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Technical Director – File Reference No. 1025-300 Financial Accounting Standards Board 401 Merritt 7 P.O. Box 06856-5116 Norwalk, CT 06856-5116



LETTER OF COMMENT NO. 240

VIA E-MAIL

#### Subject:

## Proposed Statement of Financial Accounting Standards: Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans

Dear Mr. Herz:

On behalf of all shareholders and retirees, I appreciate the opportunity to comment on the exposure draft. The Board's current conclusion that the accounting for retirement and similar obligations, as outlined in SFAS #87 and related statements, is an evolving process and that a project that revisits the decisions made twenty years ago is necessary.

Although Phase I of the project is focused primarily on balance sheet changes, recent events also drive an imperative to adjust other entries permitted in SEC filings under GAAP. As both a Lucent Technologies shareholder and as a Lucent retiree, I will use Lucent's most recent filings and public statements to illustrate why change is necessary and urgent on behalf of all stakeholders.

The problem: current FASB standards permit the aggregation of different pension plans, with different assets, liabilities and legal obligations, none of which are transferable, to be presented in a single accounting statement (as in page 81 of the exposure draft).

The result: Knowledgeable analysts and even corporate officers are permitted to use these aggregated results in shareholder communications, masking the reality that the corporation has unfunded liabilities.

There is some recognition in the exposure draft of this problem relative to asset/liability statements:

Appendix C (underlines are changes)

AMENDMENTS TO STATEMENTS 87 and 88

19B. The statuses of all overfunded plans shall be aggregated and recognized as an asset in the employer's statement of financial position. The statuses of

all underfunded plans shall be aggregated and recognized as a liability in the employer's statement of financial position.

There is an urgent need for this change to be incorporated into the statement of "Obligations and Funded Status" used by all stakeholders.

Let me demonstrate the problem with two public disclosure examples, using the data in Attachment 1 from Lucent's most recent 10-K. Attachment 1 presents the pension assets and obligations from two different pages of the filing. The smaller of the pension funds, labeled "occupational", has a surplus. The largest of the pension funds, labeled "management" has an unfunded liability of over \$1 billion. Moreover, in an earlier footnote, the 10-K point out that this is not a single-year event (page F-8):

The estimated accumulated benefit obligation related to the U.S. management pension plan and several other smaller pension plans exceeded the value of the plan assets as of September 30, 2005, 2004 and 2003.

Next, the two public disclosure examples that illustrate the problem:

1) A well regarded analyst's public disclosure of Lucent's pension status. On April 13, 2006, a Bernstein Research paper was issued entitled "Lucent & Alcatel: Lucent Pension and OPEB Well Funded and Well Managed." Under a paragraph entitled Lucent's pension is overfunded it goes on to state:

While Lucent's pension obligations are no doubt sizeable, at \$31.3B as of the end of FY2005, its plan assets are even larger, resulting in a surplus of nearly \$2.7

The report even goes on to say

\$2.7B in surplus assets – a huge buffer against possible future performance shortfalls.

whereas there is no buffer at all for the management pension plan since it already is in deficit. The Bernstein report also presents, as an Exhibit, only the data from Page F-60 in the 10-K (see Attachment 1) and in no place does it refer to the shortfalls on the very next page of the 10-K or in the footnotes that the management pension liabilities exceed its assets for three consecutive years. The Bernstein Research report is included as an attachment to this e-mail.

- 2) A report by a Lucent officer to an investment community. In a May 23,2006 presentation to an investment community meeting (Attachment 2), the Chief Financial Officer of Lucent presented the statement:
  - Pensions: Combined over-funded status on a GAAP basis as of September 30, 2005.

The presentation slide included footnotes, but none that referred to the management pension shortfall disclosed within the body of the 10-K that was certified by the previous Chief Financial Officer of Lucent.

The result of these examples is direct, straightforward and important. The current accounting principles for pension reporting permitted by FASB allow – and may even encourage – the selective reporting of pension assets and liabilities by experts in the investment community and corporate officials that can easily mislead all stakeholders – shareholders, investors, employees and retirees.

This requires the most urgent attention and change by FASB in Phase I of its deliberations on change. I appreciate your actions in your final deliberations.

