

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

IN RE NORTEL NETWORKS CORP.
SECURITIES LITIGATION

This Documents Relates to: All Actions

) Consolidated Civil Action
) No. 01-CV-1855 (RMB)
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**DECLARATION OF JANE D. NETTESHEIM IN SUPPORT OF APPROVAL OF
PROPOSED PLAN OF ALLOCATION FOR PROCEEDS OF SETTLEMENT OF
NORTEL I ACTION**

I, JANE D. NETTESHEIM, hereby declare under penalty of perjury as follows:

Qualifications and Background

1. I am a financial economist and vice president of Stanford Consulting Group, Inc. ("SCG"), which provides research, consulting, and expert services in financial economics and related areas to clients, including government agencies, corporations, and law firms. I have a B.A. in biology from the University of Colorado and an M.B.A. from the University of Hawaii, and I completed the coursework in the Ph.D. program in finance at the London Business School, University of London (I did not write a dissertation and thus did not complete the Ph.D. degree). My curriculum vitae and the list of the expert testimony I have provided by deposition or at trial are attached as Exhibits 1 and 2. The fees charged for this project are the standard hourly rates of employees of SCG. My current hourly rate is \$475.

2. I have served as a consultant and expert in the areas of market efficiency, materiality, causation and damages in a number of securities class actions. I have examined the relationship between stock price movements and changes in market

and industry indices for a number of stocks in a variety of industries. I also have examined the relationship between information releases and changes in stock prices for a number of companies in a variety of industries. I have analyzed various data sources for information about shareholdings and trading activity for different types of market participants.

3. SCG was retained to by Lead Plaintiff's Counsel to consult and to provide expert services on matters related to market efficiency and the damages incurred by the Plaintiff Class in the above captioned litigation. SCG president Blaine F. Nye, Ph.D., previously submitted one report in connection with this retention.¹ SCG has been consulted on the materiality of information regarding Nortel Networks Corporation ("Nortel"), the causation of damages to the Class as a result of the alleged misstatements and/or omissions, and the calculation of Class-wide damages.

4. SCG was also requested to assist Lead Plaintiff's Counsel in the development of the Plan of Allocation (the "Plan") which, if approved by the Court, will be used to distribute the proceeds of the Settlement of this action to the members of the Class. The proposed Plan is included in the Notice of Certifications in Canada and Proposed Settlements of Class Actions, Motions for Attorneys' Fees and Settlement Fairness Hearings ("Nortel I Settlement Notice"). This affidavit is submitted in support of the Plan.

Summary of Opinions

5. It is my opinion that the Plan is reasonable in that it results in a fair allocation of the Settlement proceeds to all Class members.

¹ The Declaration of Blaine F. Nye, Ph.D., dated July 31, 2003, addressed the efficiency of the market for trading in Nortel stock.

6. My opinion is based upon my professional knowledge and experience, as well as on a review of documents and information relevant to this matter, and analyses described in this report. Documents received from counsel or obtained by SCG staff include, in general categories:

- the Second Consolidated Amended Class Action Complaint dated January 19, 2002
- Nortel filings with the Securities and Exchange Commission (“SEC”)
- price and volume data on Nortel common stock and put and call options on Nortel common stock
- price data on market indices, industry indices, and price and quote data on stock of peer companies
- news articles about Nortel
- securities analysts’ reports about Nortel
- institutional ownership data for Nortel stock
- data on shares outstanding for Nortel stock and stock of Nortel peers
- short position reports for Nortel stock
- insider holdings data for Nortel stock

I. Description of the Settlement Proceeds

7. As stated in the Nortel I Settlement Notice, the Settlement “will provide total proceeds worth approximately \$1,142,775,308, including \$438,667,428 in cash, plus 314,333,875 shares of common stock of Nortel ..., having an aggregate market value as of June 30, 2006 of approximately \$704,107,880.” These proceeds, after deduction of

fees and expenses, will be allocated to the members of the Class who file acceptable Proofs of Claim ("Authorized Claimants") in accordance with the Plan.

II. Market Efficiency of Nortel Stock

8. The Declaration of Blaine F. Nye, Ph.D., dated July 31, 2003 (the "Nye Declaration"), addresses the efficiency of the market for trading in Nortel stock. The Nye Declaration demonstrates that Nortel common stock traded in an open and efficient market during the Nortel I Class Period and that trading on the New York Stock Exchange and on the Toronto Stock Exchange constituted one market during the Nortel I Class Period. The Nye Declaration is attached to this Affidavit as Exhibit 3.

