FORM 10-Q

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

[X] Quarterly Report Pursuant to Section 13 or 15(d) of the
Securities Exchange Act of 1934
For the quarterly period ended September 30, 2004

OR

[ ] Transition Report Pursuant to Section 13 or 15(d)
of the Securities Exchange Act of 1934
For the transition period from _____ to _____

Commission File Number 1-3492

HALLIBURTON COMPANY

(a Delaware Corporation)
75-2677995

5 Houston Center
1401 McKinney, Suite 2400
Houston, Texas 77010
(Address of Principal Executive Offices)

Telephone Number - Area Code (713) 759-2600

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes X No ___

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act).
Yes X No ___

As of October 22, 2004, 441,975,012 shares of Halliburton Company common stock, $2.50 par value per share, were outstanding.

HALLIBURTON COMPANY

Index

PART I. FINANCIAL INFORMATION
Item 1. Financial Statements

HALLIBURTON COMPANY
Condensed Consolidated Statements of Operations
(Unaudited)
(Millions of dollars and shares except per share data)

	Three Months Ended September 30		Nine Months Ended September 30	
	2004	2003	2004	2003
Revenue:				
Services	$ 4,264	$ 3,661	$ 13,748	$ 9,396
Product sales	531	474	1,537	1,398
Equity in earnings (losses) of unconsolidated affiliates	(5)	13	(20)	13
Total revenue	4,790	4,148	15,265	10,807
Operating costs and expenses:				
Cost of services	3,926	3,436	13,163	8,940
Cost of sales	465	429	1,380	1,258
General and administrative	97	80	271	241
Gain on sale of business assets, net	(40)	(1)	(40)	(49)
Total operating costs and expenses	4,448	3,944	14,774	10,390
Operating income	342	204	491	417
Interest expense	(51)	(33)	(160)	(85)
Interest income	13	7	30	22
Foreign currency gains (losses), net	1	(17)	(9)	(4)
Other, net	(2)	-	2	2
Income from continuing operations before income taxes, minority interest, and change in accounting principle	303	161	354	352
Provision for income taxes	(111)	(63)	(131)	(142)
Minority interest in net income of subsidiaries	(6)	(6)	(19)	(17)
Income from continuing operations before change in accounting principle	186	92	204	193
Loss from discontinued operations, net of tax (provision) benefit of $72, $(3), $218, and $27	(230)	(34)	(980)	(58)
Cumulative effect of change in accounting principle, net of tax benefit of $5	-	-	-	(8)
Net income (loss)	$ (44)	$ 58	$ (776)	$ 127
Basic income (loss) per share:				
Income from continuing operations before change in accounting principle	$ 0.43	$ 0.21	$ 0.47	$ 0.44
Loss from discontinued operations, net	(0.54)	(0.08)	(2.25)	(0.13)
Cumulative effect of change in accounting principle, net	-	-	-	(0.02)
Net income (loss)	$ (0.11)	$ 0.13	$ (1.78)	$ 0.29
Diluted income (loss) per share:				
Income from continuing operations before change in accounting principle	$ 0.42	$ 0.21	$ 0.46	$ 0.44
Loss from discontinued operations, net	(0.51)	(0.08)	(2.22)	(0.13)
Cumulative effect of change in accounting principle, net	-	-	-	(0.02)
Net income (loss)	$ (0.09)	$ 0.13	$ (1.76)	$ 0.29
Cash dividends per share	$ 0.125	$ 0.125	$ 0.375	$ 0.375
Basic weighted average common shares outstanding	438	435	437	434
Diluted weighted average common shares outstanding	442	437	441	436

See notes to condensed consolidated financial statements.

HALLIBURTON COMPANY
Condensed Consolidated Balance Sheets
(Unaudited)
(Millions of dollars and shares except per share data)

	September 30 2004	December 31 2003
Assets		
Current assets:		
Cash and equivalents	$ 2,996	$ 1,815
Receivables:		
Notes and accounts receivable	2,602	2,909
Unbilled work on uncompleted contracts	1,852	1,760
Insurance for asbestos- and silica-related liabilities	965	96
Total receivables	5,419	4,765
Inventories	741	695
Other current assets	667	644
Total current assets	9,823	7,919
Property, plant, and equipment, net of accumulated depreciation of $3,625 and $3,540	2,540	2,526
Noncurrent deferred income taxes	971	774
Goodwill	793	670
Equity in and advances to related companies	527	579
Insurance for asbestos- and silica-related liabilities	488	2,038
Other assets	816	993
Total assets	$ 15,958	$ 15,499
Liabilities and Shareholders' Equity		
Current liabilities:		
Asbestos- and silica-related liabilities	$ 2,415	$ 2,507
Accounts payable	2,362	1,776
Advance billings on uncompleted contracts	723	741
Accrued employee compensation and benefits	522	400
Reserve for estimated loss on uncompleted contracts	269	225
Current maturities of long-term debt	50	22
Other current liabilities	714	893
Total current liabilities	7,055	6,564
Long-term debt	3,894	3,415
Asbestos- and silica-related liabilities	2,029	1,579
Employee compensation and benefits	785	801
Other liabilities	403	493
Total liabilities	14,166	12,852
Minority interest in consolidated subsidiaries	113	100
Shareholders' equity:		
Common shares, par value $2.50 per share - authorized 1,000 and 600 shares, issued 458 and 457	1,144	1,142
Paid-in capital in excess of par value	259	273
Deferred compensation	(80)	(64)
Accumulated other comprehensive income	(296)	(298)
Retained earnings	1,130	2,071
	2,157	3,124
Less 16 and 18 shares of treasury stock, at cost	478	577
Total shareholders' equity	1,679	2,547
Total liabilities and shareholders' equity	$ 15,958	$ 15,499

See notes to condensed consolidated financial statements.

HALLIBURTON COMPANY
Condensed Consolidated Statements of Cash Flows
(Unaudited)
(Millions of dollars)

	Nine Months Ended September 30	
	2004	2003
Cash flows from operating activities:		
Net income (loss)	$ (776)	$ 127
Adjustments to reconcile net income (loss) to net cash from operations:		
Loss from discontinued operations	980	58
Depreciation, depletion, and amortization	374	384
Provision (benefit) for deferred income taxes, including $(163) and $(8) related to discontinued operations	(200)	(73)
Distributions from (advances to) related companies, net of equity in (earnings) losses	(39)	11
Change in accounting principle, net	-	8
Gain on sale of assets, net	(47)	(53)
Other non-cash items	19	(12)
Other changes:		
Accounts receivable	(252)	(608)
Accounts receivable facilities transactions	458	(180)
Inventories	(42)	(28)
Accounts payable	581	(101)
Restricted cash related to Chapter 11 proceedings	(107)	-
Other working capital, net	(30)	(46)
Other operating activities	58	(22)
Total cash flows from operating activities	977	(535)
Cash flows from investing activities:		
Capital expenditures	(422)	(371)
Sales of property, plant, and equipment	101	82
Dispositions (acquisitions) of business assets, net of cash disposed	102	222
Proceeds from sale of securities	21	57
Investments - restricted cash	88	(23)
Other investing activities	(24)	(32)
Total cash flows from investing activities	(134)	(65)
Cash flows from financing activities:		
Proceeds from long-term borrowings, net of offering costs	496	1,177
Proceeds from exercises of stock options	48	18
Payments to reacquire common stock	(6)	(6)
Borrowings (repayments) of short-term debt, net	(7)	(27)
Payments on long-term borrowings	(16)	(290)
Payments of dividends to shareholders	(165)	(164)
Other financing activities	(4)	(6)
Total cash flows from financing activities	346	702
Effect of exchange rate changes on cash	(8)	13
Increase in cash and equivalents	1,181	115
Cash and equivalents at beginning of period	1,815	1,107
Cash and equivalents at end of period	**$ 2,996**	**$ 1,222**
Supplemental disclosure of cash flow information:		
Cash payments during the period for:		
Interest	$ 136	$ 86
Income taxes	$ 190	$ 143

See notes to condensed consolidated financial statements.

Note 1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements were prepared using generally accepted accounting principles for interim financial information and the instructions to Form 10-Q and Regulation S-X. Accordingly, these financial statements do not include all information or footnotes required by generally accepted accounting principles for annual financial statements and should be read together with our 2003 Annual Report on Form 10-K, as amended. The condensed consolidated financial statements also include the accounts of all of our subsidiaries currently in Chapter 11 proceedings (see Note 13). Certain prior period amounts have been reclassified to be consistent with the current presentation.

Our accounting policies are in accordance with generally accepted accounting principles in the United States of America. The preparation of financial statements in conformity with these accounting principles requires us to make estimates and assumptions that affect:

- the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements; and
- the reported amounts of revenue and expenses during the reporting period.

Ultimate results could differ from our estimates.

In our opinion, the condensed consolidated financial statements included herein contain all adjustments necessary to present fairly our financial position as of September 30, 2004, the results of our operations for the three and nine months ended September 30, 2004 and 2003, and our cash flows for the nine months ended September 30, 2004 and 2003. Such adjustments are of a normal recurring nature. The results of operations for the nine months ended September 30, 2004 and 2003 may not be indicative of results for the full year.

Note 2. Long-Term Construction Contracts

The amounts of unapproved claims included in determining the profit or loss on contracts and the amounts of unapproved claims recorded for the three and nine months ended September 30, 2004 are as follows:

	Total Probable Unapproved Claims (included in determining contract profit or loss)		Probable Unapproved Claims Accrued Revenue (unbilled work on uncompleted contracts)	
(Millions of dollars)	Three Months Ended September 30, 2004	Nine Months Ended September 30, 2004	Three Months Ended September 30, 2004	Nine Months Ended September 30, 2004
Beginning balance	$ 262	$ 233	$ 261	$ 225
Additions	-	143	-	141
Claims resolved	(57)	(92)	(57)	(86)
Costs incurred during period	-	-	-	3
Other	(28)	(107)	(28)	(107)
Ending balance	$ 177	$ 177	$ 176	$ 176

The probable unapproved claims as of September 30, 2004 relate to six contracts, most of which are complete or substantially complete. Approximately 69% of these claims are with one customer. We are actively engaged in claims negotiations with our customers. The decrease in probable unapproved claims for the three months ended September 30, 2004 is a result of efforts to settle older contract issues that have reduced our exposure on claims, unapproved change orders, and liquidated damages. The change in probable unapproved claims for the nine months ended September 30, 2004 also reflects the terms of an October 2004 agreement in principle with Petroleo Brasilero SA (Petrobras). If implemented, this agreement would resolve outstanding issues regarding the Barracuda-Caratinga project (see Note 3). The December 31, 2 003 probable unapproved claims related to the Barracuda-Caratinga project of $114 million was reduced to $78 million and reclassified as an unapproved change order as a result of the April 2004 agreement in principle, replaced by an October 2004 agreement in principle with Petrobras. The change in probable unapproved claims in the nine months ended September 30, 2004 also included a $76 million reclassification from unapproved change orders for two projects for a single customer that is disputing the pricing of previously agreed-upon scope changes.

We have contracts with probable unapproved claims that will likely not be settled within one year totaling $122 million at September 30, 2004 and $204 million at December 31, 2003 included in the table above, which are reflected as “Other assets” on the condensed consolidated balance sheets. Other probable unapproved claims that we believe will be settled within one year included in the table above have been recorded to “Unbilled work on uncompleted contracts” included in the “Total receivables” amount on the condensed consolidated balance sheets. We have other contracts for which we are negotiating change orders to the contract scope and have agreed upon the scope of work but not the price. Including the $78 million related to the Barracuda-Caratinga project, these change orders amou nt to $102 million at September 30, 2004. Unapproved change orders at December 31, 2003 were $97 million.

Our unconsolidated related companies include probable unapproved claims as revenue to determine the amount of profit or loss for their contracts. Probable unapproved claims from our related companies are included in “Equity in and advances to related companies,” and our share totaled $54 million at September 30, 2004 and $10 million at December 31, 2003. Over 84% of these claims at September 30, 2004 are with one customer. In addition, our unconsolidated related companies are negotiating change orders to the contract scope where we have agreed upon the scope of work but not the price. Our share of these change orders totaled $41 million at September 30, 2004 and $59 million at December 31, 2003.

Note 3. Barracuda-Caratinga Project

In June 2000, Kellogg Brown & Root, Inc. (Kellogg Brown & Root) entered into a contract with Barracuda & Caratinga Leasing Company B.V., the project owner, to develop the Barracuda and Caratinga crude oilfields, which are located off the coast of Brazil. The construction manager and project owner's representative is Petrobras, the Brazilian national oil company. When completed, the project will consist of two converted supertankers, Barracuda and Caratinga, which will be used as floating production, storage, and offloading units, commonly referred to as FPSOs. In addition, there will be 32 hydrocarbon production wells, 22 water injection wells, and all subsea flow lines, umbilicals, and risers necessary to connect the underwater wells to the FPSOs. The original completion date for the Barracuda vessel was December 2003, and the original completion date for the Caratinga vessel was April 2004. The project is significantly behind the original schedule, due in part to change orders from the project owner, and is in a financial loss position.

