

APPENDIX “GGG”

06 February 2006

**Valuation of the Obligations
of the Health & Welfare Trust
as at September 30, 2005**
Nortel Networks Corporation

MERCER

Human Resource Consulting



Marsh & McLennan Companies

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Executive Summary

In accordance with Nortel Networks Corporation's ("Nortel") request, we have performed a valuation of the benefits provided through their Health and Welfare Trust ("Trust"). These benefits include life, disability, medical and dental benefits provided to active, disabled and retired employees. A fuller description of the valuation including the benefits included, the assumptions used and the results is provided in the body of this report.

We have estimated the unfunded liability of the Trust as of September 30, 2005 relating to Nortel's obligations to fall between approximately \$480 million and \$635 million, largely depending on the extent of the liability with respect to Retiree Medical, Dental and Life Insurance benefits ("Post-Retirement Benefits") as described in the following table.

	Assets	Liabilities	Unfunded Liability
Accounting basis	127,500	717,300	589,800
Full present value	127,500	762,744	635,244
Full present value less not fully eligible	127,500	642,346	514,846
Full present value less actives	127,500	608,755	481,255

The "full present value" represents the full liability with respect to current plan members and current plan provisions. Under the assumptions described in this report, this liability represents the amount that would be required to satisfy Nortel's obligations to current plan members.

The "accounting basis" liability is determined on a basis consistent with the liabilities valued for accounting purposes. The liability with respect to employees who are not fully

eligible for Post-Retirement Benefits is a pro rata portion of the present value based on service. The other two values represent the liability under the assumption that some or all of the obligation with respect to active employees has not yet crystallized. All of the values assume that the obligation with respect to retired employees has crystallized and that the promises to those employees would not be changed.

Assets of approximately \$20 million have been accumulated with respect to the employee-paid Optional Life Insurance program. It has been assumed that these assets are available to satisfy the obligations of the Optional Life Insurance program with respect to active employees but not with respect to disabled employees. It has also been assumed that these assets are not available to satisfy Nortel's obligations with respect to other benefits. Under these assumptions, the Optional Life Insurance program has surplus assets of approximately \$20 million.

The results of this valuation are based on assumptions which have been discussed with Nortel and which are described in this report. The ultimate cost of the benefit plans is dependent on actual experience. We have estimated the sensitivity of the results of our valuation to certain key assumptions. A 1% decrease in the discount rate would increase the total liability by approximately 13%. A 1% increase in the healthcare trend rate would increase the total liability by approximately 8%.

Respectfully submitted,



Bruce Langstroth, BSc, LLB, MBA
Fellow of the Canadian Institute of Actuaries
Fellow of the Society of Actuaries

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Scope of Work

Mercer Human Resource Consulting ("Mercer") was engaged to value the net obligations of Nortel Networks Corporation's ("Nortel") Health & Welfare Trust (the "Trust"). A description of the work to be performed was provided in our November 7, 2005 letter to Norma Crowder.

The results of this valuation represent the net obligations of the Trust in the event they were to be fully funded as of September 30, 2005. They are intended for use by Nortel in reviewing the Trust and its ongoing operations and may not be suitable for other purposes. In particular, the results of this valuation are not appropriate for accounting purposes or determining contribution levels, without modification. Other purposes may require additional determinations.

Our valuation did not include a valuation of Trust assets. We have used and relied upon asset market values provided by Nortel.

The scope of our work did not include legal or tax review of the Trust or legal opinions provided in relation to the Trust, a review of the Trust's investment strategy or a determination of appropriate contribution levels.

We understand that the benefits provided through the Trust (and covered by this valuation) include the following:

- Medical, Dental and Life Insurance benefits provided to retired employees ("Post-Retirement Benefits");
- Income payments to disabled employees (Short-Term Disability ("STD") and Long-Term Disability ("LTD"));
- Medical, Dental and Life Insurance benefits provided to disabled employees;
- Income benefits for beneficiaries of deceased employees (Survivor Income Benefit ("SIB") and Survivor Transition Benefit ("STB"));

- Medical and Dental benefits provided to active employees;
- Employer-paid Basic Life Insurance provided to active employees; and
- Employee-paid Optional Life Insurance provided to active employees.

The data used in this valuation includes plan provisions, membership data, claims data and Trust financial data. This data has been provided by Nortel, Sun Life, FGI, and Greenshield Canada. We have applied tests for internal consistency and, where the data from prior valuations is available, tests for consistency with prior data. The results of these tests were satisfactory. We have not audited any of the data. Audits of the data would not normally be a part of this work. While we have performed tests to confirm the consistency of the data, we have relied on the providers to properly record and maintain the data that they have provided to us.

The assumptions and methods used in this valuation are the same as, or consistent with the assumptions used in the valuation of the liabilities valued for accounting purposes under Section 3461 of the Canadian Institute of Chartered Accounts Handbook and Statements of Financial Position 106 and 112. The assumptions used in our valuation and described in this report were agreed to by Nortel. The ultimate costs of the obligations valued in this report will depend on actual experience which may vary from the assumptions that have been made. Sensitivities to selected assumptions have been provided to assist Nortel in understanding experience to which the ultimate costs are particularly sensitive.

The discount rates established for this determination are the same as the discount rates established for accounting purposes for the 2005 fiscal year-end.¹ These rates reflect the prevailing market rates for Canadian Corporate AA bonds at September 30, 2005. This basis was chosen for the following reasons:

- The resulting liability represents the amount that would be required to fully fund the obligations of the Trust as of the valuation date.
- Asset market values reflect market values as of the valuation date.

Other purposes may require the establishment of different assumptions regarding discount rates. In particular, the discount rates used in a valuation for the purposes of determining contribution levels might reflect longer term expectations regarding yields instead of current market yields. Different discount rates might give rise to a higher or lower liability than that determined in our valuation.

