents therein to the market. He was put on leave March 15, 2004.

10. Defendants Dunn and Beatty are the “Individual Defendants.” They are liable for the false statements pleaded in ¶¶11 and 13, as those statements were “group-published” information.

FALSE AND MISLEADING STATEMENTS DURING THE CLASS PERIOD

11. On December 23, 2003, the Company issued a press release stating that consistent with its previous announcements, it had filed with the SEC an amended annual report on Form 10-K/A for the year ended December 31, 2002, an amended quarterly report on Form 10-Q/A for the period ended March 31, 2003, and an amended quarterly report on Form 10-Q/A for the period ended June 30, 2003. The release stated:

Nortel Networks had previously announced its intention to restate its financial results for 2002, 2001 and 2000 and the first and second quarters of 2003, as a result of a comprehensive asset and liability review and certain related reviews that had been undertaken by the Company. The filings contain certain restated financial results for these periods prepared in accordance with United States generally accepted accounting principles. Certain of the information contained in the filings had previously been reported in Nortel Networks Quarterly Report on Form 10-Q for the period ended September 30, 2003.

Related filings with the Canadian regulatory authorities of applicable restated financial results prepared in accordance with Canadian generally accepted accounting principles are underway and are expected to be completed shortly.

The financial results of Nortel Networks Limited (“NNL”), Nortel Networks Corporation’s principal operating subsidiary, are fully consolidated into Nortel Networks results. NNL’s preferred shares are publicly traded in Canada. NNL has also filed with the SEC an amended Annual Report on Form 10-K/A for the year ended December 31, 2002, an amended Quarterly Report on Form 10-Q/A for the period ended March 31, 2003 and an amended Quarterly Report on Form 10-Q/A for the period ended June 30, 2003. The filings contain certain restated NNL financial results for the applicable periods prepared in accordance with United States generally accepted accounting principles. Certain of the information contained in the filings had previously been reported in NNL’s Quarterly Report on Form 10-Q for the period ended September 30, 2003. NNL’s filings of applicable financial results with the Canadian regulatory authorities are also underway and are expected to be completed shortly.

12. The Company’s announcement that its SEC filings complied with GAAP reinvigorated the Company’s shares, sending the price up to \$6-\$7 per share, well above the December lows.

13. On January 29, 2004, the Company issued a press release entitled “Nortel Networks Reports Results for the Fourth Quarter and Year 2003; Q4 2003 revenues of US \$2.83 billion, up 12 percent compared to fourth quarter of 2002, and up sequentially 25 percent; Q4 2003 net earnings of US \$499 million, US \$0.11 per common share on a diluted basis; strong cash balance of US \$4.0 billion, up sequentially US \$428 million.” The press release stated in part:

Nortel Networks Corporation reported unaudited results for the fourth quarter and the year 2003 prepared in accordance with United States generally accepted accounting principles.

Fourth Quarter 2003 Results

Revenues were US\$2.83 billion for the fourth quarter of 2003 compared to US\$2.53 billion for the fourth quarter of 2002 and US\$2.27 billion for the third quarter of 2003. Nortel Networks reported net earnings in the fourth quarter of 2003 of US\$499 million, or US\$0.11 per common share on a diluted basis, compared to a net loss of US\$168 million, or US\$0.04 per common share, in the fourth quarter of 2002 and net earnings of US\$185 million, or US\$0.04 per common share on a diluted basis, in the third quarter of 2003.

Net earnings in the fourth quarter of 2003 included US\$109 million of net earnings from discontinued operations – net of tax; charges of US\$14 million for deferred stock option compensation associated with acquisitions; and US\$9 million

of special charges related to restructuring activities. The Company's results also reflected a net tax benefit of US\$37 million which included a net benefit of US\$41 million associated with tax audits and settlements.

Commenting on Nortel Networks financial performance, Frank Dunn, president and chief executive officer, Nortel Networks, said, "***With the challenges that we faced in 2003, the Company had a tremendous year, truly marking a turning point for Nortel Networks. I am extremely proud of the dedication, passion and commitment of the entire employee team that delivered the performance not only in the fourth quarter, but throughout the year.***"

14. Defendant Dunn's positive statements sent the Company's shares above \$8 per share or nearly 100% above where they traded weeks earlier.