In October 2004, the Barracuda vessel was moved offshore for sea trials and final inspections. We expect the Caratinga vessel to begin sea trials and final inspections in December 2004. Pursuant to the October 2004 agreement in principle with Petrobras described below, the Barracuda vessel must be completed by March 31, 2006, and the Caratinga vessel must be completed by June 30, 2006. However, there can be no assurance that further delays will not occur.

Our performance under the contract is secured by:

- performance letters of credit, which together have available credit of approximately $272 million as of September 30, 2004 and represent approximately 10% of the contract amount, as amended to date by change orders;
- retainage letters of credit, which together have available credit of approximately $189 million as of September 30, 2004 and which will increase in order to continue to represent 10% of the cumulative cash amounts paid to us; and
- a guarantee of Kellogg Brown & Root's performance under the agreement by Halliburton Company in favor of the project owner.

In October 2004, Kellogg Brown & Root and Petrobras, on behalf of the project owner, entered into a nonbinding agreement in principle. The October 2004 agreement in principle replaces an April 2004 agreement in principle, is the basis for settlement of the various claims between the parties, and would amend existing agreements. Implementation of the agreement in principle requires final approval of the board of directors of Petrobras and Halliburton, the project lenders, and possibly the bankruptcy court that confirmed our proposed plan of reorganization. Discussions among all parties, including the project lenders, are underway. The October 2004 agreement in principle provides for:

- the release of all claims of all parties that arise prior to the effective date of a final definitive agreement;
- the payment to us of $78 million as a result of change orders for remaining claims;
- payment by Petrobras of applicable value added taxes on the project, except for $8 million which has been paid by us;
- the performance by Petrobras of certain work under the original contract;
- the repayment on December 7, 2004 by Kellogg Brown & Root of a portion of $300 million of advance payments, without interest; and
- revised milestones and other dates, including settlement of liquidated damages and an extension of time to the FPSO final acceptance dates.

While negotiations are proceeding to reach a final agreement based on the provisions of the October 2004 agreement in principle, there can be no guarantee that an agreement will be achieved.

In the first quarter of 2004, we recorded a charge of $97 million resulting from the April 2004 agreement in principle with Petrobras, as well as adjustments to our estimates of costs expected to be incurred to complete the project. In June 2004, we recorded additional operating losses on our Barracuda-Caratinga project of approximately $310 million. The additional charge resulted from a detailed review of the project indicating higher cost estimates, schedule delays, and increased contingencies for the balance of the project until completion. Specifically, in the second quarter, with the integration phase of the Barracuda vessel we experienced a significant reduction in productivity and rework required from the vessel conversion. We took steps to mobilize more resources including specialized management personnel in both Houston and South America to oversee the final stages of the project. We conducted additional cost and schedule reviews of the remaining project activities, and we initiated several work process changes in an attempt to expedite work on the project.

As of September 30, 2004:

- the project was approximately 90% complete;
- we have recorded an inception-to-date pretax loss of $762 million related to the project, of which $310 million was recorded in the second quarter of 2004; $97 million was recorded in the first quarter of 2004; $238 million was recorded in 2003 ($55 million during the first quarter of 2003, $173 million during the second quarter of 2003 and $10 million in the fourth quarter of 2003); and $117 million was recorded in 2002;
- the losses recorded include an estimated $24 million in liquidated damages based on the October 2004 agreement in principle; and
- the probable unapproved claims were reduced from $114 million at December 31, 2003 to zero based upon the October 2004 agreement in principle.

Default provisions. In the event that we were determined to be in default under the contract, and if the project was not completed by us as a result of our default, the project owner may seek direct damages. Those damages could include completion costs in excess of the contract price and interest on borrowed funds, but would exclude consequential damages. The total damages could be up to $500 million plus the return of up to $300 million in advance payments previously received by us to the extent they have not been repaid. A termination of the contract by the project owner could have a material adverse effect on our financial condition and results of operations.

Cash flow considerations. The project owner has procured project finance funding obligations from various lenders to finance the payments due to us under the contract. In addition, the project financing includes borrowing capacity in excess of the original contract amount.

Under the loan documents, the availability date for loan draws expired December 1, 2003 and, therefore, the project owner drew down all remaining available funds on that date. As a condition to the draw-down of the remaining funds, the project owner was required to escrow the funds for the exclusive use of paying project costs. The availability of the escrowed funds can be suspended by the lenders if applicable conditions are not met. With limited exceptions, these funds may not be paid to Petrobras or its subsidiary, which is funding the drilling costs of the project, until all amounts due to us, including amounts due for the change orders as agreed in the October 2004 agreement in principle, are liquidated and paid. While this potentially reduces the risk that the funds would not be available for payment to us, we are not party to the arrangement between the lenders and the project owner and can give no assurance that there will be adequate funding to cover current or future claims and change orders.

We have now begun to fund operating cash shortfalls on the project and are obligated to fund total shortages over the remaining project life. That funding level assumes that, pursuant to amended project agreements implementing the October 2004 agreement in principle, neither we nor the project owner recover additional claims against the other. Estimated cash flows relating to the losses are as follows:

(Millions of dollars)		
Amount funded through September 30, 2004	$	330
Amount expected to be funded during the remainder of 2004, including repayment of a portion of $300 million advance payments		262
Amount expected to be funded during 2005		170
Total cash shortfalls	$	762

Note 4. Acquisitions and Dispositions

Surface Well Testing. In August 2004, we sold our Surface Well Testing and Subsea Test Tree operations within our Production Optimization segment to Power Well Service Holdings, LLC, an affiliate of First Reserve Corporation, for approximately $129 million, of which we received $126 million in cash. In the third quarter of 2004, we recorded a $40 million gain on the sale. However, for a limited period of time, we continue to have significant involvement with portions of these operations in certain countries and, therefore, have not recognized all the gain from the sale as of September 30, 2004. We expect to recognize substantially all the remaining gain in the fourth quarter of 2004.

Enventure and WellDynamics. In the first quarter of 2004, Halliburton and Shell Technology Ventures (Shell, an unrelated party) agreed to restructure two joint venture companies, Enventure Global Technologies LLC (Enventure) and WellDynamics B.V. (WellDynamics), in an effort to more closely align the ventures with near-term priorities in the core businesses of the venture owners. Prior to this transaction, Enventure (part of our Fluids segment) and WellDynamics (formerly part of our Landmark and Other Energy Services segment) were owned equally by Shell and us. Shell acquired an additional 33.5% of Enventure, leaving us with 16.5% ownership in return for enhanced and extended agreements and licenses with Shell for its Poroflex™ expandable sand screens and a distribution agreement for its Versaflex™ expandable liner hangers. As a result of this transaction, we changed the way we account for our ownership in Enventure from the equity method to the cost method of accounting for investments. We acquired an additional 1% of WellDynamics from Shell, giving us 51% ownership and control of day-to-day operations. In addition, Shell received an option to obtain our remaining interest in Enventure for an additional 14% interest in WellDynamics. No gain or loss resulted from the transaction. Beginning in the first quarter of 2004, WellDynamics was consolidated and is now included in our Production Optimization segment. The consolidation of WellDynamics resulted in an increase to our goodwill of $109 million, which was previously carried as equity method goodwill in "Equity in and advances to related companies."

Halliburton Measurement Systems. In May 2003, we sold certain assets of Halliburton Measurement Systems, which provides flow measurement and sampling systems, to NuFlo Technologies, Inc. for approximately $33 million in cash, subject to post-closing adjustments. The gain on the sale of Halliburton Measurement Systems' assets was $24 million and is included in our Production Optimization segment.

Wellstream. In March 2003, we sold the assets relating to our Wellstream business, a global provider of flexible pipe products, systems, and solutions, to Candover Partners Ltd. for $136 million in cash. The assets sold included manufacturing plants in Newcastle upon Tyne, United Kingdom, and Panama City, Florida, as well as assets and contracts in Brazil. In addition, Wellstream had $34 million in goodwill recorded at the disposition date. The transaction resulted in a loss of $15 million, which is included in our Landmark and Other Energy Services segment. Included in the loss is the write-off of the cumulative translation adjustment related to Wellstream of approximately $9 million.

Mono Pumps. In January 2003, we sold our Mono Pumps business to National Oilwell, Inc. The sale price of approximately $88 million was paid with $23 million in cash and 3.2 million shares of National Oilwell, Inc. common stock, which were valued at $65 million on January 15, 2003. We recorded a gain of $36 million on the sale in the first quarter of 2003, which was included in our Drilling and Formation Evaluation segment. Included in the gain was the write-off of the cumulative translation adjustment related to Mono Pumps of approximately $5 million. In February 2003, we sold 2.5 million of our 3.2 million shares of National Oilwell, Inc. common stock for $52 million, which resulted in a gain of $2 million, and in February 2004, we sold the remaining shares for $20 million, resulting in a gain of $6 million. These gains were recorded in "Other, net."

Note 5. Business Segment Information

Our five business segments are organized around how we manage the business: Drilling and Formation Evaluation, Fluids, Production Optimization, Landmark and Other Energy Services, and the Engineering and Construction Group or "KBR." We sometimes refer to the combination of our Drilling and Formation Evaluation, Fluids, Production Optimization, and Landmark and Other Energy Services segments as the Energy Services Group.

During the first quarter of 2004, the results of WellDynamics were moved from the Landmark and Other Energy Services segment to the Production Optimization segment, and prior year segment information has been restated.

The table below presents information on our continuing operations business segments.

(Millions of dollars)	Three Months Ended September 30 2004	Three Months Ended September 30 2003	Nine Months Ended September 30 2004	Nine Months Ended September 30 2003
Revenue:				
Drilling and Formation Evaluation	$ 450	$ 433	$ 1,317	$ 1,226
Fluids	618	510	1,707	1,508
Production Optimization	886	726	2,391	2,045
Landmark and Other Energy Services	154	136	413	417
Total Energy Services Group	2,108	1,805	5,828	5,196
Engineering and Construction Group	2,682	2,343	9,437	5,611
Total	$ 4,790	$ 4,148	$ 15,265	$ 10,807
Operating income (loss):				
Drilling and Formation Evaluation	$ 62	$ 45	$ 164	$ 160
Fluids	113	55	250	178
Production Optimization	222	118	425	298
Landmark and Other Energy Services	17	(48)	60	(51)
Total Energy Services Group	414	170	899	585
Engineering and Construction Group	(50)	49	(342)	(118)
General corporate	(22)	(15)	(66)	(50)
Total	$ 342	$ 204	$ 491	$ 417

Intersegment revenue is immaterial. Our equity in pretax earnings and losses of unconsolidated affiliates that are accounted for on the equity method is included in revenue and operating income of the applicable segment.

Total revenue for the three and nine months ended September 30, 2004 included $1.6 billion and $6.1 billion, or 34% and 40% of consolidated revenue, from the United States Government, which were derived almost entirely from our Engineering and Construction Group. Revenue from the United States Government during the three and nine months ended September 30, 2003 represented 27% and 16% of consolidated revenue. No other customer represented more than 10% of consolidated revenue in any period presented.

Note 6. Receivables

In April 2004, the expiration date for our Energy Services Group accounts receivable securitization facility was extended to April 2005. We have the ability to sell up to $300 million under this facility. As of September 30, 2004, we had sold $256 million undivided ownership interest to unaffiliated companies.

In May 2004, we entered into an agreement to sell, assign, and transfer the entire title and interest in specified United States government accounts receivable of KBR to a third party. The face value of the receivables sold to the third party is reflected as a reduction of accounts receivable in our condensed consolidated balance sheets. The amount of receivables which can be sold under the agreement varies based on the amount of eligible receivables at any given time and other factors, and the maximum amount that may be sold and outstanding under this agreement at any given time is $650 million. The total amount of receivables outstanding under this agreement as of September 30, 2004 was approximately $202 million. Subsequent to the third quarter of 2004, these receivables were collected and the balance retired, and we are not currently selling further receivables, although the facility continues to be available.

Note 7. Inventories

Inventories are stated at the lower of cost or market. We manufacture in the United States finished products and parts inventories for drill bits, completion products, bulk materials, and other tools that are recorded using the last-in, first-out method totaling $40 million at September 30, 2004 and $38 million at December 31, 2003. If the average cost method had been used, total inventories would have been $17 million higher than reported at both September 30, 2004 and at December 31, 2003.

Inventories at September 30, 2004 and December 31, 2003 consisted of the following:

(Millions of dollars)	September 30 2004	December 31 2003
Finished products and parts	$ 530	$ 503
Raw materials and supplies	162	159
Work in process	49	33
Total	$ 741	$ 695

Finished products and parts are reported net of obsolescence accruals of $113 million at September 30, 2004 and $117 million at December 31, 2003.