BY E-MAIL

Herbert M. Zydney

### Attachment 1

	Lucent 10-K	filed Dec 14,2005	(period: Septemb	per 30, 2005)			
	Page F-60	Page F-61					
/ , >	Total	Management	Occupational	* NonUS			
Benefit Obligation(\$MM)	Pension Benefits						
Beginning Benefit Obligation	31,301						
Service Cost	158						
Interest Cost	1,658						
Actual Losses	931						
Amendments	78						
Benefits Paid	-2,802						
Plan Participant Contribution	4						
Settlements	-11						
Curtailments	1						
Exchange Rate Changes	-23						
Other	16						
End Benefit Obligation	31,311	18,014	11,936	1,361			
Benefit Asset (in \$MM)	Pension Asset						
Beginning Plan Asset	32,073						
Actual Return on Assets	4,689						
Benefit Paid	-2,802						
Plan Participant Contributions	4						
Company Contributions	60						
Exchange Rate Changes	-23						
Settlement	-11						
Other	14						
End Plan Asset	34,004	16,771	16,404	829			
Overfunded (Underfunded) Amount	2,693	(1,243)	4,468	(532			

#### Attachment 2 Presentation to JPMorgan Conference May 23, 2006

### 34th Annual JP Morgan Technology Conference May 23, 2006



# John Kritzmacher Chief Financial Officer



### Pension and Retiree Health Care Benefits

#### Pensions

- Combined over-funded status on a GAAP basis as of September 30, 2005
  - Fair value of plan assets of approximately \$34 billion
  - Benefit obligation of approximately \$31 billion
- Contently do not expect to make contributions through 2007\*
  - Believe it is utilikely that any required contributions would have a material impact on inquidity through 2010

#### Retiree Healthcare

- In FY06, expect to contribute approximately \$250 million of operating cash primarily for management retiree healthcare plans
- Seeking legislative change to increase flexibility to use excess pension assets to fund retiree healthcare
  - As of January 1, 2006; \$2.2 billion of excess pension assets eligible for Section 420 transfers for non-management retiree healthcare plans

Lumini Terbeshaka - Propinsion

<sup>\*</sup> Gradified U.S. persona plane, contributions bread as an east out penales funding index



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## Lucent & Alcatel: Lucent Pension and OPEB Well Funded and Well Managed; No Surprises to Detract From Deal Synergy

			4/11/2006		YTD		Cash EPS			P/E		
Ticker	Rating	CUR	Closing Price	Target Price	Rel. Perf.	2004A	2005E	2006E	2004A	2005E	2006E	Yield
LU	0	USD	2.99	4.00	9.3%	0.18	0.20	0.30	16.6	15.0	10.0	NA
CGE.FP	0	EUR	12.59	18.00	17.2%	0.56	0.67	0.85	22.5	18.8	14.8	NA
ALA	0	USD	15.22	21.60	15.0%	0.71	0.80	1.02	21.4	19.0	14.9	NA
MSDLE15			1403.51			89.91	98.47	106.60	15.6	14.3	13.2	2.9%
SPX			1286.57			76.50	81.00	85.00	16.8	15.9	15.1	1.8%

O - Outperform, M - Market-Perform, U - Underperform

#### **Highlights**

- Lucent's pension & postretirement obligations do not detract from deal valuation. We believe investor concerns over Lucent's pension and OPEB obligations in connection with the pending Alcatel merger and the adoption of IFRS are misplaced. While Alcatel would appear to have more conservative asset return assumptions, these are a reflection of a drastically different, cash-heavy asset mix. We believe Lucent's assumptions are well justified based on the actual historical returns of its plan and compared to the return assumptions of other S&P500 companies. We do not believe that there is any reason for the merged entity to make material adjustments to the assumed return, benefit discount rate or asset allocation of Lucent's pension plan, making it highly unlikely that the overfunded status or the pension credit would be negatively affected by the deal. Lucent's projected postretirement benefits liabilities remain underfunded by ~\$5.1B, requiring a cash contribution of \$255M in FY05. However, there is an excellent chance that Lucent will be allowed to shift some of its \$2.7B pension surplus toward the funding of its OPEB responsibilities. Moreover, 23% of Lucent's OPEB "obligations" are not guaranteed, and could be reduced presumptively if circumstances warrented. In any case, the Alcatel merger will have no impact on this situation. We continue to view the pending merger of Alcatel and Lucent very positively and rate both companies Outperform.
- Lucent's pension is overfunded; no cash contributions in the near future. While Lucent's pension obligations are no doubt sizeable, at \$31.3B as of the end of FY2005, its plan assets are even larger, resulting in a surplus of nearly \$2.7B and a FY2005 non-cash pension credit of \$973M to earnings based on an assumed 8.5% rate of return on assets. The company has not had to make any cash contributions to its pension plan under ERISA requirements since 1996 and does not currently expect to make any contributions through 2007, with any funding requirements beyond 2007 through 2010 unlikely to have a material impact on liquidity. Alcatel, in contrast, has pension obligations of €3.5B with pension assets of €2.3B, resulting in an underfunded status of €1.2B.
- Lucent pension asset allocation aggressive vs. Alcatel. Lucent assumed an 8.5% return on its pension plan assets for 2005 and plans to use the same rate for 2006, versus Alcatel's 4.28% return assumption for 2005. This disparity can be explained by the different asset allocation employed by each company. Lucent's plan assets are invested 62% in equity, 25% in fixed income, 6% in real estate, and 7% in private equity and other investments. In contrast, Alcatel invests only 28% of its plan assets in equities,

with 41% in bonds, 16% in real estate and the remaining 15% in cash and other short-term investments. in part due to the fact that much of its German pension assets are invested in money market securities.