15. On February 18, 2004, Nortel repeated (through Dunn) that its gross profit margin would be in the mid-40s percentage range in the short term.

16. On March 10, 2004, just weeks after the Company had ***confirmed*** the accuracy of its accounting, the Company admitted its claimed "accuracy" was, in fact, a fallacy. On March 11, 2004, *Reuters* issued a release entitled "Nortel shares sag on restatement, filing delay." The release stated in part:

Nortel Networks Corp. shares dropped 7 percent on Thursday after the leading telecom equipment maker warned it would likely restate results for the second time in six months and needed to delay filing documents with U.S. regulators.

Nortel said the delay and restatement were part of an accounting review launched last year, an issue many investors thought had been largely wrapped up in December.

It also warned a further delay could violate its debt requirements, prompting Standard & Poor's to put the company on notice that its debt rating could be cut.

Several analysts said the lack of detail was unsettling and the news had hurt Nortel's credibility, even though the restatement might not be that significant.

Nortel shares, which peaked at C\$124.50 during the Internet bubble, closed down 67 Canadian cents at C\$8.40 in Toronto after tumbling as low as C\$7.67. In New York the stock fell 50 cents to \$6.37.

It was by far the most active stock on both exchanges, with volume of 114 million in Toronto alone. Nortel topped its year-to-date trading record of 110 million set on Jan. 7.

"This marks the second time in six months that Nortel has needed to restate its financial results. While the restatement could be relatively minor – no one knows – it certainly shakes investor confidence," A.G. Edwards analyst Gregory Teets said in a note to clients.

But Sanford Bernstein analyst Paul Sagawa said he thought investors were overreacting because the changes are likely to be a noncash adjustment.

"I don't think it's going to be a massive effect. I don't think it's going to be cash. And I don't think it changes the position of the company in 2004," he said.

"I think this is a big Canadian mea culpa for something that's not particularly dangerous."

AFFECTS DEBT TERMS

Brampton, Ontario-based Nortel said it was "re-examining the establishment, timing of, support for and release to income of certain accruals and provisions in prior periods" and did not know when the review would be completed.

It said it will likely need to revise its previously announced unaudited results for the year ended Dec. 31, some quarters of 2003, and one or more earlier periods.

* * *

Nortel warned that if the delay in filing to the U.S. Securities and Exchange Commission extended beyond March 30 it would not be in compliance with obligations on some of its debt, which includes \$1.8 billion of notes and \$1.8 billion of convertible debt.

Under the terms of the debt, creditors could accelerate the repayments if the filing is delayed too long, something Nortel said it doesn't think will happen. If it did, Nortel said it would seek alternative financing.

Analysts said it was unlikely Nortel would default on the debt, but Standard & Poor's said it was considering cutting the company's 'B' long-term corporate credit, senior secured debt and other ratings.

Nortel also said Export Development Canada, which supports domestic exporters, would have the right to withdraw credit facilities of \$750 million.

17. On March 15, 2004, before the market opened, the Company issued a press release entitled "Nortel Networks Announces the Appointment of Chief Financial Officer and Controller on Interim Basis." The press release stated in part:

Nortel Networks Corporation announced the appointments of William Kerr and Chief Financial Officer on an interim basis and Mary Anne Pahapill as Controller on an interim basis. The appointments are effective immediately.

Douglas Beatty, the Company's incumbent Chief Financial Officer, and Michael Gollogly, the incumbent Controller, have been placed on paid leave of absence pending completion of the independent review being undertaken by the Nortel Networks Audit Committee.

The independent review is examining the circumstances leading to the restatement of Nortel Networks financial statements, which was announced in October 2003. The Company announced on March 10, 2004 that as a result of the work done to date in connection with the independent review, Nortel Networks believes it is likely that it will need to revise its previously announced unaudited results for the year ended December 31, 2003, and the results reported in certain of its quarterly reports for 2003, and to restate its previously filed financial results for one or more earlier periods.

* * *

The Company also announced that it and Nortel Networks Limited will each be filing today with the U.S. Securities and Exchange Commission a Form 12b-25 Notification of Late Filing relating to the previously announced delay in the filing of their respective annual reports on Form 10-K for the period ended December 31, 2003, which delay will extend beyond March 30, 2004.