Note 8. Restricted Cash

At September 30, 2004, we had restricted cash of $280 million, which primarily consists of:

- $144 million for the amount of prepetition liabilities that have been paid, as ordered by the bankruptcy court to be set aside subsequent to December 2003, as part of the DII Industries, LLC (DII Industries) and Kellogg Brown & Root reorganization proceedings. At the time the plan of reorganization becomes final and nonappealable, the cash will become unrestricted. This amount is included in “Other current assets”;
- $97 million as collateral for potential future insurance claim reimbursements, included in “Other assets”; and
- $35 million ($23 million in “Other assets” and $12 million in “Other current assets”) primarily related to cash collateral agreements for outstanding letters of credit for various construction projects.

At December 31, 2003, we had restricted cash of $159 million in “Other current assets” and $100 million in “Other assets,” which consisted of similar items as above.

Note 9. Property, Plant, and Equipment

In the second quarter of 2004, we implemented a change in accounting estimate to more accurately reflect the useful life of some of the tools of our Drilling and Formation Evaluation segment. This resulted in a combined $24 million reduction in depreciation expense in the second and third quarters of 2004, thereby reducing our consolidated net loss by $15 million, or $0.03 per share, for the nine months ended September 30, 2004. We extended the useful lives of these tools based on our review of their service lives, technological improvements in the tools, and recent changes to our repair and maintenance practices which helped to extend the lives.

Note 10. Comprehensive Income

The components of other comprehensive income (loss) adjustments to net income (loss) included the following:

	Three Months Ended September 30		Nine Months Ended September 30	
(Millions of dollars)	2004	2003	2004	2003
Net income (loss)	$ (44)	$ 58	$ (776)	$ 127
Cumulative translation adjustment, net of tax	(6)	1	(3)	13
Realization of losses included in net income (loss)	-	-	-	15
Net cumulative translation adjustment, net of tax	(6)	1	(3)	28
Pension liability adjustments	-	-	-	(7)
Unrealized gains (losses) on investments and derivatives	17	1	5	2
Total comprehensive income (loss)	$ (33)	$ 60	$ (774)	$ 150

Accumulated other comprehensive income consisted of the following:

(Millions of dollars)	September 30 2004	December 31 2003
Cumulative translation adjustments	$ (66)	$ (63)
Pension liability adjustments	(245)	(245)
Unrealized gains (losses) on investments and derivatives	15	10
Total accumulated other comprehensive income	$ (296)	$ (298)

Note 11. Debt

Senior notes due 2007. On January 26, 2004, we issued $500 million aggregate principal amount of senior notes due 2007 bearing interest at a floating rate equal to three-month LIBOR plus 0.75%, payable quarterly. On January 26, 2005, or on any interest payment date thereafter, we have the option to redeem all or a portion of the outstanding notes.

WellDynamics revolving credit line. Upon consolidation of WellDynamics in the first quarter of 2004, our long-term debt included an advance on a revolving credit line with Shell, which is the minority interest holder of WellDynamics, in the amount of $27 million due April 30, 2005 and bearing interest at a floating rate equal to three-month LIBOR plus 3.25%, payable quarterly. As of September 30, 2004, the $27 million balance was classified as current maturities of long-term debt in our condensed consolidated balance sheet. There was no remaining unused commitment under this WellDynamics revolving credit line. This line of credit contains no working capital or dividend restrictions. Under the terms of the agreement, we may, during the period of 30 days immediately preceding the end of the commitment period, request the lenders to extend the availability of the facility for a further period of 364 days from the date of our request.

Chapter 11-related financing activities. The delayed-draw term facility we entered into in the fourth quarter of 2003 expired on June 30, 2004. In the second quarter of 2004, we charged to discontinued operations $11 million in capitalized fees associated with entering into the delayed-draw term facility.

In July 2004, we entered into a $500 million 364-day revolving credit facility for general working capital purposes with terms substantially similar to our $700 million three-year revolving credit facility. The interest rates applicable to these facilities are variable and the borrowings under the revolving credit facilities will be secured by some of our assets until final and nonappealable confirmation of our proposed plan of reorganization is received and our long-term senior unsecured debt is rated BBB or higher (stable outlook) by Standard & Poor’s and Baa2 or higher (stable outlook) by Moody’s Investors Service.

In September 2004, we issued a letter of credit for approximately $172 million under our $700 million three-year revolver to replace an expiring letter of credit for our Barracuda-Caratinga project, which reduced our availability under the revolver to $528 million. As of September 30, 2004, no cash had been drawn under the $500 million 364-day revolving credit facility or the $700 million three-year revolving credit facility.

Note 12. Asbestos and Silica Obligations and Insurance Recoveries

Summary

Several of our subsidiaries, particularly DII Industries and Kellogg Brown & Root have been named as defendants in a large number of asbestos- and silica-related lawsuits. The plaintiffs allege injury primarily as a result of exposure to:

- asbestos used in products manufactured or sold by former divisions of DII Industries (primarily refractory materials, gaskets, and packing materials used in pumps and other industrial products);
- asbestos in materials used in the construction and maintenance projects of Kellogg Brown & Root or its subsidiaries; and
- silica related to sandblasting and drilling fluids operations.

We have substantial insurance to reimburse us for portions of the costs of judgments, settlements, and defense costs for these asbestos and silica personal injury claims. Since 1976, approximately 702,000 asbestos personal injury claims have been filed against us and approximately 240,000 of these claims have been closed through settlements in court proceedings at a total cost of approximately $232 million. Almost all of these claims have been made in separate lawsuits in which we are named as a defendant along with a number of other defendants, often exceeding 100 unaffiliated defendant companies in total. In 2001, we were subject to several large adverse judgments in trial court proceedings. At September 30, 2004, approximately 462,000 asbestos claims were open, and we anticipate resolving all open and future cl aims in the prepackaged Chapter 11 proceedings of DII Industries, Kellogg Brown & Root, and our other affected subsidiaries, which were filed on December 16, 2003. The first and second tables that follow summarize the various charges we have incurred during the three and nine months ended September 30, 2004 and 2003. The third table presents a rollforward of our asbestos- and silica-related liabilities and insurance receivables.

	Three Months Ended September 30			
	2004		2003	
(Millions of dollars)	Continuing Operations	Discontinued Operations	Continuing Operations	Discontinued Operations
Asbestos and silica charges:				
59.5 million shares revaluation	$ -	$ 245	$ -	$ -
Federal-Mogul partitioning agreement	-	43	-	-
Insurance receivable write-down	-	6	-	-
Revaluation of silica note	-	3	-	-
Accretion	-	(11)	-	-
Subtotal	-	286	-	-
Asbestos- and silica-related costs:				
Harbison-Walker matters	-	-	-	10
Professional fees	-	12	-	11
Cash in lieu of interest	-	1	-	10
Other costs	-	1	1	-
Subtotal	-	14	1	31
Pretax asbestos and silica charges	-	300	1	31
Tax (benefit) provision	-	(71)	-	3
Total asbestos and silica charges, net of tax (benefit) provision	$ -	$ 229	$ 1	$ 34

	Nine Months Ended September 30			
	2004		2003	
(Millions of dollars)	Continuing Operations	Discontinued Operations	Continuing Operations	Discontinued Operations
Asbestos and silica charges:				
59.5 million shares revaluation	$ -	$ 435	$ -	$ -
Federal-Mogul partitioning agreement	-	43	-	-
Insurance receivable write-down	-	686	-	-
Revaluation of the silica note	-	3	-	-
Accretion	-	(11)	-	-
Subtotal	-	1,156	-	-
Asbestos- and silica-related costs:				
Harbison-Walker matters	-	-	-	40
Professional fees	-	20	-	30
Cash in lieu of interest	-	6	-	25
Other costs	-	14	3	-
Subtotal	-	40	3	95
Pretax asbestos and silica charges	-	1,196	3	95
Tax benefit	-	(217)	(1)	(28)
Total asbestos and silica charges, net of tax benefit	$ -	$ 979	$ 2	$ 67

(Millions of dollars)		
Asbestos- and silica-related liabilities:		
December 31, 2003 balance (of which $2,507 was current)	$	4,086
59.5 million shares revaluation		435
Federal-Mogul partitioning agreement		43
Harbison-Walker payment		(119)
Revaluation of the silica note		3
Other		(4)
Asbestos- and silica-related liabilities September 30, 2004 balance (of which $2,415 was current)	$	4,444
Insurance for asbestos- and silica-related liabilities:		
December 31, 2003 balance (of which $96 was current)	$	(2,134)
Insurance settlement write-down		686
Accretion		(11)
Other		6
Insurance for asbestos- and silica-related liabilities September 30, 2004 balance (of which $965 was current)	$	(1,453)

Prepackaged Chapter 11 proceedings and recent insurance developments

Prepackaged Chapter 11 proceedings. DII Industries, Kellogg Brown & Root, and six other subsidiaries filed Chapter 11 proceedings on December 16, 2003 in bankruptcy court in Pittsburgh, Pennsylvania. With the filing of the Chapter 11 proceedings and entry of an order of the bankruptcy court, all asbestos and silica personal injury claims and related lawsuits against Halliburton and our affected subsidiaries were stayed. See Note 13 for more information.

Our subsidiaries sought Chapter 11 protection to avail themselves of the provisions of Sections 524(g) and 105 of the Bankruptcy Code which may be used to discharge current and future asbestos and silica personal injury claims against us and our subsidiaries. Upon the entry of a final and nonappealable order confirming the plan of reorganization, current and future asbestos and silica personal injury claims against us and our affiliates will be channeled into trusts established for the benefit of asbestos and silica claimants, thus releasing Halliburton and its affiliates from those claims.

A prepackaged Chapter 11 proceeding is one in which a debtor seeks approval of a plan of reorganization from affected creditors before filing for Chapter 11 protection. Prior to proceeding with the Chapter 11 filing, our affected subsidiaries solicited acceptances to a proposed plan of reorganization from known present asbestos and silica claimants. In the fourth quarter of 2003, valid votes were received from approximately 364,000 asbestos claimants and approximately 21,000 silica claimants, representing substantially all known claimants. Of the votes validly cast, over 98% of voting asbestos claimants and over 99% of voting silica claimants voted to accept the proposed plan of reorganization, meeting the voting requirements of Chapter 11 of the Bankruptcy Code for approval of the proposed plan. The preapproved p roposed plan of reorganization was filed as part of the Chapter 11 proceedings.

On July 21, 2004, the bankruptcy court entered an order, effective as of July 16, 2004, confirming the plan of reorganization to implement our proposed asbestos and silica settlement. Despite an appeal by certain of our insurance companies, on July 26, 2004, the United States District Court for the Western District of Pennsylvania affirmed the confirmation order. On August 3, 2004, certain insurance companies filed a motion to vacate the District Court's affirmation order in order to protect their appeal rights. If our previously announced agreements in principle with insurance companies are finalized and approved by the relevant bankruptcy courts, the insurance companies have agreed to dismiss their appeals. Due to efforts being made by our affected subsidiaries to complete these settlements with, among othe rs, the insurance companies that appealed the confirmation order, the parties and the District Court agreed to stay the affirmation order. We have filed motions with the bankruptcy court to request approval of the settlement agreements with substantially all of our insurance companies, and the bankruptcy court has agreed to consider the motions at a hearing scheduled for November 18, 2004. The insurance companies have agreed to join us in support of the motions. If the settlements with the insurance companies are approved by the relevant bankruptcy courts and the conditions to such settlements are satisfied, then we anticipate all appeals will be withdrawn. The affirmation order (and thus the plan of reorganization) will be final and nonappealable within 30 days after either the District Court favorably adjudicates the appeals or the appeals are withdrawn and the stay of the affirmation order is vacated.

The plan of reorganization, which is consistent with the definitive settlement agreements reached with our asbestos and silica personal injury claimants in early 2003, provides that, if and when an order confirming the proposed plan of reorganization becomes final and nonappealable, the following will be contributed to trusts for the benefit of current and future asbestos and silica personal injury claimants:

- approximately $2.3 billion in cash;
- 59.5 million shares of Halliburton common stock;
- a one-year non-interest-bearing note of $31 million for the benefit of asbestos claimants;
- a silica note with an initial payment into a silica trust of $15 million. Subsequently, the note provides that we will contribute an amount to the silica trust balance at the end of each year for the next 30 years to bring the silica trust balance to $15 million, $10 million, or $5 million based upon a formula which uses average yearly disbursements from the trust to determine that amount. The note also provides for an extension of the note for 20 additional years under certain circumstances. We have estimated the amount of this note to be approximately $24 million. We will periodically reassess our valuation of this note based upon our projections of the amounts we believe we will be required to fund into the silica trust; and
- insurance proceeds, if any, between $2.3 billion and $3.0 billion received by DII Industries and Kellogg Brown & Root. However, if the proposed settlements with our insurance companies are completed on the terms announced or proposed, insurance recoveries will not be contributed to the trusts.

We intend to fund the trusts no later than 30 days after the affirmation order becomes final and nonappealable.

In connection with reaching an agreement with representatives of asbestos and silica claimants to limit the cash required to settle pending claims to $2.775 billion, DII Industries paid $311 million to the claimants in December 2003. We also agreed to guarantee the payment of certain claims, and, in accordance with settlement agreements, we made additional payments of $119 million, plus an additional $4 million in lieu of interest, in June 2004. We may not be entitled to reimbursement for these payments if the proposed plan of reorganization does not become effective. We expect to pay an additional approximately $59 million in pending claims under these settlement agreements within 30 days after the plan of reorganizat ion becomes final and nonappealable.