This valuation is based on the plan provisions as provided by Nortel and the provisions of Government Healthcare Programs as they existed at the time of the valuation. Except as otherwise noted, it has been assumed that the Nortel and Government plan provisions

¹ Discount rates prescribed for accounting purposes are set to reflect the market yields on high-quality corporate bonds with similar cash flow patterns to that of the liability.

described and valued in this report continue unchanged. Changes to the plan provisions may have a significant impact on the liabilities determined in our valuation.

I certify that, in my opinion, and for the purposes of this report:

1. The data on which the valuation is based is sufficient and reliable.
2. This report has been prepared in accordance with generally accepted actuarial principles.

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Valuation Results

The following table presents a summary of the results of our valuation as at September 30, 2005.²

	Assets	Liabilities	Unfunded Liability
Post-Retirement Benefits	61,500	564,800	503,300
Income benefits for disabled employees	46,100	100,000	53,900
Income benefits to beneficiaries of deceased employees	19,900	21,000	1,100
Life & medical benefits provided to disabled employees	-	28,800	28,800
Unreported Basic Life, Medical & Dental claims	-	2,700	2,700
Subtotal - Nortel Obligations	127,500	717,300	589,800
Employee-paid Optional Life	20,100	200	(19,900)
Total	147,600	717,500	589,800

The results in this table are based on the assumption that the liability with respect to Post-Retirement Benefits is that determined for accounting purposes (i.e. it reflects a liability for accrued benefits for employees who are not fully eligible for benefits).

The following table presents a summary of Nortel's obligations corresponding to the above table under different scenarios regarding the extent of Nortel's obligations with respect to its Post-Retirement Benefits.

² All figures are presented in thousands of Canadian dollars.

	Assets	Liabilities	Unfunded Liability
Accounting basis	127,500	717,300	589,800
Full present value	127,500	762,744	635,244
Full present value less not fully eligible	127,500	642,346	514,846
Full present value less actives	127,500	608,755	481,255

A detailed description of these scenarios is provided in Section 5.

Please note the following:

- Nortel's unfunded liability is estimated to be approximately \$590 million. This amount could range from \$480 million to \$635 million depending on who is included in the liability determination for the Post-Retirement Benefits.
- Excess assets of approximately \$20 million have been accumulated with respect to employee-paid Optional Life insurance. There is an immaterial liability of approximately \$0.2 million relating to unreported Optional Life insurance claims. We have assumed Nortel's obligations include a liability of approximately \$3 million relating to Optional Life insurance provided to disabled employees. However, plan documentation is clear that disabled employees are not required to pay for their Optional Life insurance. Plan documentation is not clear as to whether the costs of that insurance are Nortel's to bear or Nortel's employees. In the event that it was determined that it was the obligation of Nortel's employees, the approximately \$20 million of assets could be applied against the liability. We understand that this matter has been the subject of a number of discussions between Nortel and Mercer but that no definitive conclusion has been reached. For accounting purposes, it has been assumed that the obligation is Nortel's and the assets are held for the benefit of Nortel's employees. A similar approach has been taken in presenting results above.
- The assets accumulated with respect to Retiree benefits relate to Retiree Life insurance.
- Income benefits for the beneficiaries of deceased employees includes SIB and STB. Assets have been accumulated with respect to the SIB plan.

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Background

Nortel has established a Health & Welfare Trust for the purposes of funding its employee benefit plans.

Most of Nortel's benefits, including life insurance, disability, medical and dental, and survivor income benefits, are funded through the Trust. These benefits are extended to active, disabled and retired employees.

Most of the benefits are funded by Nortel on a "pay-as-you-go" basis. Nortel makes contributions to the Trust as required to pay for the current benefits paid for by the Trust.

Optional Life Insurance is funded by employee contributions. To the extent that employee contributions have exceeded the costs of the insurance, assets have been accumulated. These assets are maintained for the benefit of Nortel's employees and we have assumed are not available for the satisfaction of the other obligations of the Trust.³

Nortel has made contributions in excess of current benefit payments with respect to Long Term Disability (LTD), Survivor Income Benefit (SIB) and Retiree Life Insurance. Nortel has targeted a partial funding level so as to avoid the possibility that contributions in excess of the ultimate costs would be stranded in the Trust.⁴

³ Optional Life Insurance is paid for by Nortel's employees. The premium is waived if an employee becomes disabled. Plan documentation is not clear whether the employees or Nortel is responsible for the costs of the Optional Life Insurance program for disabled employees. In the absence of clear documentation, it has been assumed that Nortel is responsible for the costs. If Nortel's employees were responsible for the costs, the Optional Life assets could be used to pay the costs of the insurance for disabled employees thereby reducing Nortel's obligations by approximately \$3 million.

⁴ Canada Customs and Revenue Agency rules relating to Health & Welfare Trusts prohibit employers from withdrawing contributions once made.

Assets have been designated for the use of specific benefits and accounted for in that manner. The assets, other than those relating to Optional Life, have been accounted for as "plan assets" (meaning that assets are netted against liabilities and investment income is netted against interest costs) for accounting purposes.

Trust assets have been invested in high quality, long term, fixed income instruments.

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Non-Pension Benefits Provided to Retired Employees

Nortel has established a Post-Retirement Benefits plan to provide Life Insurance and Medical and Dental benefits to its retired employees. This plan was last amended in 2000. The benefits to which a present or future retiree may be entitled depend on the program in which they were enrolled. The liability with respect to Post-Retirement Benefits relates to both current retirees who currently receive benefits and active employees who may receive benefits when they retire.

The liability for post-retirement benefits can be viewed from several different perspectives. For accounting purposes, the liability for active employees who are not fully eligible for benefits is a proportion of the full liability reflecting service to date (this is labelled as the "accounting basis"). This amount represents the portion of the liability that has been accrued and expensed for the purposes of Nortel's financial statements.