- Different asset allocations reflect geographical differences. Lucent's assumed return on pension assets has historically fallen within an average range versus all other S&P 500 companies. Similarly, Alcatel's pension asset return assumptions are in-line with those of other European communications companies with similar pension asset allocations. Pension funding and asset allocation requirements differ greatly by country, so it is a bit misguided to compare return assumptions across geographies. In general, companies strive to match their pension asset and liability flows in constructing their pension investment portfolios. Given that the bulk of Lucent's pension liabilities cover a U.S.-based work force, and given the company's historical success in managing its pension plan, we think the combined Lucent/Alcatel entity will largely leave the current plans intact.
- Lucent's pension plan returns have justified its assumptions. Looking further at actual returns, we see that Lucent's plan assets have earned an average 15.5% return over the past 3 years and 10.7% return over the past decade, yielding an average 684 bps of excess return over yearly actuarial assumptions over the past 3 years and 180 bps over the past decade. In this light, Lucent's return assumption could even seem conservative. On the other hand, Alcatel's plan assets achieved an average 7% return over the same 3-year time frame, yielding an average 250 bps of excess return over yearly assumptions. Finally, even if Lucent's actual pension fund asset returns were to fall short of the company's return assumptions, the plan's level of overfunding is large enough to absorb such swings. Indeed, Lucent's pension plans are among the 10 most overfunded S&P 500 pension programs. The combination of average pension assumptions, strong historical plan performance and the significant surplus, make the likelihood of any future problem very small. Indeed, we believe it reasonable to expect the US government would step in to support insolvent pension plans long before Lucent's admirably funded program were to become a liability.
- Lucent's unfunded postretirement liabilities unaffected by merger, potential for improvement. Lucent's postretirement benefit obligations are currently underfunded by ~\$5.1B, which resulted in a cash requirement of \$255M in FY2005 with a similar contribution expected for FY2006, growing to \$431M by 2007, due to the depletion of plan assets. While the payments are significant, once again, the assumptions used to arrive at these estimates appear reasonable versus other S&P 500 companies. We note that the current 19% funded status of Lucent's postretirement liabilities actually compares favorably to other U.S. companies, considering that only 133 out of the 320 S&P companies with postretirement obligations have funding of any sort for these liabilities. Moreover, postretirement obligations to Lucent's non-represented retiree base are at Lucent's discretion. While Lucent has no specific plans to cut these benefits, which comprise 23% of its total obligation and 40% of its expected 2007 cash contribution, doing so could significantly mitigate a worst-case scenario. Finally, Lucent has petitioned the US government to allow it to transfer nearly \$2B from its pension plan to its postretirement funding. If approved as expected, this would forestall any further increase in cash contributions for many years.
- Deal synergies far outweigh any pension and postretirement risks. We continue to view the pending Alcatel/Lucent merger as a strong positive for both companies, as it creates a company that will be a strong leader in every important communication technology area with strong incumbent positions at nearly every major telecom carrier worldwide. We think any perceived risks regarding the future of Lucent's pension and postretirement plans as part of the merged entity, however implausible they may be, are dwarfed by the greater than £10B net present value of synergies we think this deal will create.

#### **Investment Conclusion**

We think recent investor concern regarding the future of Lucent's pension and postretirement plans as part of the merged Lucent/Alcatel entity IFRS are largely unwarranted. We expect the status quo to remain going forward for both companies' plans, with no threat to Lucent's pension credit or the funded status of its pension plan. Lucent's 8.5% pension asset return assumptions are much higher than Alcatel's 4.28% assumption, though the disparity appears to be well-justified when looking at Lucent's much more equity-heavy pension portfolio as well as the historical returns that portfolio has achieved versus Alcatel. The return assumption is in-line with the median for S&P500 companies, and the 5.5% discount rate on future obligations is in the most conservative quintile. Lucent has managed its pension plan well, with historical returns in the top quintile of all S&P500 plans resulting in \$2.7B in surplus assets – a huge buffer against possible future performance shortfalls. We believe the combination of reasonable assumptions, excellent historical performance and significant surplus funding renders the risk of plan insolvency immaterial.