NORTEL'S FALSE FINANCIAL REPORTING DURING THE CLASS PERIOD

18. In order to inflate the price of Nortel's stock, defendants caused the Company to falsely report its results for Q4 2003 through manipulating the timing of accruals and provisions.

19. The Q4 2003 results were included in press releases disseminated to the public during the Class Period.

20. Nortel will have to admit that it inappropriately recorded transactions included in its Q4 2003 results, and will have to restate those results to remove millions in improperly reported

income, such that its Q4 2003 financial statements were not a fair presentation of Nortel's results and were presented in violation of Generally Accepted Accounting Principles ("GAAP") and SEC rules.

21. GAAP are those principles recognized by the accounting profession as the conventions, rules and procedures necessary to define accepted accounting practice at a particular time. SEC Regulation S-X (17 C.F.R. §210.4-01(a)(1)) states that financial statements filed with the SEC which are not prepared in compliance with GAAP are presumed to be misleading and inaccurate, despite footnote or other disclosure. Regulation S-X requires that interim financial statements must also comply with GAAP, with the exception that interim financial statements need not include disclosure which would be duplicative of disclosures accompanying annual financial statements. 17 C.F.R. §210.10-01(a).

22. In Nortel's 2002 Form 10-K, it represented that it recognized revenue in accordance with GAAP.

23. Pursuant to GAAP, which describes the accounting for revenues, revenue should not be recognized unless there is persuasive evidence of an agreement, collection is probable and delivery has occurred.

24. During the Class Period, Nortel improperly recognized revenue even though these conditions did not exist.

25. The fact that Nortel will restate its financial statements for Q4 2003 will be an admission that the financial statements originally issued were false and that the overstatement of revenues and income was material. Pursuant to GAAP, as set forth in Accounting Principles Board Opinion ("APB") No. 20, the type of restatement announced by Nortel was to correct for material errors in its previously issued financial statements. *See* APB No. 20, ¶¶7-13. The restatement of past financial statements is a disfavored method of recognizing an accounting change as it dilutes

confidence by investors in the financial statements, it makes it difficult to compare financial statements and it is often difficult, if not impossible, to generate the numbers when restatement occurs. *See* APB No. 20, ¶14. Thus, GAAP provides that financial statements should only be restated in limited circumstances, *i.e.*, when there is a change in the reporting entity, there is a change in accounting principles used or to correct an error in previously issued financial statements. Nortel's restatement will not be due to a change in reporting entity or a change in accounting principle, but rather to errors in previously issued financial statements. Thus, the restatement will be an admission by Nortel that its previously issued financial results and its public statements regarding those results were false.

26. Due to these accounting improprieties, the Company presented its financial results and statements in a manner which violated GAAP, including the following fundamental accounting principles:

(a) The principle that interim financial reporting should be based upon the same accounting principles and practices used to prepare annual financial statements was violated (APB No. 28, ¶10);

(b) The principle that financial reporting should provide information that is useful to present and potential investors and creditors and other users in making rational investment, credit and similar decisions was violated (FASB Statement of Concepts No. 1, ¶34);

(c) The principle that financial reporting should provide information about the economic resources of an enterprise, the claims to those resources, and effects of transactions, events and circumstances that change resources and claims to those resources was violated (FASB Statement of Concepts No. 1, ¶40);

(d) The principle that financial reporting should provide information about how management of an enterprise has discharged its stewardship responsibility to owners (stockholders) for the use of enterprise resources entrusted to it was violated. To the extent that management offers securities of the enterprise to the public, it voluntarily accepts wider responsibilities for accountability to prospective investors and to the public in general (FASB Statement of Concepts No. 1, ¶50);

(e) The principle that financial reporting should provide information about an enterprise's financial performance during a period was violated. Investors and creditors often use information about the past to help in assessing the prospects of an enterprise. Thus, although investment and credit decisions reflect investors' expectations about future enterprise performance, those expectations are commonly based at least partly on evaluations of past enterprise performance (FASB Statement of Concepts No. 1, ¶42);