The accounting basis represents the accrued liability for accounting purposes. For the purposes of determining the magnitude of Nortel's obligations for the purposes of reviewing the Trust, it may be more appropriate to select one of the other determinations. All of the alternatives represent the full present value of future benefits. The differences between the alternatives relates to the employee groups included in the liability.

- **Full liability for future benefits.** All retired and active employees are included in the liability. The liability for active employees is the full present value of future benefits. This would represent the magnitude of the obligations inherent in the promises that have been made to current and past employees.
- **Retirees + fully eligible.** This liability excludes active employees who are not fully eligible for benefits. Active employees who are not fully eligible have been excluded on the basis that there is no obligation to provide those benefits until the employees actually retire. Active employees who are fully eligible have been included on the

basis that there is some notional “vesting” of the obligation and the employees could, at their option, retire immediately and be entitled to benefits.

- **Retirees only.** This liability excludes all active employees. The amount represents the liability for benefits that could be viewed to have “vested” in the sense that individuals have retired with the promise of those benefits.

The magnitude of the liability with respect to Post-Retirement Benefits will depend on the perspective that Nortel chooses to apply to the liability.

Plan Provisions

Plan provisions applicable to Retiree Life, Medical and Dental Benefits are described in Appendix A.

Data

The valuation of the Post-Retirement Benefits documented in this report is based on membership data as of November 30, 2005 provided by Sun Life and Nortel. The following table presents a summary of that data.

Active and LTD Members	Nortel Networks			Nortel Technology
	Non-Union	Union	Total	Non-Union
Number	4,150	1,218	5,368	4,017
Average Earnings	\$85,315	\$55,662	\$78,587	\$97,446
Average Age (Years)	42.1	46.0	43.0	40.0
Average Service (Years)	11.9	19.8	13.7	10.7
Inactive Members				
Retirees				
Number with medical coverage	3,221	5,385	8,606	622
Average age (years)	70.8	70.4	70.6	67.2
Number with life insurance	3,233	5,469	8,702	650
Average life insurance amount	\$47,180	\$16,606	\$27,965	\$62,943
Spouses of Retirees				
Number with medical coverage	2,708	3,896	6,604	555
Average age (years)	67.8	68.4	68.2	64.8

Active and LTD Members	Nortel Networks			Nortel Technology
	Non-Union	Union	Total	Non-Union
Surviving Spouses				
Number	424	296	720	47
Average age (years)	77.7	73.7	76.1	74.9
Number with annual STB (estimate)	N/A	269	269	N/A
Average monthly STB (estimate)	N/A	\$523	\$523	N/A

A detailed breakdown of the membership data is provided in Appendix B.

Claims data was provided by Sun Life and Greenshield Canada.

Methods and Assumptions

The liability for the Post-Retirement Benefits is determined for each individual. The liability is equal to the present value of future benefits. Anticipated benefits are discounted for the likelihood of payment, increases in medical and dental costs and the time value of money. For the purposes of determining the liability under the accounting approach, the liability for active employees who are not fully eligible for benefits has been pro rated on service. The other determinations of the liability are based on the full present value and differ based on the specific employee groups included in the determination. Unrecognized gains and losses that are carried for accounting purposes have not been included in this valuation since they relate only to the recognition of costs of the program for accounting purposes.

The assumptions used to value the Post-Retirement Benefits are the same as or consistent with the assumptions used in the accounting valuation and represent management's best estimate assumptions. These assumptions are described in the following table:

Discount Rate⁵	5.17% per annum		
Salary Increases	Inflation and productivity increases assumed to be 3.50% per annum.		
Merit and Promotion	Merit and promotion increases are based on age, Job Code Incentive (JCI) level and Professional / Non-professional code as follows:		
	Age	Prof & JCI above 1 or Non-Prof & JCI above 4	Prof & JCI Level 1 or Non-Prof & JCI below 5
	20	0.00%	0.00%
	25	4.00%	1.00%
	30	4.00%	0.50%
	35	3.00%	0.50%

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40	2.25%	0.50%
45	1.75%	0.00%
50	1.25%	0.00%
55	1.25%	0.00%

Mortality**Uninsured Pensioner 1994 Mortality table statically projected to 2005**

Rates at sample ages are shown below (per 1,000 members):

Age	Male	Female
20	0.44	0.26
30	0.82	0.34
40	1.06	0.65
50	2.27	1.27
60	7.18	4.52
70	21.61	13.97
80	59.72	39.21
90	157.35	120.95

Withdrawal

We have made an allowance for future terminations of employment before retirement for reasons other than death or retirement. Sample termination rates, by employee group, are as follows:

Age	Managerial	
	(Non-Unionized)	Negotiated (Unionized)
20	12.92%	9.18%
25	10.86%	9.18%
30	9.03%	7.49%
35	7.34%	5.16%
40	5.66%	3.70%
45	3.97%	2.55%
50	3.03%	1.48%
55	1.14%	0.43%

The termination scale ends at the full eligibility date.

**Retirement Rates
Program****Retirement Scale****Traditional (Grandfathered and Non-Grandfathered) Programs****Managerial Plan (Part I)**

- 5% per year from Company-Initiated Retirement Age⁽¹⁾ to Employee-Initiated Retirement Age⁽²⁾
- 40% at Employee-Initiated Retirement Age
- 15% per year from Employee-Initiated Retirement Age to Age 65
- 100% at Age 65

Managerial Plan (Part II)

- 5% per year from Age 55 to Age 59
- 20% per year from Age 60 to Age 64
- 100% at Age 65

Negotiated Plan

- 15% per year from Company-Initiated Retirement Age⁶ to Employee-Initiated Retirement Age⁷
- 40% at Employee-Initiated Retirement Age
- 15% per year from Employee-Initiated Retirement Age to Age 65
- 100% at Age 65

Balanced Program**Managerial Plan Only**

Same as Managerial Plan for Part II members

SARP Program**Negotiated Plan Only**

Same as Negotiated Plan for Traditional Programs

Marital Status

- For active employees, 80% are assumed to be married at retirement with males assumed to be 2 years older than their female spouses.
- For current retirees, actual spousal information was used

**Age 65 2005 Per
Covered Person Claim
Costs (before
Administration and****Grandfathered Traditional Program**

Semi-private Hospital	\$52
Prescription Drugs ⁸	\$830

⁶ Company-Initiated Retirement Age refers to the earlier of:

- Age 55 with 25 years of pensionable service, and 30 years of pensionable service

⁷ Employee-Initiated Retirement Age refers to the earlier of:

- age 65,
- age 60 with age plus pensionable service equal to 80 or more, and
- age 55 with age plus pensionable service equal to 85 or more, or age 55 with 20 years of pensionable service for female members, in service with Nortel Networks on May 31, 1973.