Our plan of reorganization calls for a portion of our total asbestos and silica liability to be settled by contributing 59.5 million shares of Halliburton common stock into the trusts. We will adjust our asbestos and silica liability related to the shares if the average value of Halliburton common stock for the five days immediately prior to and including the end of each fiscal quarter has increased by 5% or more from the most recent valuation of the shares. As of September 30, 2004, we revalued our shares to approximately $2.0 billion ($33.48 per share), an increase of $435 million from December 31, 2003, of which $190 million was recorded in the first quarter of 2004 and $245 million was recorded in the third quarter of 2004. The value of the shares to be contributed was classified as a long-term liability on ou r condensed consolidated balance sheets, and the shares were not included in our calculation of basic or diluted earnings per share. If the shares had been included in the calculation as of the beginning of 2004, our diluted earnings per share from continuing operations would have been reduced by $0.05 for both the nine and three months ended September 30, 2004. When and if we receive final and nonappealable confirmation of our proposed plan of reorganization, we will:

- increase or decrease our asbestos and silica liability to value the 59.5 million shares of Halliburton common stock based on the value of Halliburton stock on the date of final and nonappealable confirmation of our proposed plan of reorganization;
- reclassify from a long-term liability to shareholders’ equity the final value of the 59.5 million shares of Halliburton common stock; and
- include the 59.5 million shares in our calculations of earnings per share on a prospective basis.

We understand that the United States Congress may consider adopting legislation that would establish a national trust fund as the exclusive means for recovery for asbestos-related disease. We are uncertain as to what contributions we would be required to make to a national trust, if any, although it is possible that they could be substantial and that they could continue for several years. Our level of participation in and contribution to a national trust could be greater or less than it otherwise would have been as a result of having subsidiaries that have filed Chapter 11 proceedings due to asbestos liability.

Recent insurance developments. In January 2004, we reached a comprehensive agreement with Equitas to settle our insurance claims against certain underwriters at Lloyd’s of London, reinsured by Equitas. The settlement, if all conditions precedent are satisfied, will resolve all asbestos-related claims made against Lloyd’s underwriters by us, including those made by our subsidiaries affected by the Chapter 11 proceedings. Provided that the confirmation order becomes final and nonappealable and the current United States Congress does not pass national asbestos litigation reform legislation before January 5, 2005, Equitas will pay us $575 million, representing approximately 60% of the applicable limits of liab ility that we believe DII Industries had substantial likelihood of recovering from Equitas. The first payment of $500 million, which is classified as a current receivable as of September 30, 2004, will occur within 15 working days of the later of January 5, 2005 or the date on which the confirmation order becomes final and nonappealable. A second payment of $75 million will be made 18 months after the first payment.

In May 2004, we entered into nonbinding agreements in principle with representatives of the London Market insurance companies that, if implemented, would settle insurance disputes with substantially all the solvent London Market insurance companies for asbestos- and silica-related claims and all other claims under the applicable insurance policies and terminate all the applicable insurance policies. The agreements in principle with the London Market insurance companies are subject to board of directors’ approval of all parties, agreement by all remaining London Market insurance companies, and an order by the bankruptcy court confirming the plan of reorganization that has become final and nonappealable. Currently, we expect to receive cash payments during the years of 2005 through 2009.

We also have entered into agreements in principle with certain of our insolvent London Market insurance companies and with our solvent domestic insurance companies that, if implemented, would settle asbestos- and silica-related claims and all other claims under the applicable insurance policies and terminate all the applicable insurance policies. We are currently drafting the final settlement agreements with our insurers. The final settlement agreements with our remaining insurance companies would be subject to board of directors' approval of all parties, an order by the bankruptcy court approving the final settlement agreements, approval by the Federal-Mogul bankruptcy court (see "Federal-Mogul" below), approval by certain other parties, and our confirmation order becoming final and nonappealable.< /FONT>

These proposed settlements with our insurance companies are subject to numerous conditions, similar to the conditions of the Equitas settlement, including the condition that the United States Congress does not pass national asbestos litigation reform legislation before January 5, 2005. Although we are working toward implementation of these proposed settlements, there can be no assurance that the transactions contemplated by these agreements in principle can be completed on the terms announced.

Under the terms of our announced insurance settlements and proposed insurance settlements, we expect to receive cash proceeds with a nominal amount of approximately $1.5 billion and with a present value of approximately $1.4 billion for our asbestos- and silica-related insurance receivables. The present value was determined by discounting the expected future cash payments with a discount rate implicit in the settlements which is approximately 5.5% related to the domestic insurance companies. Beginning in the third quarter of 2004, this discount is accreted as interest income (classified as discontinued operations) over the life of the expected future cash payments.

We have filed motions with the bankruptcy court to request approval of the settlement agreements with substantially all of our insurance companies, and the bankruptcy court has agreed to consider the motions at a hearing scheduled for November 18, 2004. The insurance companies have agreed to join us in support of the motions.

Our December 31, 2003 estimate of our asbestos- and silica-related insurance receivables already included the charge for the settlement amount under the Equitas agreement reached in January 2004, as well as certain other probable settlements with companies for which we could reasonably estimate the amount of the settlement. During 2004, we reduced the amount recorded as insurance receivables for asbestos- and silica-related liabilities insured by domestic companies based upon proposed agreements in principle, resulting in pretax charges to discontinued operations of approximately $686 million.

Other insurance matters

Harbison-Walker Chapter 11 proceedings. A large portion of our asbestos claims relate to alleged injuries from asbestos used in a small number of products manufactured or sold by Harbison-Walker Refractories Company, whose operations DII Industries acquired in 1967 and spun off in 1992. At the time of the spin-off, Harbison-Walker assumed liability for asbestos claims filed after the spin-off, and it agreed to defend and indemnify DII Industries from liability for those claims, although DII Industries continues to have direct liability to tort claimants for all post-spin-off refractory asbestos claims. DII Industries retained responsibility for all asbestos claims pending as of the date of the spin-off. The agreemen t governing the spin-off provided that Harbison-Walker would have the right to access DII Industries' historic insurance coverage for the asbestos-related liabilities that Harbison-Walker assumed in the spin-off.

In July 2001, DII Industries determined that the demands that Harbison-Walker was making on the shared insurance policies were not acceptable to DII Industries and that Harbison-Walker probably would not be able to fulfill its indemnification obligations to DII Industries. Accordingly, DII Industries took up the defense of unsettled post-spin-off refractory claims that name it as a defendant in order to prevent Harbison-Walker from unnecessarily eroding the insurance coverage both companies access for these claims.

On February 14, 2002, Harbison-Walker filed a voluntary petition for reorganization under Chapter 11 of the Bankruptcy Code. In its initial Chapter 11 filings, Harbison-Walker stated it would seek to utilize Sections 524(g) and 105 of the Bankruptcy Code to propose and seek confirmation of a plan of reorganization that would provide for distributions for all legitimate pending and future asbestos and silica claims asserted directly against Harbison-Walker or asserted against DII Industries. In order to protect the shared insurance from dissipation, DII Industries began to assist Harbison-Walker in its Chapter 11 proceedings as follows:

- on February 14, 2002, DII Industries paid $40 million to Harbison-Walker's United States parent holding company, RHI Refractories Holding Company (RHI Refractories);
- DII Industries agreed to provide up to $35 million in debtor-in-possession financing to Harbison-Walker ($5 million was paid in 2002 and the remaining $30 million was paid in 2003); and
- during 2003, DII Industries purchased $50 million of Harbison-Walker's outstanding insurance receivables, of which $10 million were estimated to be uncollectible.

In 2003, DII Industries entered into a definitive agreement with Harbison-Walker. This agreement was approved by the Harbison-Walker bankruptcy court on December 4, 2003. Under the terms of this agreement, once our plan of reorganization is final, all asbestos and silica personal injury claims against Harbison-Walker and certain of its affiliates will be channeled into trusts created in our bankruptcy proceedings. Our asbestos and silica obligations and related insurance recoveries recorded as of September 30, 2004 and December 31, 2003 reflect the terms of this definitive agreement.

In the first quarter of 2004, we entered into an agreement with RHI Refractories to settle remaining funding issues relating to Harbison-Walker. The agreement calls for a $10 million payment to RHI Refractories and a $1 million payment to our asbestos and silica trusts on behalf of RHI Refractories. These amounts were expensed during 2003. These payments will be made shortly after the effective date of the plan of reorganization of DII Industries, Kellogg Brown & Root and other subsidiaries.

London-based insurance companies. Equitas and other London-based companies have attempted to impose more restrictive documentation requirements on DII Industries and its affiliates than are currently required under existing coverage-in-place agreements related to certain asbestos claims. Coverage-in-place agreements are settlement agreements between policyholders and the insurance companies specifying the terms and conditions under which coverage will be applied as claims are presented for payment. These agreements in an asbestos claims context govern such things as what events will be deemed to trigger coverage, how liability for a claim will be allocated among insurance companies, and what procedures the policyhol der must follow in order to obligate the insurer to pay claims. These insurance companies stated that the new restrictive requirements are part of an effort to limit payment of settlements to claimants who are truly impaired by exposure to asbestos and can identify the product or premises that caused their exposure.

DII Industries is a plaintiff in two lawsuits against a number of London-based insurance companies asserting DII Industries' rights under an existing coverage-in-place agreement and under insurance policies not yet subject to coverage-in-place agreements. DII Industries believes that the more restrictive documentation requirements are inconsistent with the current coverage-in-place agreements and are unenforceable. The insurance companies that DII Industries has sued continue to pay larger claim settlements where the more restrictive documentation is obtained or where court judgments are entered. Likewise, they continue to pay previously agreed amounts of defense costs that DII Industries incurs defending claims.

In light of the bankruptcy court's approval of our settlement agreement with Equitas, we have dismissed Equitas from the cases that we filed against them. If, however, the conditions precedent to payment are not satisfied, we have the right to re-file these cases against Equitas. If our agreements in principle with the solvent London Market insurance companies are finalized and become effective, all of our lawsuits with the various London Market insurance companies will be resolved.

Federal-Mogul. A significant portion of the insurance coverage applicable to Worthington Pump, a former division of DII Industries, is alleged by Federal-Mogul (and others who formerly were associated with Worthington Pump prior to its acquisition by DII Industries) to be shared with them. In 2001, Federal-Mogul and a large number of its affiliated companies filed a voluntary petition for reorganization under Chapter 11 of the Bankruptcy Code in the bankruptcy court in Wilmington, Delaware. In response to Federal-Mogul's allegations of shared insurance coverage, DII Industries filed a lawsuit on December 7, 2001 in Federal-Mogul's Chapter 11 proceedings asserting DII Industries' rights to asbestos ins urance coverage under historic general liability policies issued to McGraw-Edison Company, Studebaker-Worthington, Inc. and its predecessor. The parties to this litigation have agreed to mediate this dispute. A number of insurance companies who have agreed to coverage-in-place agreements with DII Industries have suspended payment under the shared Worthington Pump policies until the Federal-Mogul bankruptcy court resolves the insurance issues. Consequently, the effect of the Federal-Mogul Chapter 11 proceedings on DII Industries' rights to access this shared insurance has been uncertain. During the first quarter of 2004, we reached an agreement with Federal-Mogul which resolved all disputes regarding the insurance coverage provided by Equitas.

During October 2004, we reached an agreement in principle with Federal-Mogul, our insurance companies, and another party sharing in the insurance coverage to obtain their consent and support of a partitioning of the insurance policies. Under the terms of the agreement in principle, DII Industries would be allocated 50% of the limits of any applicable insurance policy, and the remaining 50% of limits of the insurance policies would be allocated to the remaining policyholders. As part of the settlement, DII Industries agreed to pay $46 million in three installment payments. The first payment of $16 million will be paid on the same day that DII Industries funds the asbestos and silica trusts. The second and third payments of $15 million each will occur on the first and second anniversaries from the date of the first payment. We are currently attempting to finalize this agreement in principle so that we may also finalize the settlements with the London Market insurance companies and the domestic insurance companies. If we are able to finalize this agreement in principle and the related agreements in principle with our solvent insurers, we will be able to dismiss all of our remaining insurance coverage lawsuits concerning asbestos-related and silica-related matters. In the third quarter of 2004, we accrued $43 million, which represents the present value of the $46 million to be paid. The discount will be accreted as interest expense (classified as discontinued operations) over the life of the expected future cash payments beginning in the fourth quarter of 2004.

Assuming that the agreement in principle with Federal-Mogul is finalized, DII Industries and Federal-Mogul agree to share equally in recoveries from insolvent London-based insurance companies. To the extent that Federal-Mogul's recoveries from certain insolvent London-based insurance companies received on or before January 1, 2006 do not equal at least $4.5 million, DII Industries agreed to also pay to Federal-Mogul the difference between their recoveries from the insolvent London-based insurance companies and $4.5 million. Any recoveries received by Federal-Mogul from the insolvent London-based insurance companies after January 1, 2006 will be reimbursed back to DII Industries until such time as DII Industries is fully reimbursed for the amount of the payment.