III. Analysis of Per-Share Damages for Nortel Stock

9. The following in this section of this Affidavit is my analysis of per-share damages incurred by Plaintiffs and Class members under Section 10(b) of the Securities Exchange Act of 1934, and Rule 10b-5 of the SEC.

10. On October 24, 2000, after market close, Nortel issued a press release announcing financial results for third-quarter 2000. Nortel confirmed its expected revenue percentage growth rate of low 40's in 2000 and increased its expected percentage growth of EPS to low 40's, up from its previous guidance of EPS growth rates in the high 30's.

11. On February 15, 2001, after market close, Nortel lowered its guidance for the year 2001 and stated that revenues would grow 15% and earnings would grow 10% in contrast to statements made less than one month earlier when Nortel provided guidance that sales and profits would grow 30% despite economic uncertainty. Nortel also announced that it would reduce its workforce. On February 16, 2001, Nortel stock declined 32.8%, the company-specific return was -27.5% net of market and industry

effects, with New York Stock Exchange (“NYSE”) and Toronto Stock Exchange (“TSE”) volume 4.2 times the average daily volume during the Nortel I Class Period.

12. In order to determine the losses that were incurred by purchasers of the common stock of Nortel, I used analyses and statistical techniques commonly used by economists. I examined statistical relationships between Nortel stock returns and market and industry returns using regression analysis.² The market index used in this analysis was the NYSE Index, a market capitalization weighted index of all of the stocks listed on the New York Stock Exchange. The industry index was a market capitalization-weighted index of several companies identified as Nortel competitors in Nortel annual reports and analysts’ reports whose returns (net of the market’s returns) were statistically significantly correlated with Nortel’s stock returns.

13. The results from regression analysis were used to determine the level of price inflation³ in Nortel stock prices during the Nortel I Class Period. The price inflation in Nortel stock prices during the Nortel I Class Period was measured from the stock price decline on February 16, 2001, net of market and industry effects, which was 27.5%. Thus, price inflation was 27.5% of reported prices throughout the Nortel I Class Period.

² Daily closing stock prices and daily closing index prices were used in the regression analyses.

³ Price inflation refers to the price of a share of stock in excess of its true value, i.e., the difference between a reported stock price and its price had the fraud not occurred. Price inflation is used to calculate damages on a per share basis and in the calculation of aggregate damages.

IV. Analysis of Aggregate Damages for Nortel Stock⁴

14. Aggregate damages were calculated using reported trading volume from the NYSE and TSE, shares outstanding, data on institutional holdings, data on insiders' holdings, and monthly short interest, and daily price inflation of 27.5% of the reported closing prices. Daily reported volume from the NYSE and TSE was reduced 25% to eliminate specialist activity and other intra-day trading. Shares available to trade were calculated as shares outstanding less insider holdings (transactions by insiders during the Nortel I Class Period were accounted for in the calculation) and less institutional holdings that did not trade during the Nortel I Class Period according to quarterly reported holdings of institutions. Shares available to trade were allocated between US/Canadian institutional and non-institutional investors according to average traded institutional holdings relative to total average shares available to trade during the Nortel I Class Period. Reduced reported trading volume was allocated to institutional trading using the ratio of all block trading volume to total trading volume during the Nortel I Class Period. Increases in short interest were added to potentially damaged shares in the aggregate damages model and decreases in short interest reduced potentially damaged shares.

15. The PSLRA limits damages per share when the company's stock price during the Nortel I Class Period was less than the average price during the 90-day period following the alleged curative disclosure (the "90-day lookback"). The average daily

⁴ The aggregate damages discussed in this section of this Affidavit do not include damages on shares issued by Nortel in connection with Nortel's acquisition of JDS Uniphase AG, the Zurich, Switzerland-based subsidiary of JDS Uniphase Corporation (the "JDS Zurich Subsidiary"). Aggregate damages associated with shares issued in connection with the JDS acquisition are discussed below.

closing price of Nortel stock over the ninety days after the end of the Nortel I Class Period was \$16.29. In this case, the PSLRA does not constrain damages.