Taxes)	Other Medical	\$53
	Vision Care	\$21
	<u>Dental Care</u>	<u>\$212</u>
	Total	\$1,168

Non-Grandfathered Traditional Program

Catastrophic Medical Program ⁹	\$1,109
Healthcare Spending Account	\$50 per year of service from age 40 to retirement age

Balanced Program

Healthcare Spending Account	\$50 per year of service from age 40 to retirement age
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SARP

Healthcare Spending Account	\$50 per year of service from age 40 to retirement age
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Post-retirement Increases in Utilization by Age	Cost at Age						
	55	60	65	70	75	80	85
Supplementary Hospital	52%	69%	100%	146%	213%	283%	352%
Prescription Drugs ⁸	69%	84%	100%	115%	126%	134%	134%
Other Medical	49%	66%	100%	154%	233%	237%	501%
Vision Care	100%	100%	100%	100%	100%	100%	100%
Dental Care	105%	103%	100%	98%	95%	93%	90%
Catastrophic Medical Plan ⁹	69%	84%	100%	115%	126%	134%	134%
Healthcare Spending Account	100%	100%	100%	100%	100%	100%	100%
Prescription Drug Offset Assumption at Age 65 and After	Alberta: 55% of claims Ontario: 55% of claims Others: 0%						
Lifetime Maximum Factors for the Catastrophic Medical Plan	The liabilities and service cost amounts for the catastrophic medical coverage under the Non-Grandfathered Traditional Program were calculated based on the above assumptions, multiplied by the factors in the table below to reflect the expected impact of the plan's lifetime deductible (\$7,500 per family) and lifetime maximum (\$500,000 per family) provisions. It has been assumed that the current flat lifetime deductible and maximum amounts do not increase in the future.						

⁸ Drug costs are reduced from age 65 due to coverage from the provincial government drug plans. The assumptions shown here are before the assumed offset amount.

⁹ All drug costs can be claimed under this plan. The costs for drug benefits are reduced from age 65 due to the coverage from the provincial government drug plans. The assumptions shown here are before the assumed offset amount.

		Factors for Lifetime Deductible of \$7,500 and Lifetime Maximum of \$500,000 per Family	
Age Group			
Less than 30		0.04	
30 to 34		0.05	
35 to 39		0.07	
40 to 44		0.08	
45 to 49		0.11	
50 to 54		0.13	
55 to 59		0.18	
Greater than 60		0.11	
Provincial Government Plan		Effective May 1, 2002 in British Columbia, the retiree premium for the government plans are as follows:	
		Province	Single Family
		British Columbia	\$54 \$96
Administrative Expenses	Medical	4.30%	of claims
	Dental	4.30%	of claims
	Life Insurance	1.50%	of claims
	STB	2.30%	of claims

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Benefits Provided to Disabled Employees

In general, disabled employees are provided the same benefits as active employees.¹⁰ These benefits are provided for the duration of the employee's disability. The benefits provided are typically the benefits in effect at the time the employee is disabled.¹¹ The liability associated with this obligation is the present value of income payments or expense reimbursements provided to disabled employees while they are disabled. Income and/or benefits are discounted for the likelihood of continuing disability and the time value of money. Anticipated payments are increased to reflect increases in the cost of living (indexed Long Term Disability) or increases in the cost of Medical and Dental benefits (continuation of Medical and Dental benefits).

Liabilities are determined for the following benefits:

- Income payments to disabled employees (STD and LTD);
- Continuation of medical and dental benefits to disabled employees and their dependents; and
- Continuation of life insurance to disabled employees.

There is a contingent liability associated with disabled union employees who remain eligible for STB (those employees who were disabled prior to the termination of the plan). Where such employees die, their spouses, if any, would be entitled to the STB benefit. The liability with respect to unreported STB claims relating to disabled union employees is relatively immaterial (less than \$100,000) and has not been included in the results.

¹⁰ Where the benefit program has changed since the employee became disabled, the employee may be provided benefits under the earlier benefit program. As an example, certain disabled union employees are provided with STB coverage.

¹¹ So, for example, STB benefits continue to be provided to disabled union employees who were disabled prior to the elimination of the benefit.

The following sections describe these benefits and their valuation in more detail.

Short-Term Disability: Income Payments and the Continuation of Medical and Dental Benefits During Disability

During the initial period of disability, income payments are paid under the provisions of the STD plan.

Plan Provisions

STD benefits are provided for up to one year for most union employees. The benefit level ranges between 90% of earnings and 66.7% of earnings, depending on service and the duration of the claim. For example, the benefit level is 90% for the first 5 weeks and 66-2/3% for the next 47 weeks for a union employee with 2 years of service.

Non-union employees are entitled to STD benefits for up to six months. The benefit is 100% of salary for the first 13 weeks and 70% of salary for the remainder of the benefit period. Employee-paid optional STD is available to increase the STD benefit to 90% of salary for weeks 14 – 26.

Effective January 1, 2004, STD benefits for COEU members are the same as for non-union employees.

Medical and dental benefits and life insurance are continued during STD for both union and non-union employees.