Lucent's postretirement benefits liabilities are indeed large, with a current underfunded status of ~\$5.1B. However, we do not see any change in its funded status or expected cash outlays resulting from the pending merger with Alcatel. Also, Lucent has petitioned the US government to allow it to transfer nearly \$2B from its pension surplus into the postretirement benefits plan, likely mitigating possible increases in future cash contributions. Finally, Lucent does have the option of making changes to its postretirement plans for non-represented employees in a negative scenario.

We continue to view the pending merger of Lucent and Alcatel as a win-win for both companies, with potential synergies far outweighing any perceived pension risks. Overall, we think the merger could yield more than 500 bps of operating margin improvement by 2009, adding over €10B to the current combined value of both companies, with immediate accretion to Alcatel's earnings. As such, we rate Alcatel Outperform with a DCF-based fair value target price of €18, and we rate Lucent Outperform with a target price of \$4.00.

#### Details

#### Lucent's pension assumptions are reasonable and conservative

While Lucent's pension obligations are no doubt sizeable, at \$31.3B as of the end of FY2005, its plan assets are even larger, resulting in a surplus of nearly \$2.7B and a FY2005 non-cash pension credit of \$973M to earnings based on an assumed 8.5% rate of return on assets. The company has not had to make any cash contributions to its pension plan under ERISA requirements since 1996 and does not currently expect to make any contributions through 2007, with any funding requirements beyond 2007 through 2010 unlikely to have a material impact on liquidity. Alcatel, in contrast, has pension obligations of €3.5B with pension assets of €2.3B, resulting in an underfunded status of €1.2B (Exhibit 1).

Exhibit 1
Lucent and Alcatel's Pension Assets and Obligations

	Lucent		Alcatel	
Benefit Obligation (in \$MM)	Pension Benefits	Postretirement Benefits	Benefit Obligation (in €MM)	Pension Benefits
Beginning Benefit Obligation	31,301	6,487	Beginning Benefit Obligation	3,282
Service Cost	158	7	Service Cost	60
Interest Cost	1,658	344	Interest Cost	139
Actual Losses	931	48	Plan Participant Contribution	5
Amendments	78	248	Amendments	0
Benefits Paid	(2,802)	(940)	Business Combinations	31
Plan Participant Contribution	4	112	Disposals	(2)
Settlements	(11)	0	Curtailments	(7)
Curtailments	1	0	Settlements	(26)
Exchange Rate Changes	(23)	0	Benefit Paid	(177)
Other	16	0	Other	191
End Benefit Obligation	31,311	6,306	End Benefit Obligation	3,496
Benefit Asset (in \$MM)	Pension Asset	Postretirement Asset	Benefit Asset (in €MM)	Pension Asset
Beginning Plan Asset	32,073	1,630	Beginning Plan Asset	2,106
Actual Return on Assets	4,689	102	Actual Return on Assets	93
Benefit Paid	(2,802)	(940)	Employer Contribution	111
Plan Participant Contributions	4	112	Plan Participant Contributions	80
Company Contributions	60	284	Amendments	5
Exchange Rate Changes	(23)	0	Business Conbinations	0
Settlement	(11)	0	Benefit Paid	(117)
Other	14	12	Other	8
End Plan Asset	34,004	1,200	End Plan Asset	2,286
Overfunded (Underfunded) Amount	2,693	(5)106)	Overfunded (Underfunded) Amount	(1,210)

Source: Company Reports

Just to refresh investors' memories about pension accounting, FAS 87 tries to smooth the impact of pension asset returns on earnings by using expected rates of return instead of actual returns, and using a discount rate to arrive at a present value of future obligations and to capture the increase in pension benefit obligations due to the passage of time. A high return assumption decreases pension expense, while a high discount rate assumption decreases the present value of pension obligations (improving the funded status of the plan) and usually also reduces pension expense. Therefore, the more aggressive these assumptions are, the lower the earnings quality of the firm.

Looking at Lucent's pension assumptions, we think they are reasonable and even conservative. Lucent's actual 10-year annual rate of return on pension plan has averaged 10.7%. From 2000 to 2005, company guided expected return down from 9.00% in 2000 to 8.50%, and discount rate down from 7.50% in 2000 to 5.50% in 2005 (Exhibit 2). This appears reasonable and falls into the broad range of assumptions used by S&P 500 companies (Exhibits 3, 4 & 5). Looking at the funded status of all S&P 500 companies as of the end of 2004 (when the overfunded status of Lucent's pension plan was only \$772M versus its current overfunded status of \$2.7B), Lucent still compared very well to its peer, placing among the top 10 best funded pension plans (Exhibit 6).

(Note: we use data of S&P 500 companies' 2004 reports for illustrative purposes).