16. Using the above described methodology, the aggregate damages total approximately \$9.1 billion. Approximately 802 million shares were purchased and retained during the Nortel I Class Period.⁵

17. In addition to the damages calculated above for shares purchased on the open market, additional shares were acquired during the Nortel I Class Period in connection with Nortel's acquisition of JDS Uniphase AG, the Zurich, Switzerland-based subsidiary of JDS Uniphase Corporation (the "JDS Acquisition").

18. A definitive agreement for the JDS Acquisition was announced on February 6, 2001. In connection with the acquisition, Nortel issued approximately 65.7 million common shares of Nortel to JDS Uniphase Corporation upon close of the acquisition. These shares were valued at \$38.08 per share, with a total value of approximately \$2.5 billion.⁶ The JDS Acquisition closed on February 13, 2001. As discussed above, my estimate of the price inflation in Nortel stock during the Nortel I Class Period was 27.5% of reported prices throughout the Nortel I Class Period. Total damages incurred on the shares issued in connection with the JDS Acquisition are

⁵ Including the shares issued in connection with the JDS Acquisition, approximately 868 million shares of Nortel stock were purchased during the Class Period and retained through the end of the Class Period.

⁶ In addition, \$500 million in common shares of Nortel was to be issued after December 31, 2003 as deferred consideration. The deferred consideration was only to be paid to the extent that the Nortel did not meet certain purchase commitments with JDS Uniphase Corporation by December 31, 2003. Any shares issued in connection with this deferred consideration are not included in this analysis. (See Nortel's SEC Form 8-K filed February 7, 2001.)

calculated as the number of shares issued multiplied by the price per share multiplied by the percentage price inflation, and amount to approximately \$687 million.

V. Call and Put Options on Nortel Stock

19. For my analysis of damages for options on Nortel stock, the value of the Nortel stock absent the fraud was determined using the same methodology as described under the section of this Affidavit entitled “Analysis of Per-Share Damages for Nortel Stock.”

Analysis of per-option damages: call options

20. If Nortel’s true financial condition and expected prospects had been disclosed during the Nortel I Class Period, the call options on Nortel stock would have had lower prices because the daily value of the common stock absent the fraud was lower than the price at which it traded. The daily values of the various series of Nortel call options have been calculated based on the actual trading price of the underlying common stock as well as the value of the underlying common stock (i.e., Nortel common stock) absent the fraud using the Black-Scholes option pricing model, a widely-used and well-accepted financial model for valuing options.⁷ Price inflation of a call option is equal to the difference between the value of the call option based on the actual trading price of the underlying common stock, and the value of the call option based on the value of the underlying common stock absent the fraud.

⁷ Data inputs to the Black-Scholes model included the daily values of Nortel common stock, the predicted daily values of Nortel common stock absent the fraud, the daily implied volatility of the stock price (calculated daily, based on the average of the reported bid and ask price for each option series), the federal constant maturity rates as the risk-free rate of interest, and the time to maturity. The average of the daily bid and ask prices for each option series was used as the daily trading price.

21. It should be noted that the price of a call option includes a premium component. The premium component is affected by the time to maturity and the volatility of returns on the underlying stock. A call option with a longer time to maturity will have a higher price than a call option with the same exercise price and a shorter maturity. A loss of the premium over time is normal.

Analysis of per-option damages: put options

21. If Nortel's true financial condition and expected prospects had been disclosed during the Nortel I Class Period, the put options would have had higher prices because the daily value of the common stock absent the fraud was lower than the prices at which it traded. The daily values of the various series of Nortel put options have been calculated based on the actual trading price of the underlying common stock as well as the value of the underlying common stock absent the fraud using the Black-Scholes option pricing model. Price deflation of a put option is equal to the difference between the value of the put option based on the true value of Nortel's underlying common stock absent the fraud and the value of the put option based on the actual trading price of Nortel's underlying common stock. Persons who wrote (sold) put options during the Nortel I Class Period and who were liable on the put option at the close of trading on February 15, 2001 were damaged by receiving a lower price than the value of the risk they undertook.

Aggregate Damages for Options on Nortel Stock

22. Aggregate damages incurred by Class members on the purchase of call options on Nortel stock, and the sale of put options on Nortel stock, during the Nortel I

Class Period were calculated using daily data provided by Iverson Financial Systems⁸ for U.S. traded options and by the Montreal Exchange for Canadian traded options during the Nortel I Class Period. Changes in open interest in a particular option were used to determine the number of options purchased or closed out on each day during the period. Aggregate damages incurred by Class members on the purchases of call options on Nortel stock and the sale of put options on Nortel stock during the Nortel I Class Period were approximately \$374 million.