Excess insurance on construction claims. Kellogg Brown & Root does not have primary insurance coverage related to construction claims. However, excess insurance coverage policies with other insurance companies are in place. On March 20, 2002, Kellogg Brown & Root filed a lawsuit against the insurance companies that issued these excess insurance policies, seeking to establish the specific terms under which it can obtain reimbursement for costs incurred in settling and defending construction claims. Until this lawsuit is resolved, the scope of the excess insurance coverage will remain uncertain, and as such, we have not recorded any recoveries related to excess insurance coverage. If we are able to finalize ou r agreements in principle with our solvent insurance companies, we will also dismiss this lawsuit.

Other insurance matters. In the event that we finalize all of the agreements in principle with our insurance companies and the other relevant third parties, we will still continue to pursue our insurance rights against certain insolvent domestic insurance companies, such as Highlands Insurance Company (under insurance policies that were issued to Dresser Industries, Inc. and certain of its predecessors), The Home Insurance Company, and certain insolvent London-based insurance companies.

Note 13. Chapter 11 Reorganization Proceedings

On December 16, 2003, the following wholly owned subsidiaries of Halliburton (collectively, the Debtors or Debtors-in-Possession) filed Chapter 11 proceedings in bankruptcy court in Pittsburgh, Pennsylvania:

- DII Industries, LLC;
- Kellogg Brown & Root, Inc.;
- Mid-Valley, Inc.;
- KBR Technical Services, Inc.;
- Kellogg Brown & Root Engineering Corporation;
- Kellogg Brown & Root International, Inc. (a Delaware corporation);
- Kellogg Brown & Root International, Inc. (a Panamanian corporation); and
- BPM Minerals, LLC.

On July 21, 2004, the bankruptcy court entered an order, effective as of July 16, 2004, confirming the plan of reorganization to implement our proposed asbestos and silica settlement. Despite an appeal by certain of our insurance companies, on July 26, 2004, the United States District Court for the Western District of Pennsylvania affirmed the confirmation order. On August 3, 2004, certain insurance companies filed a motion to vacate the District Court's affirmation order in order to protect their appeal rights. If our previously announced agreements in principle with our insurance companies are finalized and approved by the relevant bankruptcy courts, the insurance companies have agreed to dismiss their appeals. Due to efforts being made by our affected subsidiaries to complete these settlements with, among others, the insurance companies that appealed the confirmation order, the parties and the District Court agreed to stay the affirmation order. We have filed motions with the bankruptcy court to request approval of the settlement agreements with substantially all of our insurance companies, and the bankruptcy court has agreed to consider the motions at a hearing scheduled for November 18, 2004. The insurance companies have agreed to join us in support of the motions. If the settlements with the insurance companies are approved by the relevant bankruptcy courts and the conditions to such settlements are satisfied, then we anticipate all appeals will be withdrawn. The affirmation order (and thus the plan of reorganization) will be final and nonappealable within 30 days after either the District Court favorably adjudicates the appeals or the appeals are withdrawn and the stay of the affirmation order is vacated.

The affected subsidiaries will continue to be wholly owned by Halliburton Company under the proposed plan. Halliburton Company (the registrant), Halliburton's Energy Services Group, and Kellogg Brown & Root's government services businesses are not included in the Chapter 11 filing. Upon effectiveness of the plan of reorganization, current and future asbestos and silica personal injury claims filed against us and our subsidiaries will be channeled into trusts established under Sections 524(g) and 105 of the Bankruptcy Code for the benefit of claimants, thus releasing Halliburton and its affiliates from those claims.

Debtors-in-Possession financial statements. Under the Bankruptcy Code, we are required to periodically file with the bankruptcy court various documents, including financial statements of the Debtors-in-Possession. These financial statements are prepared according to requirements of the Bankruptcy Code. While these financial statements accurately provide information required by the Bankruptcy Code, they are unconsolidated, unaudited, and prepared in a format different from that used in our condensed consolidated financial statements filed under the securities laws and from that used in the condensed combined financial statements that follow. For example, the "Right to Halliburton shares" ar e currently adjusted to fair value periodically in the financial statements prepared for the bankruptcy court, but not in the condensed combined financial statements. Accordingly, we believe the substance and format of the financial statements prepared for the bankruptcy court do not allow meaningful comparison with the following condensed combined financial statements.

Basis of presentation. We continue to consolidate the Debtors in our condensed consolidated financial statements. While generally it is appropriate to deconsolidate a subsidiary during its Chapter 11 proceedings on the basis that control no longer rests with the parent, the facts and circumstances particular to our situation support the continued consolidation of these subsidiaries. Specifically:

- substantially all affected creditors have approved the terms of the plan of reorganization and related transactions;
- the entire duration of the Chapter 11 proceedings is likely to be short, excluding any potential appeals;
- the Debtors were solvent and filed Chapter 11 proceedings to resolve asbestos and silica claims rather than as a result of insolvency; and
- the plan of reorganization provides that we will continue to own 100% of the equity of the Debtors upon completion of the plan of reorganization. The plan of reorganization will not impact our equity ownership of the Debtors.

All reorganization items, including but not limited to all professional fees and provisions for losses, are included as discontinued operations in both our condensed consolidated financial statements and the condensed combined financial statements of the Debtors-in-Possession. During the first nine months of 2004, we recorded a total of $20 million as reorganization items, which consisted primarily of professional fees and $11 million of bridge loan fees, and disbursed $26 million in cash for reorganization items.

Furthermore, certain claims against the Debtors existing before the Chapter 11 filing are considered liabilities subject to compromise. The principal categories of claims subject to compromise included the following:

- $2.4 billion at September 30, 2004 and $2.5 billion at December 31, 2003 of current asbestos- and silica-related liabilities; and
- $2.0 billion at September 30, 2004 and $1.6 billion at December 31, 2003 of noncurrent asbestos- and silica-related liabilities.

Prior to the filing of the Chapter 11 proceedings, DII Industries was the parent for all Energy Services Group and KBR operations. As part of a prefiling corporate restructuring, immediately prior to the Chapter 11 filing, DII Industries distributed the Energy Services Group operations to Halliburton Company, while the operations of KBR continued to be conducted through subsidiaries of DII Industries. The condensed combined balance sheet as of December 31, 2003 of the Debtors-in-Possession was prepared as if this distribution had taken place as of January 1, 2003.

Debtors-in-Possession
Condensed Combined Statements of Operations
(Unaudited)
(Millions of dollars)

	Three Months Ended September 30, 2004	Nine Months Ended September 30, 2004
Revenue	$ 384	$ 1,314
Equity in losses of majority-owned subsidiaries	(199)	(224)
Total revenue	185	1,090
Operating costs and expenses	289	1,467
Operating loss	(104)	(377)
Nonoperating income	17	43
Loss from continuing operations before income taxes	(87)	(334)
Income tax (provision) benefit	(39)	43
Loss from continuing operations	(126)	(291)
Loss from discontinued operations, net of tax benefit of $73 and $219	(229)	(979)
Net loss	$ (355)	$ (1,270)

The subsidiaries of DII Industries that are not included in the Chapter 11 filing are presented in the condensed combined financial statements using the equity method of accounting. These subsidiaries had revenue of $2.5 billion and operating income of $49 million for the three months ended September 30, 2004 and revenue of $8.3 billion and operating income of $5 million for the nine months ended September 30, 2004. These subsidiaries had assets of $2.6 billion and liabilities of $2.6 billion as of September 30, 2004, and assets of $2.3 billion and liabilities of $2.3 billion as of December 31, 2003.

Debtors-in-Possession
Condensed Combined Balance Sheets
(Unaudited)
(Millions of dollars)

	September 30 2004	December 31 2003
Assets		
Current assets:		
Cash and equivalents	$ 67	$ 108
Receivables:		
Trade, net	142	191
Unbilled insurance for asbestos- and silica-related liabilities	873	-
Intercompany, net	52	50
Unbilled work on uncompleted contracts	151	60
Other, net	56	75
Total receivables, net	1,274	376
Inventories	20	23
Right to Halliburton shares (1)	1,547	1,547
Restricted cash - prepetition liability payments	144	37
Other current assets	54	43
Total current assets	3,106	2,134
Property, plant, and equipment, net	94	91
Goodwill, net	188	188
Investments in majority-owned subsidiaries	1,223	1,567
Insurance for asbestos- and silica-related liabilities	488	2,038
Noncurrent deferred income taxes	600	436
Other assets	326	257
Total assets	$ 6,025	$ 6,711
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable	$ 270	$ 13
Accrued employee compensation and benefits	6	30
Advance billings on uncompleted contracts	67	23
Prepetition liabilities not subject to compromise	375	834
Current prepetition asbestos- and silica-related liabilities subject to compromise	2,415	2,507
Other current liabilities	-	14
Total current liabilities	3,133	3,421
Prepetition liabilities not subject to compromise	128	137
Noncurrent prepetition asbestos- and silica-related liabilities subject to compromise	2,029	1,579
Other liabilities	26	2
Total liabilities	5,316	5,139
Shareholders' equity	709	1,572
Total liabilities and shareholders' equity	$ 6,025	$ 6,711

(1) Represents an option for DII Industries to acquire 59.5 million shares of Halliburton stock at no cost and was valued at $26.00 per share.

Debtors-in-Possession
Condensed Combined Statement of Cash Flows
(Unaudited)
(Millions of dollars)

	Nine Months Ended September 30, 2004
Total cash flows from operating activities	$ (495)
Total cash flows from investing activities	(10)
Total cash flows from activities with Halliburton	457
Effect of exchange rate changes on cash	7
Decrease in cash and equivalents	(41)
Cash and equivalents at beginning of period	108
Cash and equivalents at end of period	$ 67

There can be no assurance that we will obtain all of the required judicial approval of the proposed plan of reorganization or any revised plan of reorganization acceptable to us. A prolonged Chapter 11 proceeding could adversely affect the Debtors' relationships with customers, suppliers, and employees, which in turn could adversely affect the Debtors' competitive position, financial condition, and results of operations. In addition, if the Debtors are unsuccessful in obtaining final and nonappealable confirmation of a plan of reorganization, the assets of the Debtors could be liquidated in the Chapter 11 proceedings, which could have a material adverse effect on Halliburton.

Note 14. United States Government Contract Work

We provide substantial work under our government contracts business to the United States Department of Defense and other governmental agencies, including worldwide United States Army logistics contracts, known as LogCAP, and contracts to rebuild Iraq's petroleum industry, known as RIO and PCO Oil South. Our government services revenue related to Iraq totaled approximately $1.4 billion and $5.4 billion for the three and nine months ended September 30, 2004. Our units operating in Iraq and elsewhere under government contracts such as LogCAP, RIO, and PCO Oil South consistently review the amounts charged and the services performed under these contracts. Our operations under these contracts are also regularly reviewed and audited by the Defense Contract Audit Agency (DCAA) and other governmental agencies. The DCA A serves in an advisory role to our customer. When issues are found during the governmental agency audit process, these issues are typically discussed and reviewed with us. The DCAA will then issue an audit report with their recommendations to our customer's contracting officer. We then will work with our customer to reach a resolution.

Fuel. In December 2003, the DCAA issued a preliminary audit report which alleged that we may have overcharged the Department of Defense by $61 million in importing fuel into Iraq. To the best of our knowledge and belief, the DCAA report was never finalized. The DCAA questioned costs associated with fuel purchases made in Kuwait that were more expensive than buying and transporting fuel from Turkey. We responded that we had maintained close coordination of the fuel mission with the Army Corps of Engineers (COE), which is our customer and oversees the project, throughout the life of the task order and that the COE had directed us to use the Kuwait sources. After a review, the COE concluded that we obt ained a fair price for the fuel. However, Department of Defense officials thereafter referred the matter to the agency's inspector general, which we understand has commenced an investigation.

The DCAA has issued various audit reports related to task orders under the RIO contract which reported $296 million in questioned and unsupported costs The majority of these costs are associated with the humanitarian fuel mission. In these reports, the DCAA has compared fuel costs we incurred during the duration of the RIO contract in 2003 and early 2004 to fuel prices obtained by the Defense Energy Supply Center (DESC) in April 2004, when the fuel mission was transferred to that agency. We believe the conditions specified by the customer for fuel purchases are materially different under the DESC and RIO contracts, and therefore a direct comparison of costs is not valid. We are currently preparing responses to the COE contracting officer, which we believe will substantiate that the costs questioned by the DCAA are allowable and reimbursable.