Methods and Assumptions

The reserve for income payments, medical and dental benefits and life insurance for disabled employees during the initial period of disability is determined in aggregate. The reserve is calculated as a percentage of recent paid claims. The percentage is set at a level to reflect average benefit periods and the relative costs associated with medical and dental benefits and life insurance. The factors used in the determination of the reserve are as follows:

Income Benefit	8.3% of annualized paid claims
Medical and Dental Benefit and Life Insurance	14% of liability for income benefits

Long-Term Disability: Income Payments and Continuation of Medical and Dental Benefits

After the initial period of disability, income benefits are provided under the terms of the LTD Plan. Claims administration practices become more focussed on maximizing the likelihood of return to work. Benefits are paid to the earlier of return to work, death or attainment of age 65. Depending on the employee's benefit selections, income benefits may be increased annually to reflect increases in the cost of living.

Plan Provisions

LTD benefits are provided after the STD benefits end.

For most union employees, the income benefit is a flat amount that varies with benefit group. There is a 75% all source maximum and no provision for Cost of Living Adjustment (COLA) on the benefit.

Non-union employees can choose a benefit equal to 50% or 70% of salary, with or without cost of living increases. Annual cost of living increases, if selected, are set at 60% of the increase in the Consumer Price Index to a maximum of 6% per annum. The cost of living increase is applied on the first January at least two years after benefits begin and each January thereafter.

During the initial period of disability (18 months for non-union employees and two years for union employees), an employee is considered to be disabled if they are unable to perform the duties of his or her own occupation. After that time, an employee is considered to be disabled if they are unable to perform the duties of any occupation for which they are reasonably suited.

Benefits may be reduced by income received from other sources such as a Canada Pension Plan disability pension. In addition, the benefit will be reduced on a dollar-for-dollar basis for total income in excess of a percentage of pre-disability earnings.

For both union and non-union LTD employees, continuation of medical and dental benefits and life insurance is provided up to the earlier of recovery, death or age 65. If the employee continues to be disabled at age 65, Medical and Dental benefits would be continued under the provisions of the Post-Retirement Benefits plan.

Data

The following table presents a summary of the data provided by Sun Life as of September 30, 2005 and, for comparison purposes, December 31, 2004.

	Number	Average Age at Disability	Average Duration of Disability (Years)	Average Net Monthly Benefit
December 31, 2004	497	42.6	10.1	\$2,169
September 30, 2005	479	42.3	10.4	\$1,973

Methods and Assumptions

The liability for income payments and the continuation of medical and dental benefits is equal to the present value of future income payments, reimbursement of medical and dental expenses and expenses and taxes associated with these payments. The liability consists of a reserve for incurred but not reported claims and a reserve for reported claims. The liability for incurred but not reported claims is determined on an aggregate basis reflecting claiming patterns under the plan. The liability for reported claims is determined for each reported claim as the present value of future income payments, medical and dental benefits and associated expenses and taxes. The future stream of payments is discounted for the likelihood of continuing disability and the time value of money.

LTD-specific assumptions are provided in the following table:

Discount rate	5.25% per annum		
Cost of living increases	1.50% per annum for non-union employees who have selected an indexed benefit. Inflation is assumed to be 2.50% per annum. None for union employees and non-union employees who have selected a non-indexed benefit.		
CPP/QPP Offset	35% of disabled employees within the first three years of disability who have not been approved for a Canada/Quebec Pension Plan disability pension will be approved for a disability pension.		
Mortality	1988-94 CIA Group LTD mortality		
Recovery	1988-94 CIA Group LTD recoveries		
Expenses	3.45% of income payments for LTD and 4.20% of paid claims for Medical and Dental.		
Assumed 2005 Claim Cost per Disabled Employee per Year (includes taxes and expenses)	Union		Non-Union
	Medical	\$5,549	\$2,202
	Dental	\$971	\$1,176

Reserve for incurred but not reported claims	The reserve for incurred but not reported claims is determined as the product of the expected number of claims and the expected cost of those claims as described below.	
	Disability Incidence Rates	3/1,000 employees
	Reporting Lag on Claims	6.5 months
	Number of Employees	8,761
	Average Gross Benefit	\$3,900/month
	PV factors	
	- Income	5.7
	- Medical	6.5
	- Dental	6

Additional assumptions are described in section 8.

Long-Term Disability: Continuation of Life Insurance for Disabled Employees

Life insurance coverage for disabled employees is continued at no cost.

Plan Provisions

There is employer-paid Basic Life Insurance coverage and employee-paid Optional Life Insurance coverage. The premium on the Optional Life Insurance is waived for the employee while they are disabled. The cost of Basic Life Insurance during an employee's disability is paid for by Nortel. The cost of Optional Life insurance during an employee's disability is assumed to be paid for by Nortel.¹²

Most disabled union employees are entitled to a flat amount of Basic Life Insurance depending on union and period in which they were disabled. Non-union employees and COEU members are provided with Basic Life Insurance equal to one times salary. All employees have access to Optional Life Insurance for amounts up to five times salary for non-union employees.

For both groups, the definition of disability is the same as for the LTD's definition.

¹² Plan documents are clear that the Optional Life Insurance premium is waived during the course of disability. They are less clear on the subject of who – Nortel or past or present employees – is responsible for the cost of the coverage continued during an employee's disability. In the absence of definitive documentation, it has been assumed for accounting purposes that Nortel is responsible for the cost of the coverage.

Data

Data was provided by Sun Life (census data) and Nortel (amounts of insurance) as of September 30. This data is summarized in the following table:

	Number	Average Amount of Basic Life Insurance	Number with Optional Life Insurance	Average Amount of Optional Life Insurance
Union	214	\$62,000 ¹³	174	\$61,000
Non-Union	265	\$60,000	202	\$176,000

Methods and Assumptions

The liability for the continuation of life insurance is equal to the present value of future life insurance benefits and the expenses and taxes associated with these payments. The liability consists of a reserve for incurred but not reported claims and a reserve for reported claims. The liability for incurred but not reported claims is determined on an aggregate basis reflecting claiming patterns under the plan. The liability for reported claims is determined for each reported claim as the present value of future life insurance benefits and associated expenses and taxes. The future stream of payments is discounted for the likelihood of continuing disability and the time value of money.