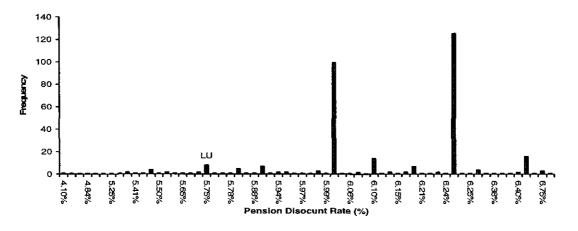
Flobal Networking & Communications Equipment

Exhibit 2 Lucent's Pension Assumptions against Actual Returns

LU Pension	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Expected Return	9.00%	9.00%	9.00%	9.00%	9.00%	9.00%	9.00%	8.75%	8.75%	8.50%
Discount Rate	8.00%	7.25%	6.00%	7.25%	7.50%	7.50%	7.00%	6.50%	5.75%	5.50%
Actual Return	9.9%	23.5%	5.3%	19.7%	23.8%	~15.0%	-6.9%	17.0%	14.9%	14.6%

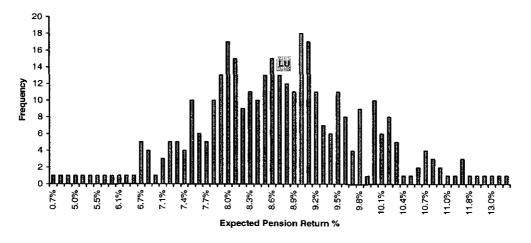
Source: Company Reports

Exhibit 3
Pension Discount Rate: LU vs. S&P 500, 2004



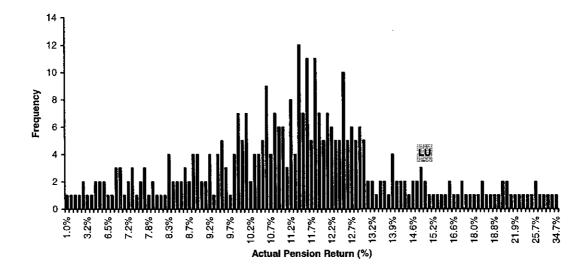
Source: Company Reports, Accounting Observer

Exhibit 4 Pension Expected Return: LU vs. S&P 500, 2004



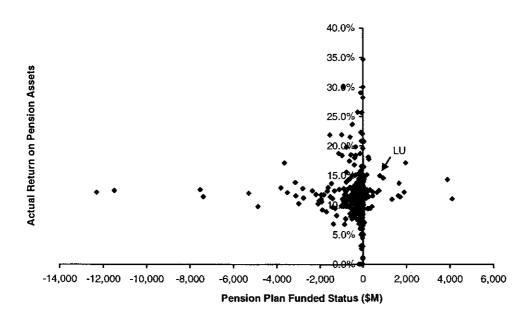
Source: Company Reports, Accounting Observer

Exhibit 5
Pension Actual Return: LU vs. S&P 500, 2004



Source: Company Reports, Accounting Observer

Exhibit 6
S&P 500 Companies: 2004 Pension Funded Status vs. Actual 2004 Return on Pension Assets



Source: Accounting Observer, Bernstein Analysis

#### The disparity of assumptions between Lucent and Alcatel mainly due to asset allocation

When we look at the expected rates of return for Lucent and Alcatel, we see there are big difference in the companies' assumptions: Lucent assumed an 8.5% return on its pension plan assets for 2005 and plans to use the same rate for 2006, versus Alcatel's 4.28% return assumption for 2005 (Exhibit 7). Many investors have expressed concern that Lucent's overfunded pension will become underfunded by applying Alcatel's expected return on the combined company, therefore reducing the potential cost synergies to be realized. We do not think this will be the case because much of this disparity can be explained by the different asset allocation employed by each company, and the combined company will likely to keep two pension plans intact (addressed in the next section).

First of all, let us look at each company's pension asset allocation: Lucent's plan assets are invested 62% in equity, 25% in fixed income, 6% in real estate, and 7% in private equity and other investments. In contrast, Alcatel invests only 28% of its plan assets in equities, with 41% in bonds, 16% in real estate and the remaining 15% in cash and other short-term investments, in part due to the fact that much of its German pension assets are invested in money market securities (**Exhibit 8**). Looking further at actual returns, we see that Lucent's plan assets have earned an average 15.5% return over the past 3 years, yielding an average 684 bps of excess return over yearly actuarial assumptions. On the other hand, Alcatel's plan assets achieved an average 7% return over the same 3-year time frame, yielding an average 250 bps of excess return over yearly assumptions.