Dining Facility and Administration Centers (DFACs). During 2003, the DCAA raised issues relating to our invoicing to the Army Materiel Command (AMC) for food services for soldiers and supporting civilian personnel in Iraq and Kuwait. We believe the issues raised by the DCAA relate to the difference between the number of troops the AMC directed us to support and the number of soldiers actually served at dining facilities for United States troops and supporting civilian personnel in Iraq and Kuwait. In the first quarter of 2004, we reviewed our DFAC subcontracts in our Iraq and Kuwait areas of operation and have billed and continue to bill for all current DFAC costs. During 2004, we received notice fr om the DCAA that it was recommending withholding a portion of our DFAC billings. For DFAC billings relating to subcontracts entered into prior to February 2004, the DCAA has recommended withholding 19.35% of the billings until it completes its audits. Subsequent to February 2004, we have renegotiated our DFAC subcontracts to address the specific issues raised by the DCAA and have advised the AMC and the DCAA of the new terms of the arrangements. To date, we have had no objection by the government to these new DFAC subcontract agreements. During the third quarter of 2004, we received notification that, for three Kuwait DFACs, the DCAA is recommending to our customer that costs be disallowed because the DCAA is not satisfied with the level of documentation provided by us. The amount withheld related to suspended and recommended disallowed DFAC costs for work performed under the pre February 2004 subcontracts and totaled approximately $216 million as of September 30, 2004. The amount currently wi thheld could change as the DCAA continues their audits of the remaining DFAC facilities. We are negotiating with our customer, the AMC, to resolve this issue. We can withhold a proportionate amount of these billings from our subcontractors and are currently doing so. See “Investigations” section below for further discussion.

Laundry. During the third quarter of 2004, we received notice from the DCAA that it is recommending withholding $16 million of subcontract costs related to the laundry service for one task order in southern Iraq for which it believes we and our subcontractors have not provided adequate levels of documentation supporting the quantity of the services provided. The DCAA has recommended that the cost be withheld pending receipt of additional explanation or documentation to support subcontract cost. We are working with the AMC to resolve this issue.

Investigations. On January 22, 2004, we announced the identification by our internal audit function of a potential overbilling of approximately $6 million by La Nouvelle Trading & Contracting Company, W.L.L. (La Nouvelle), one of our subcontractors, under the LogCAP contract in Iraq, for services performed during 2003. In accordance with our policy and government regulation, the potential overcharge was reported to the Department of Defense Inspector General’s office as well as to our customer, the AMC. On January 23, 2004, we issued a check in the amount of $6 million to the AMC to cover that potential overbilling while we conducted our own investigation into the matter. Later in the first quarter of 2004, we determined that the amount of overbilling was $4 million and the subcontractor billing should have been $2 million for the services provided. As a result, we paid La Nouvelle $2 million and have billed our customer that amount. We are continuing to investigate whether La Nouvelle paid, or attempted to pay, one or two of our former employees in connection with the billing. See Note 15 “Litigation brought by La Nouvelle” for further discussion.

In October 2004, we reported to the Department of Defense Inspector General's office that two former employees in Kuwait may have had inappropriate contacts with individuals employed by or affiliated with two third-party subcontractors prior to the award of the subcontracts. The Inspector General’s office may investigate whether these two employees may have solicited and/or accepted payments from these third-party subcontractors while they were employed by us.

In October 2004, a civilian contracting official in the COE asked for a review of the process used by the COE for awarding some of the contracts to us. We understand that the Department of Defense Inspector General’s office may review the issues involved.

We understand that the United States Department of Justice, an Assistant United States Attorney based in Illinois, and others are investigating some matters relating to our government contract work. We also understand that former employees of KBR have received subpoenas and have given or may give grand jury testimony relating to some of these matters. If criminal wrongdoing were found, criminal penalties could range up to the greater of $500,000 in fines per count for a corporation, or twice the gross pecuniary gain or loss.

Withholding of payments. During 2004, the AMC issued a determination that a particular contract clause would cause it to withhold 15% from our invoices until our task orders under the LogCAP contract are definitized. We have advised the AMC that we disagree with this interpretation. The AMC has not implemented this withholding; however, it has requested additional information regarding the impact of the potential withholding on us and our subcontractors’ ability to provide troop support under the LogCAP contract. We have provided information in response to this request, but do not know whether or how this information will impact the AMC’s decision to implement the 15% withholding in the fu ture. We do not believe the potential 15% withholding will have a significant or sustained impact on our liquidity because the withholding is temporary and ends once the definitization process is complete. During the third quarter of 2004, we and the AMC identified three senior management teams to facilitate negotiation under the LogCAP task orders, and these teams are working to negotiate outstanding issues and definitize task orders as quickly possible. We are continuing to work with our customer to resolve outstanding issues. To date, definitization proposals for 30 task orders totaling over $500 million have been agreed in principle.

As of September 30, 2004, the COE had withheld $76 million of our invoices related to a portion of our RIO contract pending completion of the definitization process. All ten definitization proposals required under this contract have been submitted by us and three have been agreed in principle. The remaining seven have been reviewed by the DCAA, and we are in the process of responding to our customer on the auditor’s questions. These withholdings represent the amount invoiced in excess of 85% of the amounts we have currently estimated to the COE to complete the tasks ordered. The COE also could withhold similar amounts from future invoices under our RIO contract until our task orders under the RIO contract are definitized. Approximately $4 million was withheld from our PCO Oil South project as of September 30, 2004. We do not believe the withholding will have a significant or sustained impact on our liquidity because the withholding is temporary and ends once the definitization process is complete.

We are working diligently with our customers to proceed with significant work when we have a fully definitized task order, which should limit withholdings on future task orders.

Report on estimating system. The DCAA issued an audit report to our corporate administrative contracting officer (CACO) dated August 4, 2004 stating that, in the DCAA’s opinion, our estimating system is not adequate to produce proposals for our customer to negotiate final pricing on government contracts. The report states that the DCAA has identified approximately $1.8 billion in unsupported costs relating to proposals under our LogCAP contracts. An unsupported cost in an estimate is one in which the DCAA requires additional documentation before expressing an opinion on the acceptability of the estimate. While the alleged $1.8 billion in unsupported costs referenced in the DCAA report represent s estimated costs rather than incurred and/or billed costs and the DCAA is not recommending that such amounts be withheld, the untimely resolution of unsupported cost issues could affect the definitization process. In October 2004, we developed a corrective action plan with the CACO and DCAA and believe we will be able to demonstrate that our estimating system is adequate for negotiating with our customer and that we have appropriate support for our proposals. Should the estimating system ultimately be judged inadequate, all proposals over $100,000 would be required to be reviewed by the DCAA. Currently, all of our proposals over $500,000 must be reviewed.

Report on purchasing system. As a result of a Contractor Purchasing System Review by the Defense Contract Management Agency (DCMA) during the second quarter of 2004, the DCMA granted the continued approval of our government contract purchasing system. The review was conducted due to the unprecedented level of support we currently provide the military in Iraq and Kuwait. The DCMA's approval letter, dated September 7, 2004, stated that our purchasing system's policies and practices are "effective and efficient, and provide adequate protection of the Government's interest."

The Balkans. We have had inquiries in the past by the DCAA and the civil fraud division of the United States Department of Justice into possible overcharges for work performed during 1996 through 2000 under a contract in the Balkans, which inquiry has not yet been completed by the Department of Justice. Based on an internal investigation, we credited our customer approximately $2 million during 2000 and 2001 related to our work in the Balkans as a result of billings for which support was not readily available. We believe that the preliminary Department of Justice inquiry relates to potential overcharges in connection with a part of the Balkans contract under which approximately $100 million in work was done. We believe that any allegations of overcharges would be without merit.

Note 15. Other Commitments and Contingencies

Securities and Exchange Commission (SEC) investigation of change in accounting for revenue on long-term construction projects and related disclosures. In August 2004, we reached a settlement in the investigation by the SEC involving our 1998 and 1999 disclosure of and accounting for the recognition of revenue from unapproved claims on long-term construction projects. Our settlement with the SEC covers a failure to disclose a 1998 change in accounting practice. We disclosed the change in accounting practice in our 1999 Form 10-K and continued to do so in subsequent periods. The SEC did not determine that we departed from generally accepted accounting principles, nor did it find errors in accounting o r fraud. We neither admitted nor denied the SEC's findings, but paid a $7.5 million civil penalty, and recorded a charge of that amount in the second quarter of 2004. As part of the settlement, the company agreed to cease and desist from committing or causing future securities law violations.

Securities and related litigation. On June 3, 2002, a class action lawsuit was filed against us in federal court on behalf of purchasers of our common stock during the period of approximately May 1998 until approximately May 2002 alleging violations of the federal securities laws in connection with the accounting change and disclosures involved in the SEC investigation discussed above. In addition, the plaintiffs allege that we overstated our revenue from unapproved claims by recognizing amounts not reasonably estimable or probable of collection. After that date, approximately twenty similar class actions were filed against us. Several of those lawsuits also named as defendants Arthur Andersen, LLP, our independent accountants for the period covered by the lawsuits, and several of our present or former officers and directors. The class action cases were later consolidated and the amended consolidated class action complaint, styled *Richard Moore, et al. v. Halliburton Company, et al.*,, was filed and served upon us on or about April 11, 2003 (the "*Moore* class action"). Subsequently, in October 2002 and March 2003, two derivative actions arising out of essentially the same facts and circumstances were filed, one of which was subsequently dismissed, while the other was transferred to the same judge before whom the *Moore* class action was pending.

In early May 2003, we announced that we had entered into a written memorandum of understanding setting forth the terms upon which both the *Moore* class action and the remaining derivative action would be settled. In June 2003, the lead plaintiffs in the *Moore* class action filed a motion for leave to file a second amended consolidated complaint, which was granted by the court. In addition to restating the original accounting and disclosure c laims, the second amended consolidated complaint includes claims arising out of the 1998 acquisition of Dresser Industries, Inc. by Halliburton, including that we failed to timely disclose the resulting asbestos liability exposure (the "Dresser claims"). The Dresser claims were included in the settlement discussions leading up to the signing of the memorandum of understanding and are among the claims the parties intended to be resolved by the terms of the proposed settlement of the consolidated *Moore* class action and the derivative action.

The memorandum of understanding called for Halliburton to pay $6 million, which would be funded by insurance proceeds. After the May 2003 announcement regarding the memorandum of understanding, one of the lead plaintiffs in the consolidated class action announced that it was dissatisfied with the lead plaintiffs' counsel's handling of settlement negotiations and what the dissident plaintiff regarded as inadequate communications by the lead plaintiffs' counsel. The dissident lead plaintiff further asserted that it believes that, for various reasons, the $6 million settlement amount is inadequate.

The attorneys representing the dissident plaintiff filed another class action complaint in August 2003, raising allegations similar to those raised in the second amended consolidated complaint regarding the accounting/disclosure claims and the Dresser claims. In addition, the complaint enhances the Dresser claims to include allegations related to our accounting with respect to the acquisition, integration and reserves of Dresser. We moved to dismiss that complaint, styled *Kimble v. Halliburton Company, et al.;* however, the court never ruled on our motion and ordered the case consolidated with the *Moore* class action. On August 3, 2004 the attorneys representing the dissident plaintiff filed a motion for leave to file yet another class action complaint styled *Murphey v. Halliburton Company, et al.* The court has not ruled on that motion. The proposed complaint raises and augments allegations similar to those in the *Moore* class action and the *Kimble* action, including additional allegations regarding disclosure of asbestos liability exposure.

On June 7, 2004, the court entered an order preliminarily approving the settlement. Following the transfer of the case(s) to another district judge and a final hearing on the fairness of the settlement, on September 9, 2004, the court entered an order denying the motion for final approval of the settlement in the *Moore* class action and ordering the parties, among other things, to mediate. The mediation is expected to take place in the first quarter of 2005. After the court's denial of the motion to approve the settlement, we withdrew from the settlement as we believe we are entitled to do by its terms (although the settli ng plaintiffs assert otherwise).

On September 9, 2004, the court ordered that if no objections to the settlement of the derivative action described above were made by October 20, 2004, the court would finally approve the derivative action settlement. No timely objections were made to the settlement of the derivative action.

BJ Services Company patent litigation. On April 12, 2002, a federal court jury in Houston, Texas, returned a verdict against Halliburton Energy Services, Inc., a wholly owned subsidiary, in a patent infringement lawsuit brought by BJ Services Company. In January 2004, we filed a petition requesting that the United States Supreme Court review and reverse the judgment, which was denied in April 2004. In April 2004, we paid the $107 million judgment amount, including pre- and post-judgment interest.

Anglo-Dutch (Tenge). On October 24, 2003, a Texas district court jury returned a verdict finding a subsidiary of Halliburton liable to Anglo-Dutch (Tenge) L.L.C. and Anglo-Dutch Petroleum International, Inc. for breaching a confidentiality agreement related to an investment opportunity we considered in the late 1990s in an oilfield in the former Soviet Republic of Kazakhstan. On January 20, 2004, the judge in that case entered judgment against us and our codefendants, Ramco Oil & Gas, Ltd. and Ramco Energy, PLC (collectively, Ramco), jointly and severally, for the total sum of $106 million. A charge in the amount of $77 million was recorded in the third quarter of 2003 related to this matter. In April 2004, we reached a settlement with the plaintiffs and made all payments to the plaintiffs pursuant to the settlement agreement. As a result of the settlement, the judgment entered against us has been vacated and the litigation dismissed. The settlement also provided Halliburton total indemnity for contribution claims, if any, of Ramco against Halliburton. After consideration of the settlement and legal costs, we reversed approximately $13 million of our remaining accrual in the first quarter of 2004. In the second quarter of 2004, we recovered the $25 million cash that we posted in lieu of a bond related to this matter, which was included in restricted cash as of December 31, 2003.