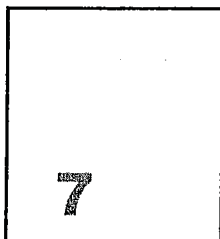
Assumptions specific to the continuation of life insurance benefits are provided in the following table:

Mortality Assumption	Disability claim mortality assumptions were based on the Kreiger Basic table modified by the 1988-94 CIA study factors.	
Expense and Taxes on Life Waiver Benefit	7.95% of reserve	
Mortality	1988-94 CIA Group LTD mortality	
Recovery	1988-94 CIA Group LTD recoveries	
Reserve for incurred but not reported claims	The reserve for incurred but not reported claims is determined as the product of the expected number of claims and the expected cost of those claims as described below.	
	Disability Incidence Rates	3/1,000 employees
	Reporting Lag on Claims	6.5 months

¹³ The average is based on available Mercer estimates as insured life amounts were not provided for the union group.

Number of Employees	8,761
Average Insurance Amount	\$82,000 - Basic? \$281,000 - Optional?
PV factor	1.6

Additional assumptions are described in Section 8.



Survivor Income Benefits and Survivor Transition Benefits

SIB and STB are income benefits provided to survivors of deceased employees. These plans are closed for all intents and purposes¹⁴ and the liability relates to the obligation to continue to pay benefits to the survivors of deceased employees. See Appendix D for more detail.

Plan Provisions

SIB is a monthly income benefit provided upon the death of an eligible non-union employee. Benefits are provided for the lifetime of the surviving spouse.

STB is a monthly income benefit provided upon the death of eligible union employees. Benefits are provided for 60 months following the death of the employee. In the case of an occupation-related death of an employee, the benefit also provided an additional lump sum benefit.

Neither SIB nor STB are offered to active employees. STB coverage continues to be offered to certain disabled union employees.¹⁵ Survivors of deceased employees in receipt of benefits will continue to receive benefits until the end of their benefit period.

¹⁴ Certain disabled union employees continue to be provided coverage.

¹⁵ STB coverage continues to be provided to CAW members who were disabled on April 1, 2003 (and continue to be disabled) and CUCW members who were disabled on March 1, 2004 (and continue to be disabled).

Data

The following table presents the data provided by Sun Life as of December 31, 2004 and September 30, 2005.

	September 30, 2005		December 31, 2004	
	Number	Monthly Benefit Amount	Number	Monthly Benefit Amount
STB	302	\$530	309	\$524
SIB	90	\$1,366	91	\$1,362

Methods and Assumptions

The liability for STB and SIB is determined as the present value of future benefit payments. The following assumptions were made in the determination of this liability:

- Discount rate equal to 4.75% per annum.
- Mortality equal to 1994 Uninsured Pensioner mortality projected to 2005.
- Expenses and taxes equal to 9.46% of paid claims.

See the "General Assumptions" section for assumptions generally applicable to this valuation.

A reserve for incurred but not reported claims has not been established on the basis of materiality.¹⁶

¹⁶ Only certain disabled union employees would be entitled to STB if they were to die.


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Benefits Provided to Active Employees

Nortel provides its active employees with benefits that include Basic Life insurance, Optional Life insurance, STD, Long Term Disability, Medical and Dental. Optional Life insurance is paid for by Nortel's employees.¹⁷ The other benefits are paid for by Nortel.

With the exception of LTD, which has been addressed under benefits provided to disabled employees, the liabilities with respect to benefits provided to active employees are associated with unreported claims and are largely immaterial.

Methods and Assumptions

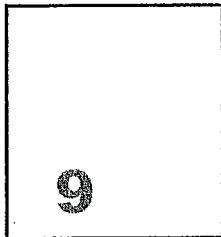
The liability for incurred but not reported claims ("IBNR") has been determined in aggregate¹⁸ as the amount of premium (life insurance) or paid claims (Medical and Dental) for the benefit during the average reporting period. This amount has been increased to reflect expense and taxes associated with providing and administering the benefits. The following table presents the average reporting lag assumed in the determination of the IBNR.

Benefit	Average Reporting Lag (months)
Drugs	0.6
Other Medical	2.0

¹⁷ Optional Life insurance for disabled employees has been accounted for as Nortel's obligation.

¹⁸ The liability is estimated for total unreported claims rather than attempting to estimate the liability with respect to individual claims as is done with respect to reported disability claims.

Benefit	Average Reporting Lag (months)
Dental	1.2
Life insurance	1.0



Assets

Nortel partially funds their Retiree Life, LTD and SIB obligations. Nortel has chosen to fund these obligations at less than the full extent of the liability due to restrictions associated with Health and Welfare Trusts. Specifically, contributions to Health and Welfare Trusts may not be returned to the employer.

Optional Life is funded by employee contributions. The Optional Life assets represent the accumulated value of employee contributions in excess of the costs of the optional life insurance.

Nortel has administered contributions made to the Trust in relation to a specific benefit, and investment earnings on those contributions, as being assets dedicated to those benefits and has indicated their intention to continue to administer the Trust in a consistent manner. As such, for accounting purposes under Statement of Financial Standards Numbers 106 and 112 and Canadian Institute of Chartered Accountants Handbook Section 3461, these assets have been accounted for as plan assets.

The following table presents a reconciliation of Trust assets by benefit.¹⁹

	Retiree Life	LTD	SIB	Optional Life	Total
Balance at September 30, 2004	61,079	74,524	18,755	18,938	173,296
Contributions	-	(18,098)	-	2,183	(15,915)
Benefit payments	7,374	11,846	1,487	3,641	24,348
Investment income	3,133	3,822	972	977	8,904

¹⁹ Figures are in thousands of Canadian dollars.