Exhibit 7
Expected and Actual Returns: Lucent vs. Alcatel

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
LU Pension					•					
Expected Return	9.00%	9.00%	9.00%	9.00%	9.00%	9.00%	9.00%	8.75%	8.75%	8.50%
Discount Rate	8.00%	7.25%	6.00%	7.25%	7.50%	7.50%	7.00%	6.50%	5.75%	5.50%
Actual Return	9.9%	23.5%	5.3%	19.7%	23.8%	-15.0%	-6.9%	17.0%	14.9%	14.6%
Net Pension Credit	265	329	558	614	822	1,137	972	669	868	718
LU OPEB										
Discount Rate	8.00%	7.25%	6.00%	7.25%	7.50%	7.00%	6.50%	5.75%	5.50%	5.50%
Health Care Cost Trend for Next Year	6.10%	5.60%	5.40%	9.20%	7.60%	8.60%	9.80%	10.40%	11.10%	10.80%
ALA Pension										
Expected Return	N/A	6.8%	7.1%	6.80%	6.10%	5.13%	4.47%	4.50%	4.70%	4.28%
Discount Rate	N/A	5.6%	5.8%	5.10%	5.50%	5.90%	5.75%	4.81%	4.46%	3.95%
Actual Réturn	N/A	21.1%	9.0%	14:1%	10.6%	-1.6%	-1.6%	4.3%	7.0%	9.8%
ALA Post-Retirement*										
Discount Rate	N/A	7.8%	7.00%	7.50%	7.00%	7.50%	6.50%	5.25%	5.27%	4.979
Post-Retirement Cost Trend Rate	N/A	9.3%	8.8%	8.0%	7.50%	5.00%	5.00%	5.00%	5.00%	5.00%

\* No data for Alcatel in 1996 due to pre-SFAS 132

Source: Company Reports

Exhibit 8
Pension Asset Allocation: Lucent vs. Alcatel

LU Asset Breakdown (2005)	Pension	Postretirement	Α
Equity Securities	62%	28%	E
Fixed Income Securities	25%	69%	F
Real Estate	6%	0%	R
Private Equity and Other	7%	3%	C
Total	100%	100%	

ALA Asset Breakdown (2005)	Pension
Equity Securities	28%
Fixed Income Securities	41%
Real Estate	16%
Cash & Short-Term Investments	15%
	100%

Source: Company Reports

Lucent's assumed return on pension assets has historically fallen within an average range versus all other S&P 500 companies, as we illustrated above. As John Kritzmacher, Lucent Technologies' CFO, pointed out, "the assumed rate of return is driven entirely by the expected returns on the allocated mix of assets in the pension trust. And the 8.50% return is applicable to the mix of assets that we have in these trusts today". Similarly, Alcatel's pension asset return assumptions are in-line with those of other European communications companies with similar pension asset allocations. We looked at Alcatel's pension asset return assumptions and allocation relative to other European communication companies as well as other large cap French companies. Alcatel's return assumption is on the low side versus the group, though they appear reasonable given its conservative 28% equity allocation (Exhibit 9). Pension funding and asset allocation requirements differ greatly by country, so it is a bit misguided to compare return assumptions across geographies. In general, companies strive to match their pension asset and liability flows in constructing their pension investment portfolios.

Exhibit 9
Pension Rate Assumptions: Alcatel vs. Other European Companies

European Pension Plan	is				Α	sset Allocati	on
		Fair Value		Expected			
	Benefit	of Plan	Discount	Rate of		Fixed	Cash &
(Euro M. unless noted)	Obligation	Assets	Rate	Return	Equity	Income	Other
Alcatel (2005)	3,496	2,286	4.0%	4.3%	28%	41%	31%
Alcatel (2004)	3,210	3,282	4.5%	4.7%	27%	40%	33%
Nokia (2005)	890	904	4.2%	4.4%	25%	72%	3%
Ericsson (SEK M, 2005)	22,314	16,784	4.3%	5.1%	n/a	n/a	n/a
Siemens (2005)	24,977	21,479	4.5%	6.7%	31%	56%	13%
L'Oreal (2005)	2,543	1,302	4.5%	5.4%	n/a	. n/a	n/a
Sanofi-Aventis (2005)	9,425	5,350	6.7%	4.6%	58%	41%	1%
France Telecom (2004)	4,552	166	4.5%	5.0%	66%	24%	10%
Total SA (2004)	8,117	5,362	7.0%	5.1%	44%	50%	6%
Suez (2004)	3,499	2,101	6.1%	5.4%	29%	48%	23%
Vivendi (2004)	1,276	685	6.4%	5.1%	46%	47%	7%

Source: Company Reports

In summary, European companies appear to allocate a greater portion of pension assets towards fixed income rather than equity, likely reflecting individual country requirements. Given that the bulk of Lucent's pension liabilities cover a U.S.-based work force, and given the company's historical success in managing its pension plan, we think the combined Lucent/Alcatel entity will largely leave the current plans in tact.