VI. Total Damages

23. Total damages under Section 10(b) for purchasers of the common stock and call options and sellers of put options of Nortel during the Nortel I Class Period are approximately \$10.2 billion.

THE PLAN OF ALLOCATION

24. The proposed Plan of Allocation is set forth beginning at page 15 of the printed Nortel I Settlement Notice. In my opinion, the Plan reflects a fair and reasonable method to allocate the Settlement's proceeds to all Class members in a manner consistent with the measures of damages described above. If the proposed Plan is approved, each accepted claimant's pro rata share of the Net Cash Settlement Fund and Net Settlement Shares shall be based upon the claimant's "Recognized Claim" from their transactions in Nortel securities during the Nortel I Class Period as calculated under the Plan of Allocation's formulae.

⁸ I understand that Iverson Financial Systems was acquired by Capco in 2004.

(i) Common Stock Transactions:

25. As set forth in detail in the Plan with respect to Nortel common stock purchases, a claimant's Recognized Claim is based upon the above described contention that during the Nortel I Class Period the price of Nortel common stock was artificially inflated by 27.5% of reported trading prices. This estimated inflation is the excess amount that Class Members allegedly paid, over fair market value, for Nortel common stock during the Nortel I Class Period. This artificial inflation was completely removed when, after the close of trading on February 15, 2001, Nortel, in contrast to prior reports, indicated lowered expected earnings growth and that it would reduce its workforce. If the Nortel common stock purchased during the Nortel I Class Period was held through the close of trading on February 15, 2001, then the Recognized Claim under the Plan of Allocation is 27.5% of the price paid.⁹ To the extent that a Class Member sold shares of Nortel common stock purchased during the Nortel I Class Period at a loss¹⁰ but prior to the close of trading on February 15, 2001, it would be very difficult, under recent Supreme Court authority, to show that any part of that loss was caused by the defendants' conduct. Nevertheless, I understand that Class members will release their claims with respect to all such purchases, and for purposes of the Settlement a very small allocation is being allowed to Class Members for such losses. The Recognized Claim under the Plan for shares sold at a loss prior to the close of trading on February 15, 2001, is limited to 2.75% of such loss (10% of the amount of lost inflation) because of the greater

⁹ As mentioned above, Nortel's stock price never recovered during the 90-day period following the end of the Class Period, no reduction of damages is required under the United States Private Securities Litigation Reform Act ("PSLRA").

¹⁰ Provided that during the Class Period 27.5% of the price was artificial inflation, Claimants who purchase and sell at a loss during the Class Period would receive an amount of inflation on sale than was less than the amount of inflation paid on purchase.

difficulties a claimant would face in demonstrating that the reduced inflation received on sale was caused by the Defendants alleged misrepresentations.

(ii) Call Option Transactions:

26. As further detailed in the Plan, for call options on Nortel common stock purchased during the Nortel I Class Period and owned as of the close of trading on February 15, 2001, a claimant's Recognized Claim shall be the lesser of: (a) 50%¹¹ of the difference, if a loss, between (x) the amount paid for the call options during the Nortel I Class Period (net of brokerage commissions and transaction charges) and (y) the sum for which said call options were subsequently sold at a loss (after brokerage commissions and transaction charges) (or \$0.00 if the call option expired while still owned by the claimant); or (b) \$4.09 per share covered by such call option contracts (50% of the \$8.18 loss on February 16, 2001 per common share).

27. Shares of Nortel acquired during the Nortel I Class Period through the exercise of a call option shall be treated as a purchase on the date of exercise for the exercise price plus the cost of the call option, and any Recognized Claim arising from such transaction shall be computed as provided for other purchases of common stock.

(iii) Put Option Transactions:

28. For Nortel put options sold (written) during the Nortel I Class Period that were the obligation of the claimant at the close of trading on February 15, 2001, the claimant's Recognized Claim shall be the lesser of: (a) the difference, if a loss, between (x) the amount received for writing the put options during the Nortel I Class Period (net of brokerage commissions and transaction charges) and (y) the sum for which said put

¹¹ This discount reflects the fact that the purchase of a call option includes payment of a premium.