Unrealized gains/(losses)	4,662	(2,302)	1,633	1,639	5,632
Balance at September 30, 2005	61,500	46,100	19,874	20,096	147,569

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Sensitivities

The ultimate costs of the obligations valued in this report will depend on actual experience which may vary from the assumptions that have been made. These assumptions have been described in other parts of this report. The following table presents the unfunded liability under several scenarios:

	Assets	Liabilities	Unfunded Liability
Accounting basis	127,500	717,300	589,800
Discount rate + 1%	127,500	634,798	507,298
Discount rate - 1%	127,500	798,806	671,306
Healthcare trend rate + 1%	127,500	765,150	637,650
Healthcare trend rate - 1%	127,500	674,529	547,029
Disabled mortality/recoveries at 110%	127,500	711,187	583,687
Disabled mortality/recoveries at 90%	127,500	717,538	590,038

The sensitivities have been presented on the "accounting basis". The other liability bases described would have similar sensitivities as presented here.

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Appendix A – Retiree Benefit Plan Provisions

Please see the following chart:

Summary of Plan Provisions			
	Grandfathered Traditional Program	Non-Grandfathered Traditional Program Catastrophic Program	Non-Grandfathered Traditional, Balanced Program and SARP Healthcare Spending Account
Eligibility	<ul style="list-style-type: none"> ▪ Age 50 or have at least 28 years of service as at April 30, 2000 ▪ Part I: Employee must retire directly from active status or Long Term Disability ▪ Part II: Employee must be at least age 55 with 5 years of service at retirement 	<ul style="list-style-type: none"> ▪ If employee does not qualify for the Grandfathered Traditional program ▪ Part I: Employee must retire directly from active status or Long Term Disability ▪ Part II: Employee must be at least age 55 with 10 years of service at retirement 	<ul style="list-style-type: none"> ▪ Part I: Employee must retire directly from active status or Long Term Disability ▪ Part II: Balanced Program & SARP; employee must be at least age 55 with 10 years of service at retirement ▪ Investor program for Quebec retirees under age 65 who retire from active status
Medical and Dental Coverage			
Deductible	<ul style="list-style-type: none"> ▪ \$25/50 (single/family) per calendar year ▪ Applies to expenses incurred under either or both health and dental plans 	<ul style="list-style-type: none"> ▪ \$7,500 lifetime out-of-pocket deductible per family ▪ Applies to certain medical benefits only 	<ul style="list-style-type: none"> ▪ N/A
Overall Plan Maximum	<ul style="list-style-type: none"> ▪ Unlimited 	<ul style="list-style-type: none"> ▪ \$500,000 lifetime maximum per family 	<ul style="list-style-type: none"> ▪ N/A
Benefit Amount	<ul style="list-style-type: none"> ▪ Out-of-pocket maximum of \$1,000 per calendar year per family 	<ul style="list-style-type: none"> ▪ Reimburses 100% (from catastrophic plan) of eligible medical expenses 	<ul style="list-style-type: none"> ▪ Annual company paid allocation is \$50 per year of service from age 40

Summary of Plan Provisions

		Non-Grandfathered Traditional Program	Non-Grandfathered Traditional, Balanced Program and SARP
		after the lifetime deductible is satisfied	
Spousal & Dependent Coverage	▪ Yes	▪ Yes	▪ Annual company paid allocation reduced by half after the death of the retiree
Spousal & Dependent Coverage	▪ Yes	▪ Yes	▪ Annual company paid allocation reduced by half after the death of the retiree
Medical	▪	▪	▪
Drug (Non-Quebec)	▪ Prescription drugs covered at 80%	▪ Prescription drugs, generic substitution where possible ▪ \$7 dispensing fee maximum	▪ Subject to Income Tax Act Section 118.2
Drug (Quebec) – Retirees 65 and over: 2 Choices	<u>Provincial RQ Drug Plan</u> <ul style="list-style-type: none"> ▪ Covers 72.6% up to \$822 out of pocket/yr ▪ 100% of expenses in excess of \$822 ▪ Monthly deductible \$9.13/month ▪ Nortel pays premiums (taxable benefit) to a maximum of \$175/yr <u>NN RAMQ Equivalent Drug Plan</u> <ul style="list-style-type: none"> ▪ 80% eligible on RAMQ formulary up to \$822/yr ▪ 100% of expenses in excess of \$822 ▪ Retiree pays premiums 	<u>Provincial RQ Drug Plan</u> <ul style="list-style-type: none"> ▪ Covers 72.6% up to \$822 out of pocket/yr ▪ 100% of expenses in excess of \$822 ▪ Monthly deductible \$9.13/month ▪ Nortel pays premiums (taxable benefit) to a maximum of \$175/yr <u>NN RAMQ Equivalent Drug Plan</u> <ul style="list-style-type: none"> ▪ 80% eligible on RAMQ formulary up to \$822/yr ▪ 100% of expenses in excess of \$822 ▪ Retiree pays premiums 	<u>Provincial RQ Drug Plan</u> <ul style="list-style-type: none"> ▪ Covers 72.6% up to \$822 out of pocket/yr ▪ 100% of expenses in excess of \$822 ▪ Monthly deductible \$9.13/month ▪ Nortel pays premiums (taxable benefit) to a maximum of \$175/yr <u>NN RAMQ Equivalent Drug Plan</u> <ul style="list-style-type: none"> ▪ 80% eligible on RAMQ formulary up to \$822/yr ▪ 100% of expenses in excess of \$822 ▪ Retiree pays premiums
Hospital	<ul style="list-style-type: none"> ▪ 100% of the first \$50 per day and 50% of the remaining cost ▪ Difference between ward and private room coverage 	▪ Not covered	▪ Subject to Income Tax Act Section 118.2
Private Duty Nursing	▪ 80% to a maximum of \$12,500 in period of illness/injury	▪ 100% subject to deductible and overall plan maximum	▪ Subject to Income Tax Act Section 118.2