#### Lucent's unfunded postretirement liabilities are significant, though no changes as a result of the merger

Lucent's postretirement benefit obligations are currently underfunded by ~\$5.1B, which resulted in a cash requirement of \$255M in FY2005. Going forward, the company expects to have a similar cash requirement in FY2006, growing to \$431M in FY2007 due to the depletion of plan assets, peaking at \$526M in FY2008, and then slowly declining from that level through 2015 (Exhibit 10). While this magnitude of cash outlay is undoubtedly significant, these estimates have been explicitly disclosed by the company for quite some time and should not be affected by the merger with Alcatel.

Exhibit 10 Lucent's expected postretirement cash contributions

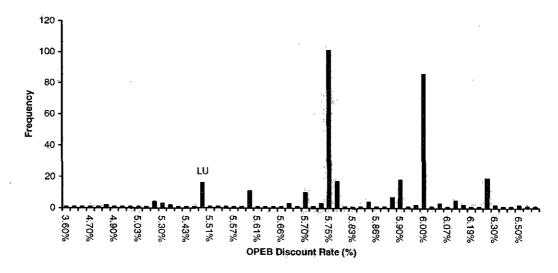
(\$M)	Formerly Represented Retirce Health Plans	Non-Represented Retirce Health Plans	Other Benefit Plans	TOTAL POSTRETIREMENT CASH CONTRIBUTION	Non-Represented  Cash Contribution as a  Goof Total
2006	\$25	\$218	\$11	\$254	86%
2007	247	173	11	\$431	40%
2008	359	157	10	<b>\$526</b>	30%
2009	343	149	10	\$502	30%
2010	324	140	10	\$474	30%
2011-2015	1,438	568	182	\$2,188	26%

Source: Lucent 10K

As seen in **Exhibit 11**, the discount rate Lucent used to arrive at its postretirement liability number in 2004 was actually more conservative than the bulk of other S&P 500 companies, so we do not see any risk of its liability increasing upon the adoption of IFRS. We do note that the current 19% funded status of Lucent's postretirement liabilities actually compares somewhat favorably to other S&P 500 companies, considering that only 133 of the 320 S&P 500 companies with postretirement obligations have funding of any sort for these liabilities. While the funded status of Lucent's postretirement plan has declined over time, it has consistently exceeded aggregate S&P 500 postretirement funding levels over the past 7 years (Exhibit 12).

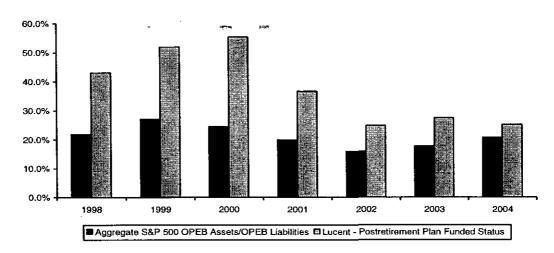
A more in-depth look at the components of Lucent's postretirement obligation reveals that in a worst-case scenario, Lucent could actually take actions to significantly reduce its unfunded postretirement liabilities and cash outlay requirements. Lucent's pension liabilities to non-represented employees, which represent 23% of its total postretirement obligations (Exhibit 13) and ~40% of its 2007 estimated postretirement cash contribution (Exhibit 10), are essentially at Lucent's discretion. While Lucent has certainly not made any plans to change its benefits program for non-represented employees, it nonetheless remains an option in a dire situation. Finally, Lucent has petitioned the US government to allow it to transfer nearly \$2B from its pension plan to its postretirement funding. If approved as expected, this would forestall any further increase in cash contributions for many years.

Exhibit 11 OPEB Discount Rate: LU vs. S&P 500, 2004



Source: Company reports, Accounting Observer

Exhibit 12
Lucent – Post Retirement Plan Funded Status vs. aggregate S&P 500 OPEB Assets/OPEB Liabilities



Source: Accounting Observer, Company reports, Bernstein analysis

Exhibit 13 Lucent -- 2005 Postretirement Plan breakdown

(\$ M)	2005	Cof	2005	Col	Funded	G of
	Benefit Obligation	Total	Plan Assets	Total	Status	Total
Non-Represented Health	1,472	23%	0	:0%	-1,472	29%
Formerly Represented Health	3,298	52%	544	45%	-2,754	54%
Group Life & Other	1,536	24%	656	55%	-880	17%
Total	\$6,306		\$1,200		-\$5,106	

Source: Lucent 10K

#### Deal synergies far outweigh any pension and postretirement risks

Overall, we expect few changes to Lucent's pension and postretirement situation to result from its pending merger with Alcatel and the adoption of IFRS. Logically, if IFRS assumptions for the combined company were to change Lucent's pension credit to a pension expense, therefore putting pressure on earnings, Alcatel probably would not have considered the merger agreement. As Alcatel CFO Jean-Pascal Beaufret said on their joint conference call with Lucent discussing the merger, "I believe . . . that reporting the combined companies under IFRS standards would probably change the way we account for pension obligations and OPEB obligations, but not in a detrimental way for the overall strong balance sheet of the combined company."