Newmont Gold. In July 1998, Newmont Gold, a gold mining and extraction company, filed a lawsuit over the failure of a blower manufactured and supplied to Newmont by Roots, a former division of Dresser Equipment Group. The plaintiff alleges that during the manufacturing process, Roots had reversed the blades on a component of the blower known as the inlet guide vane assembly, resulting in the blower's failure and the shutdown of the gold extraction mill for a period of approximately one month during 1996. In January 2002, a Nevada trial court granted summary judgment to Roots on all counts and Newmont appealed. In February 2004, the Nevada Supreme Court reversed the summary judgment and remanded the case to the trial court, holding that fact issues existed which would require trial. We believe our exposure is no more than $40 million. We believe that we have valid defenses to Newmont's claims and intend to vigorously defend the matter. As of September 30, 2004, we had not accrued any amounts related to this matter.

Smith International award. In June 2004, a Texas district court jury returned a verdict in our favor in connection with a patent infringement lawsuit we filed against Smith International (Smith). We were awarded $24 million in damages by the jury. We filed the lawsuit in September 2002 seeking damages for Smith's infringement of our patented Energy Balanced ™ roller cone drill bit technology. The jury found that Smith's competing bits willfully infringed three of our patents. Under applicable law the judge has the discretion to enhance the damages to a total amount of up to three times the amount awarded by the jury and to award attorney's fees and costs. Subsequent to the verdic t, upon our motion, the court enhanced the jury verdict by $12 million and added another $5 million in attorneys' fees and costs for a total judgment of $41 million. Unless pending motions for judgment as a matter of law are granted, Smith is expected to appeal.

Related litigation dealing with claims of infringement of the same technology is pending in courts in Italy and England and expected to go to trial during 2005.

Improper payments reported to the SEC. During the second quarter of 2002, we reported to the SEC that one of our foreign subsidiaries operating in Nigeria made improper payments of approximately $2.4 million to entities owned by a Nigerian national who held himself out as a tax consultant, when in fact he was an employee of a local tax authority. The payments were made to obtain favorable tax treatment and clearly violated our Code of Business Conduct and our internal control procedures. The payments were discovered during our audit of the foreign subsidiary. We conducted an investigation assisted by outside legal counsel and, based on the findings of the investigation, we terminated several employe es. None of our senior officers were involved. We are cooperating with the SEC in its review of the matter. We took further action to ensure that our foreign subsidiary paid all taxes owed in Nigeria. A preliminary assessment of approximately $4 million was issued by the Nigerian tax authorities in the second quarter of 2003. We are cooperating with the Nigerian tax authorities to determine the total amount due as quickly as possible.

Investigation into Nigerian joint venture and related matters. The SEC is conducting a formal investigation into payments made in connection with the construction and subsequent expansion by TSKJ of a multibillion dollar natural gas liquefaction complex and related facilities at Bonny Island in Rivers State, Nigeria. The United States Department of Justice is also conducting an investigation. TSKJ is a private limited liability company registered in Madeira, Portugal whose members are Technip SA of France, Snamprogetti Netherlands B.V., which is an affiliate of ENI SpA of Italy, JGC Corporation of Japan, and Kellogg Brown & Root, each of which owns 25% of the venture.

The SEC and the Department of Justice have been reviewing these matters in light of the requirements of the United States Foreign Corrupt Practices Act. We have produced documents to the SEC both voluntarily and pursuant to a subpoena, and intend to make our employees available to the SEC for testimony. In addition, we understand that the SEC has issued a subpoena to A. Jack Stanley, who most recently served as a consultant and chairman of Kellogg Brown & Root, and to other current and former Kellogg Brown & Root employees. We further understand that the Department of Justice has invoked its authority under a sitting grand jury to obtain letters rogatory for the purpose of obtaining information abroad.

TSKJ and other similarly owned entities entered into various contracts to build and expand the liquefied natural gas project for Nigeria LNG Limited, which is owned by the Nigerian National Petroleum Corporation, Shell Gas B.V., Cleag Limited (an affiliate of Total), and Agip International B.V. Commencing in 1995, TSKJ entered into a series of agency agreements in connection with the Nigerian project. We understand that a French magistrate has officially placed Jeffrey Tesler, an agent of TSKJ, under investigation for corruption of a foreign public official. In Nigeria, a legislative committee of the National Assembly and the Economic and Financial Crimes Commission, which is organized as part of the executive branch of the government, are also investigating these matters. Our representatives have met with the Fre nch magistrate and Nigerian officials and expressed our willingness to cooperate with those investigations. In October 2004, representatives of TSKJ voluntarily testified before the Nigerian legislative committee.

As a result of our continuing investigation into these matters, information has been uncovered suggesting that, commencing at least 10 years ago, the members of TSKJ considered payments to Nigerian officials. We provided this information to the United States Department of Justice, the SEC, the French magistrate, and the Nigerian Economics and Financial Crimes Commission. We also notified the other owners of TSKJ of the recently uncovered information and asked each of them to conduct their own investigation.

We understand from the ongoing governmental and other investigations that payments may have been made to Nigerian officials. In addition, we understand that, at our request, TSKJ has suspended the receipt of services from and payments to TSKJ's agent, Tri-Star Investments, of which Jeffrey Tesler is a principal, and is considering instituting legal proceedings to declare all agency agreements with Tri-Star terminated and to recover all amounts previously paid under those agreements.

We understand that the Department of Justice has expanded its investigation to include whether Mr. Stanley may have received payments in connection with bidding practices on certain foreign projects. We also understand that the matters under investigation by the Department of Justice involve parties other than Kellogg Brown & Root and M.W. Kellogg, a joint venture in which Kellogg Brown & Root has a 55% interest, cover an extended period of time, in some cases significantly before our acquisition of Dresser Industries, including M. W. Kellogg in 1998, and possibly include the construction of a fertilizer plant in Nigeria in the early 1990's and the activities of agents and service providers.

In June 2004, we terminated all relationships with Mr. Stanley and another consultant and former employee of M.W. Kellogg. The terminations occurred because of violations of our Code of Business Conduct that allegedly involve the receipt of improper personal benefits in connection with TSKJ's construction of the natural gas liquefaction facility in Nigeria.

There can be no assurance that any governmental investigation or our investigation of these matters will not conclude that violations of applicable laws have occurred.

As of September 30, 2004, we had not accrued any amounts related to these investigations.

Operations in Iran. We received and responded to an inquiry in mid-2001 from the Office of Foreign Assets Control (OFAC) of the United States Treasury Department with respect to operations in Iran by a Halliburton subsidiary that is incorporated in the Cayman Islands. The OFAC inquiry requested information with respect to compliance with the Iranian Transaction Regulations. These regulations prohibit United States citizens, including United States corporations and other United States business organizations, from engaging in commercial, financial, or trade transactions with Iran, unless authorized by OFAC or exempted by statute. Our 2001 written response to OFAC stated that we believed that we were i n full compliance with applicable sanction regulations. In January 2004, we received a follow-up letter from OFAC requesting additional information. We responded fully to this request on March 19, 2004. We understand this matter has now been referred by OFAC to the Department of Justice. In July 2004, we received a grand jury subpoena from an Assistant United States District Attorney requesting the production of documents. We are cooperating with the government's investigation and have responded to the subpoena by producing documents on September 16, 2004. As of September 30, 2004, we had not accrued any amounts related to this investigation.

Separate from the OFAC inquiry, we completed a study in 2003 of our activities in Iran during 2002 and 2003 and concluded that these activities were in full compliance with applicable sanction regulations. These sanction regulations require isolation of entities that conduct activities in Iran from contact with United States citizens or managers of United States companies.

Litigation brought by La Nouvelle. In October 2004, La Nouvelle, a subcontractor to us in connection with our government services work in Kuwait and Iraq, filed suit alleging breach of contract and interference with contractual and business relations. The relief sought includes $224 million in damages for breach of contract, which includes $34 million for tortious interference, and an unspecified sum for consequential and punitive damages. The dispute arises from our termination of a master agreement pursuant to which La Nouvelle operated a number of DFACs in Kuwait and Iraq and the replacement of La Nouvelle with ESS which, prior to La Nouvelle's termination, had served as La Nouvelle's s ubcontractor. In addition, La Nouvelle alleges that we wrongfully withheld from La Nouvelle certain sums due La Nouvelle under its various subcontracts.

While we admit that we have withheld certain sums from La Nouvelle, we believe that we were contractually entitled to do so and that we had the right to terminate the master agreement with La Nouvelle for cause. The case has only recently been filed and our investigation is in its preliminary stages. Accordingly, it is premature to assess the likelihood of an unfavorable result. It is, however, our intention to vigorously defend the action.

David Hudak and International Hydrocut Technologies Corp. On October 12, 2004 David Hudak and International Hydrocut Technologies Corp. (collectively Hudak), filed suit against us in the United States District Court alleging civil Racketeer Influenced and Corrupt Organizations Act violations, fraud, breach of contract, unfair trade practices, and other torts. The action, which seeks unspecified damages, arises out of Hudak's alleged purchase in early 1994 of certain explosive charges which were later alleged by the United States Department of Justice to be military ordnance, the possession of which by persons not possessing the requisite licenses and registrations is unlawful. As a result of th at allegation by the government, Hudak was charged with, but later acquitted of, certain criminal offenses in connection with his possession of the explosive charges. As mentioned above, the alleged transaction(s) took place more than ten years ago. The fact that most of the individuals that may have been involved, as well as the entities themselves, are no longer affiliated with us, will complicate our investigation. For those reasons and because the litigation is in its most preliminary stages, it is premature to assess the likelihood of an adverse result. It is, however, our intention to vigorously defend this action. As of September 30, 2004, we had not accrued any amounts related to this matter.

Environmental. We are subject to numerous environmental, legal, and regulatory requirements related to our operations worldwide. In the United States, these laws and regulations include, among others:

- the Comprehensive Environmental Response, Compensation, and Liability Act;
- the Resources Conservation and Recovery Act;

- the Clean Air Act;
- the Federal Water Pollution Control Act; and
- the Toxic Substances Control Act.

In addition to the federal laws and regulations, states and other countries where we do business may have numerous environmental, legal, and regulatory requirements by which we must abide. We evaluate and address the environmental impact of our operations by assessing and remediating contaminated properties in order to avoid future liabilities and comply with environmental, legal, and regulatory requirements. On occasion, we are involved in specific environmental litigation and claims, including the remediation of properties we own or have operated, as well as efforts to meet or correct compliance-related matters. Our Health, Safety and Environment group has several programs in place to maintain environmental leadership and to prevent the occurrence of environmental contamination.

We do not expect costs related to these remediation requirements to have a material adverse effect on our consolidated financial position or our results of operations. Our accrued liabilities for environmental matters were $38 million as of September 30, 2004 and $31 million as of December 31, 2003. The liability covers numerous properties and no individual property accounts for more than $5 million of the liability balance. In some instances, we have been named a potentially responsible party by a regulatory agency, but in each of those cases, we do not believe we have any material liability. We have subsidiaries that have been named as potentially responsible parties along with other third parties for 14 federal and state superfund sites for which we have established a liability. As of September 30, 2004, those 14 sites accounted for approximately $10 million of our total $38 million liability**.**

Letters of credit. In the normal course of business, we have agreements with banks under which approximately $1.1 billion of letters of credit or bank guarantees were outstanding as of September 30, 2004, including $191 million which relate to our joint ventures' operations.

In the fourth quarter of 2003, we entered into a senior secured master letter of credit facility (Master LC Facility) with a syndicate of banks which covered at least 90% of the face amount of our then existing letters of credit. The Master LC Facility became effective in December 2003. Each bank has permanently waived any right that it had to demand cash collateral as a result of the filing of Chapter 11 proceedings by certain of our subsidiaries. In addition, at the discretion of the banks involved, the Master LC Facility provides for the issuance of new letters of credit, so long as the total facility does not exceed an amount equal to the amount of outstanding letters of credit at closing plus $250 million, or approximately $1.5 billion.

The purpose of the Master LC Facility is to provide an advance for letter of credit draws, if any, and to satisfy any cash collateralization rights of issuers of substantially all our then existing letters of credit during the pendency of the Chapter 11 proceedings of eight of our subsidiaries. In May 2004, we extended the Master LC Facility, and advances under the Master LC Facility will now remain available until the earlier of December 31, 2004 or when an order confirming the proposed plan of reorganization becomes final and nonappealable. At that time, all advances outstanding under the Master LC Facility, if any, will become term loans payable in full on June 30, 2005 and all other letters of credit shall cease to be subject to the terms of the Master LC Facility. If our subsidiaries do not exit Chapter 11 pr oceedings until after December 31, 2004, we would expect to be able to extend the availability of the Master LC Facility. As of September 30, 2004 and December 31, 2003, there were no outstanding advances under the Master LC Facility.