Summary of Plan Provisions

		Non-Grandfathered Traditional Program	Non-Grandfathered Traditional, Balanced Program and SARP
Vision Care	<ul style="list-style-type: none"> 50% up to a maximum of \$100/ 2yrs /per person, and \$200/2yrs for severe eye conditions <p><u>CAW and COEU</u></p> <ul style="list-style-type: none"> Maximum of \$100 /2yrs /per person, and \$200/2yrs for severe eye conditions 	Not covered	Subject to Income Tax Act Section 118.2
Hearing Aid	<ul style="list-style-type: none"> 50% to a maximum of \$200 /2yrs/ per person 	Not covered	Subject to Income Tax Act Section 118.2
Provincial Health Insurance Premium	<ul style="list-style-type: none"> Nortel Networks pays provincial health insurance premiums for retirees in Alberta and British Columbia. These premiums are a tax benefit to retirees. 	<ul style="list-style-type: none"> Nortel Networks pays provincial health insurance premiums for retirees in Alberta and British Columbia. These premiums are a tax benefit to retirees. 	<ul style="list-style-type: none"> Nortel Networks pays provincial health insurance premiums for retirees in Alberta and British Columbia. These premiums are a tax benefit to retirees.
Other – Medical	<ul style="list-style-type: none"> Includes: <p><u>80% co-insurance:</u></p> <ul style="list-style-type: none"> Out of province medical coverage Medical equipment and supplies Ambulance services X-rays Accidental dental Paramedical services (\$250 maximum per person per calendar year) Orthopaedic shoes Physiotherapist (no maximum) Other parameds (\$250 maximum) <p><u>50% co-insurance:</u></p> <ul style="list-style-type: none"> Hearing aids Nursing Homes 	<ul style="list-style-type: none"> Includes: <ul style="list-style-type: none"> Medical equipment and supplies Ambulance services X-rays Selected list of paramedical services (physiotherapist, chiropractor, speech therapist, osteopath) \$250 maximum per practitioner per calendar year 100% subject to deductible and overall plan maximum 	Subject to Income Tax Act Section 118.2
Dental	Coinsurance of:	Not Covered	Subject to Income Tax Act Section 118.2
Basic	80%		
Periodontic / Endodontic	50%		
Major Restorative	50%		
Orthodontic	None		
Maximum Benefit	<ul style="list-style-type: none"> Periodontic / Endodontic: \$1,000 per person in any 3 		

Summary of Plan Provisions

		Non-Grandfathered Traditional Program	Non-Grandfathered Traditional, Balanced Program and SARP
	years		
	<ul style="list-style-type: none"> Major: \$1,000 per person per calendar year 		
Life Insurance	<ul style="list-style-type: none"> Equal to pre-retirement basic life coverage Reducing by 5% on each retirement anniversary 	<u>Non Grandfathered Traditional</u> <ul style="list-style-type: none"> \$35,000 in company paid coverage or \$10,000 death benefit 	<u>Balanced SARP</u> <ul style="list-style-type: none"> \$35,000 in company paid coverage or \$10,000 death benefit \$30,000 in company paid coverage or \$10,000 death benefit for CAW retirees \$35,000 in company paid coverage or \$10,000 death benefit for COEU retirees
	Non-Union		
	<u>Non-Union Pre '91 retiree</u>		
	<ul style="list-style-type: none"> Reduction stops when coverage is 75% of pre-retirement basic life coverage 		
	<u>Non-Union Post '91 retiree</u>		
	<ul style="list-style-type: none"> Reduction stops when coverage is 25% of pre-retirement basic life coverage Minimum coverage of \$20,000 		
	<u>Exceptions to the Above:</u>		
	<ul style="list-style-type: none"> For retirees on private payroll whose band was 12 and above, and for NEDCO retirees: the initial amount of insurance remains level after retirement 		
	Union		
	<u>Union Pre '91 retiree</u>		
	<ul style="list-style-type: none"> Reduction stops when coverage is 75% of pre- 		

Summary of Plan Provisions

	Non-Grandfathered Traditional Program	Non-Grandfathered Traditional, Balanced Program and SARP
retirement basic life coverage		
<u>Union Post '91 retiree</u>		
- Reduction stops when coverage is 50% of pre- retirement basic life coverage		
- Minimum coverage of \$10,000 except for CAW who have a minimum coverage of \$25,000		

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Appendix B – Retiree Benefit Plan Membership Data

The following tables present a breakdown of active and retired members by age and service.

Distribution of Active Members by Age and Completed Years of Service Nortel Corporation as at November 30, 2005

Age	0-4	5-9	10-14	15-19	20-24	25-29	30-34	35-39	40+	Total
Under 20										0
20-24	27									27
25-29	148	298								446
30-34	142	1108	162	1						1,413
35-39	175	1044	592	191	1					2,003
40-44	134	762	432	614	318	14				2,274
45-49	83	385	230	249	471	237	8			1,663
50-54	37	167	103	113	199	203	86	1		909
55-59	16	46	41	44	122	92	71	28	3	463
60-64	4	17	12	13	35	25	37	21	11	175
65-69	1		1	0	2	2	3	1	2	12
70-74										0
75+										0
Total	767	3,827	1,573	1,225	1,148	573	205	51	16	9,385

Distribution of Retirees and Surviving Spouses by Age
Nortel Combined as at November 30, 2005

Age	Retirees	Surviving Spouses	Total
Under 50	5	5	10
50-54	145	14	159
55-59	1,022	21	1,043
60-64	1,739	65	1,804
65-69	1,678	97	1,775
70-74	1,783	163	1,946
75 +	3,070	402	3,472
Total	9,442	767	10,209

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