We think any perceived risks about the future of Lucent's pension and postretirement plans are far outweighed by the >£10B net present value of synergies we think this deal will create. We continue to think this merger will be a win-win for both sides, creating a company that will be a leader in virtually every key area of future communication equipment growth, while achieving over 500 bps. of operating margin improvement by 2009.

Exhibit 14
Pro Forma Income Statement for Merged Lucent/Alcatel entity (in USD)

Pro Forma Basis (S Millions)	2003	2004	2005	2006E	2007E	2008E	2009E
Sales	22,397	23,738	25,203	27,147	29,161	31,281	33,110
COGS 45% 6%	14,955	14,423	15,514	16,979	18,011	19,273 -	20,355.
COGS with Synergies	14,955	14,423	15,514	16,979	17,788	18,675	19,370
Gross Margin w/o Synergies	7,442	9,315	9,689	10,168	11,150	12,007	12,756
Gross Margin with Synergies	7,442	9,315	9,689	10,168	11,373	12,606	13,741
Combined R&D	3,300	3,056	2,909	3,120	3,164	3,381	3,577
R&D with Synergies	3,300	3,056	2,909	3,120	3,062	3,222	3,311
SG&A	4,033	3,859	4,077	4,075	4,183	4,463	4,727
SG&A with Synergies	4,033	3,859	4,077	4,075	3,995	4,066	4,304
PF Operating Income	110	2,400	2,704	2,974	3,803	4,163	4,452
Operating Income w/ Synergies	110	2,400	2,704	2,974	4,316	5,318	6,125
PF Other Income	(130)	189	264	397	378	402	424
Interest Expense	409	396	341	338	321	321	321
PF EBIT	(2,321)	1,457	2,418	2,800	4,298	5,360	6,228
Tax	(372)	(103)	(30)	(546)	(645)	(939)	(1245)
PF Net Income	(2,693)	1,354	2,387	2,253	3,653	4,421	4,983
Operating Income as a % of Sales	0.5%	10.1%	10.7%	11.0%	14.8%	17.0%	18.5%
Tax Rate	-16%	7%	1%	20%	15%	18%	20%
Incremental Operating Income Synergies	-	-	-	-	512	1,155	1,673

Source: Company reports, Bernstein estimates

#### Valuation Methodology

We use DCF-based models to assess the fair value of each company in our coverage. As we believe that demand for telecommunications infrastructure equipment is cyclical, we occasionally use price to normalized earnings, price to peak earnings and EV to sales relative to history and relative to peers to evaluate likely trading ranges.

#### Risks

The biggest risk to our views on Alcatel and Lucent is that the pending merger of the two companies fails to go through. On a more general level, our forecasts for carrier spending and wireless infrastructure growth are based on the belief that competition is sufficient to motivate carriers to make the investments we outline. Capital spending may not grow at the projected pace if the intensity of competition is lower than expected or if the competition takes longer to emerge.

Secondly, we count on new services and applications to translate into new carrier revenue opportunities, which ultimately drive capex beyond maintenance levels. Nobody can predict with certainty what services and applications businesses and consumers will be willing to pay for; however, history suggests that customers will pay for desirable, nonessential services.

Thirdly, carrier spending tends to be lumpy, which implies that a spending upcycle may contain a few quarters of stagnant to negative growth. While we believe that the spending cycle will continue to be robust through at least 2007, occasional quarters with weak capital spending could mistakenly be interpreted as the end of the upcycle and cause downward pressure on stock prices.

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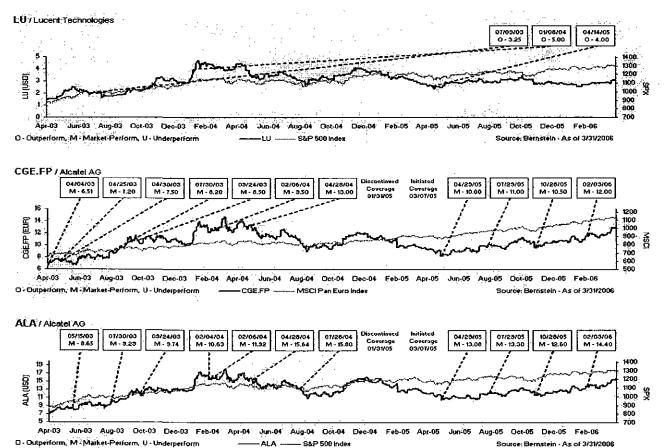
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