(f) The principle that financial reporting should be reliable in that it represents what it purports to represent was violated. That information should be reliable as well as relevant is a notion that is central to accounting (FASB Statement of Concepts No. 2, ¶¶58-59);

(g) The principle of completeness, which means that nothing is left out of the information that may be necessary to insure that it validly represents underlying events and conditions was violated (FASB Statement of Concepts No. 2, ¶79); and

(h) The principle that conservatism be used as a prudent reaction to uncertainty to try to ensure that uncertainties and risks inherent in business situations are adequately considered was violated. The best way to avoid injury to investors is to try to ensure that what is reported represents what it purports to represent (FASB Statement of Concepts No. 2, ¶¶95, 97).

27. Further, the undisclosed adverse information concealed by defendants during the Class Period is the type of information which, because of SEC regulations, regulations of the national stock exchanges and customary business practice, is expected by investors and securities analysts to be disclosed and is known by corporate officials and their legal and financial advisors to be the type of information which is expected to be and must be disclosed.

FIRST CLAIM FOR RELIEF

For Violation of §10(b) of the 1934 Act and Rule 10b-5 Against All Defendants

28. Plaintiff incorporates ¶¶1-27 by reference.

29. During the Class Period, defendants disseminated or approved the false statements specified above, which they knew or recklessly disregarded were materially false and misleading in that they contained material misrepresentations and failed to disclose material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading.

30. Defendants violated §10(b) of the 1934 Act and Rule 10b-5 in that they:

(a) Employed devices, schemes, and artifices to defraud;

(b) Made untrue statements of material facts or omitted to state material facts necessary in order to make statements made, in light of the circumstances under which they were made not misleading; or

(c) Engaged in acts, practices, and a course of business that operated as a fraud or deceit upon plaintiff and others similarly situated in connection with their purchases of Nortel publicly traded securities during the Class Period.

31. Plaintiff and the Class have suffered damages in that, in reliance on the integrity of the market, they paid artificially inflated prices for Nortel publicly traded securities. Plaintiff and the

Class would not have purchased Nortel publicly traded securities at the prices they paid, or at all, if they had been aware that the market prices had been artificially and falsely inflated by defendants' misleading statements.

32. As a direct and proximate result of these defendants' wrongful conduct, plaintiff and the other members of the Class suffered damages in connection with their purchases of Nortel publicly traded securities during the Class Period.

SECOND CLAIM FOR RELIEF

For Violation of §20(a) of the 1934 Act Against All Defendants

33. Plaintiff incorporates ¶¶1-32 by reference.

34. The executive officers of Nortel prepared, or were responsible for preparing, the Company's press releases and SEC filings. The Individual Defendants controlled other employees of Nortel. Nortel controlled the Individual Defendants and each of its officers, executives and all of its employees. By reason of such conduct, defendants are liable pursuant to §20(a) of the 1934 Act.

CLASS ACTION ALLEGATIONS

35. Plaintiff brings this action as a class action pursuant to Rule 23 of the Federal Rules of Civil Procedure on behalf of all persons who purchased Nortel publicly traded securities (the "Class") on the open market during the Class Period. Excluded from the Class are defendants, directors and officers of Nortel and their families and affiliates.

36. The members of the Class are so numerous that joinder of all members is impracticable. The disposition of their claims in a class action will provide substantial benefits to the parties and the Court. During the Class Period Nortel had more than 4 billion shares of stock outstanding, owned by thousands of persons.

37. There is a well-defined community of interest in the questions of law and fact involved in this case. Questions of law and fact common to the members of the Class which predominate over questions which may affect individual Class members include:

- (a) Whether the 1934 Act was violated by defendants;
- (b) Whether defendants omitted and/or misrepresented material facts;
- (c) Whether defendants' statements omitted material facts necessary to make the statements made, in light of the circumstances under which they were made, not misleading; and
- (d) Whether defendants knew or recklessly disregarded that their statements were false and misleading.

PRAYER

WHEREFORE, plaintiff prays for judgment as follows: declaring this action to be a proper class action; awarding damages, including interest; and such other relief as the Court may deem proper.

JURY DEMAND

Plaintiff demands a trial by jury.

DATED: March 17, 2004

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