We currently have commitments to fund approximately $55 million to certain of our related companies. These commitments arose primarily during the start-up of these entities or due to losses incurred by them. We expect approximately $46 million of the commitments to be paid during the next year.

Liquidated damages. Many of our engineering and construction contracts have milestone due dates that must be met or we may be subject to penalties for liquidated damages if claims are asserted and we were responsible for the delays. These generally relate to specified activities within a project by a set contractual date or achievement of a specified level of output or throughput of a plant we construct. Each contract defines the conditions under which a customer may make a claim for liquidated damages. In most instances, liquidated damages are not asserted by the customer but the potential to do so is used in negotiating claims and closing out the contract. We had not accrued liabilities for $46 mi llion at September 30, 2004 and $243 million at December 31, 2003 of liquidated damages we could incur based upon completing the projects as forecasted. If the October 2004 agreement in principle between Kellogg Brown & Root and Barracuda and Caratinga Leasing Company B.V. were not finalized, based on September 2004 project forecasts, Kellogg Brown & Root could be subject to an additional approximately $141 million in liquidated damages beyond the estimated $24 million of liquidated damages recorded as of September 30, 2004 in the event that the delay in the project is determined to be attributable to us. There can be no assurance that further project delays will not occur.

Other. We are a party to various other legal proceedings. We expense the cost of legal fees as incurred related to these proceedings. We believe any liabilities we may have arising from these proceedings will not be material to our consolidated financial position or results of operations.

Note 16. Accounting for Stock-Based Compensation

We have six stock-based employee compensation plans. We account for those plans under the recognition and measurement principles of Accounting Principles Board Opinion No. 25, “Accounting for Stock Issued to Employees,” and related interpretations. No cost for stock options granted is reflected in net income, as all options granted under our plans have an exercise price equal to the market value of the underlying common stock on the date of grant. In addition, no cost for the Employee Stock Purchase Plan is reflected in net income because it is not considered a compensatory plan.

The fair value of options at the date of grant and the employee stock purchase plan shares were estimated using the Black-Scholes option pricing model. The following table illustrates the effect on net income (loss) and income (loss) per share if we had applied the fair value recognition provisions of Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards No. 123, “Accounting for Stock-Based Compensation,” to stock-based employee compensation.

	Three Months Ended September 30		Nine Months Ended September 30	
(Millions of dollars except per share data)	2004	2003	2004	2003
Net income (loss), as reported	$ (44)	$ 58	$ (776)	$ 127
Total stock-based employee compensation expense determined under fair value based method for stock options and employee stock purchase plan awards, net of related tax effects	(8)	(8)	(21)	(21)
Net income (loss), pro forma	$ (52)	$ 50	$ (797)	$ 106
Basic income (loss) per share:				
As reported	$ (0.11)	$ 0.13	$ (1.78)	$ 0.29
Pro forma	$ (0.13)	$ 0.11	$ (1.83)	$ 0.24
Diluted income (loss) per share:				
As reported	$ (0.09)	$ 0.13	$ (1.76)	$ 0.29
Pro forma	$ (0.11)	$ 0.11	$ (1.81)	$ 0.23

We also maintain a restricted stock program wherein the fair market value of the stock on the date of issuance is being amortized and ratably charged to income over the average period during which the restrictions lapse. The related expense, net of tax, reflected in net income as reported for the three- and nine-month periods ended September 30, 2004 is $4 million and $9 million, and for the three- and nine-month periods ended September 30, 2003 is $3 million and $8 million.

Note 17. Income (Loss) Per Share

Basic income (loss) per share is based on the weighted average number of common shares outstanding during the period. Diluted income (loss) per share includes additional common shares that would have been outstanding if potential common shares, consisting primarily of stock options, with a dilutive effect had been issued. The effect of common stock equivalents on basic weighted average shares outstanding was an additional four million shares in the three and nine months ended September 30, 2004 and an additional two million shares in the three and nine months ended September 30, 2003. Excluded from the computation of diluted income (loss) per share are options to purchase nine million shares of common stock which were outstanding during the three and nine months ended September 30, 2004, 16 million shares which we re outstanding during the three months ended September 30, 2003, and 15 million shares during the nine months ended September 30, 2003. These options were outstanding during these quarters but were excluded because the option exercise price was greater than the average market price of the common shares. The shares issuable upon conversion of the 3.125% convertible senior notes due 2023 were not included in the computation of diluted income (loss) per share since the conditions for conversion had not been met as of September 30, 2004. Loss per share for discontinued operations and net loss for the three and nine months ended September 30, 2004 were antidilutive, as the control number used to determine whether to include any common stock equivalents in the weighted shares outstanding for the period is income from continuing operations.

On September 30, 2004, the Emerging Issues Task Force (EITF) reached a consensus on Issue No. 04-08, "The Effect of Contingently Convertible Debt on Diluted Earnings per Share," which changes the treatment of contingently convertible debt instruments in the calculation of diluted earnings per share. Contingently convertible debt instruments are financial instruments that include a contingent feature, such as a feature by which the debt becomes convertible into common shares of the issuer if the issuer's common stock price has exceeded a predetermined threshold for a specified time period. Our 3.125% convertible senior notes due 2023 are an example of these types of instruments. Prior to the effective date of the new consensus, we excluded the potential dilutive effect of the conversion feature from dilut ed earnings per share until the contingency threshold is met. EITF Issue No. 04-08 provides that these debt instruments should be included in the earnings per share computation (if dilutive) regardless of whether the contingent feature has been met. This change does not have any effect on net income (loss), but it will affect the related per share amounts. The new rules are currently expected to be effective for the fourth quarter of 2004.

We plan to adopt EITF Issue No. 04-08 as of December 31, 2004 and will restate the computations of earnings (loss) per share for prior periods. We will include, if dilutive, the assumed conversion of our $1.2 billion 3.125% convertible senior notes due July 2023 in our diluted earnings per share calculations. This will increase the denominator in our diluted earnings per share calculations by approximately 32 million shares, resulting in lower diluted earnings per share in periods in which we report net income. We expect this change to have an immaterial impact on our diluted earnings (loss) per share calculations.

Note 18. Income Taxes

Provision for income taxes of $111 million resulted in an effective rate of 37% in the third quarter of 2004, compared to an effective tax rate of 39% in the third quarter of 2003. The tax rate for the third quarter of 2004 was primarily due to a reduction of current taxes in foreign jurisdictions.

Provision for income taxes of $131 million resulted in an effective tax rate of 37% in the first nine months of 2004, compared to an effective tax rate of 40% in the first nine months of 2003. The tax rate for the first nine months of 2004 was attributable to lower tax benefits on Barracuda-Caratinga charges, offset by a reduction of current taxes in foreign jurisdictions. The tax rate for the first nine months of 2003 was partially the result of the tax effect on the gain from the sale of our Mono Pumps business and loss from the sale of Wellstream. These transactions included $14 million of realized cumulative translation loss, which is not deductible for tax purposes.

Note 19. Retirement Plans

The components of net periodic benefit cost for the three and nine months ended September 30, 2004 and September 30, 2003 are as follows:

	Pension Benefits Three Months Ended September 30				Other Postretirement Benefits Three Months Ended September 30	
	2004		2003			
(Millions of dollars)	United States	International	United States	International	2004	2003
Components of net periodic benefit cost:						
Service cost	$ 1	$ 21	$ -	$ 18	$ 1	$ -
Interest cost	2	37	3	30	1	3
Expected return on plan assets	(2)	(41)	(3)	(34)	-	-
Transition amount	-	-	-	(1)	-	-
Amortization of prior service cost	-	-	-	-	(2)	-
Settlements/curtailments	-	-	2	-	-	-
Recognized actuarial loss	1	3	-	5	-	1
Net periodic benefit cost	$ 2	$ 20	$ 2	$ 18	$ -	$ 4

	Pension Benefits Nine Months Ended September 30				Other Postretirement Benefits Nine Months Ended September 30	
	2004		2003			
(Millions of dollars)	United States	International	United States	International	2004	2003
Components of net periodic benefit cost:						
Service cost	$ 1	$ 64	$ 1	$ 54	$ 1	$ 1
Interest cost	7	109	8	90	4	9
Expected return on plan assets	(8)	(122)	(9)	(102)	-	-
Transition amount	-	-	-	(1)	-	-
Amortization of prior service cost	-	-	-	-	(7)	-
Settlements/curtailments	1	-	2	-	-	-
Recognized actuarial loss	3	11	1	14	1	1
Net periodic benefit (income) cost	$ 4	$ 62	$ 3	$ 55	$ (1)	$ 11

We currently expect to contribute approximately $67 million to our pension plans in 2004. As of September 30, 2004, we have contributed $57 million of this amount.

Effective July 1, 2004, we adopted FASB Staff Position (FSP) No. FAS 106-2 “Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003,” which is related to our retiree medical plans. The impact of the FSP was recognized in the third quarter of 2004 and was immaterial.

Dresser retiree medical. In January 2004, the plan administrator of the Dresser Retiree Life and Medical Program filed a declaratory judgment action in the United States District Court seeking a ruling that Halliburton need not continue providing a large portion of the medical benefits for retirees of the former Dresser Industries, which Halliburton acquired in 1998 and most of which Halliburton has since disposed of. If the court does not rule that the benefits can be discontinued, we would accrue up to approximately $10 million for current retiree medical costs, and we would incur additional costs of provid ing medical benefits to Dresser retirees in future periods.

Note 20. Reorganization of Engineering and Construction Group

Effective October 1, 2004, we restructured the Engineering and Construction Group into two divisions, the Energy and Chemicals division and the Government and Infrastructure division. In the third quarter of 2004, we recorded restructuring and related costs of $18 million related to the reorganization, consisting of $10 million in personnel termination benefits and $8 million in impairment charges on technology-related assets. For the three and nine months ended September 30, 2004, $13 million of the restructuring charge was included in “Cost of services” and $5 million was included in “General and administrative” on the condensed consolidated statements of operations. As of September 30, 2004, $10 million had not been paid and is included in other current liabilities. We expect an additional c harge of approximately $12 million in the fourth quarter of 2004 primarily for personnel termination benefits.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

EXECUTIVE OVERVIEW

During the first nine months of 2004, we continued to:

- make progress on our asbestos and silica settlement;
- provide a large amount of government services work in the Middle East;
- move closer to completion of our Barracuda-Caratinga project, a large multiyear construction project in Brazil; and
- address the substantial expected future demands on our funds.

Our operational performance for the first nine months of 2004 was particularly strong in our Energy Services Group (ESG) and liquefied natural gas (LNG) operations from our Engineering and Construction Group or "KBR." With increased activity as reflected by the increase in rig count and high crew utilization combined with pricing improvements we implemented in May 2004, the Energy Services Group revenue increased by 12% and operating income increased by 54% compared to the first nine months of 2003. Additionally, effective October 1, 2004, we restructured our Engineering and Construction Group into two divisions, the Energy and Chemicals division and the Government and Infrastructure division. We believe that the reorganization is a necessary step towards positioning the Engineering and Construction Grou p for a stronger 2005 and beyond.

Asbestos and silica. Having reached definitive settlements with almost all of our asbestos and silica personal injury claimants, certain of our subsidiaries filed Chapter 11 proceedings on December 16, 2003. A preapproved proposed plan of reorganization was filed as part of the Chapter 11 proceedings.

On July 21, 2004, the bankruptcy court entered an order, effective as of July 16, 2004, confirming the plan of reorganization to implement our proposed asbestos and silica settlement. Despite an appeal by certain of our insurance companies, on July 26, 2004, the United States District Court for the Western District of Pennsylvania affirmed the confirmation order. On August 3, 2004, certain insurance companies filed a motion to vacate the District Court's affirmation order in order to protect their appeal rights. If our previously announced agreements in principle with insurance companies are finalized and approved by the relevant bankruptcy courts, the insurance companies have agreed to dismiss their appeals. Due to efforts being made by our affected subsidiaries to complete these settlements with, among othe rs, the insurance companies that appealed the confirmation order, the parties and the District Court agreed to stay the affirmation order. We have filed motions with the bankruptcy court to request approval of the settlement agreements with substantially all of our insurance companies, and the bankruptcy court has agreed to consider the motions at a hearing scheduled for November 18, 2004. The insurance companies have agreed to join us in support of the motions. If the settlements with the insurance companies are approved by the relevant bankruptcy courts and the conditions to such settlements are satisfied, then we anticipate all appeals will be withdrawn. The affirmation order (and thus the plan of reorganization) will be final and nonappealable within 30 days after either the District Court favorably adjudicates the appeals or the appeals are withdrawn and the stay of the affirmation order is vacated.

We entered into a settlement with Equitas, the largest insurer of our asbestos and silica claims, during the first quarter of 2004. The settlement calls for Equitas to pay us $575 million, representing approximately 60% of applicable limits of liability that DII Industries had substantial likelihood of recovering from Equitas, provided that our plan of reorganization becomes effective and the current United States Congress does not pass national asbestos litigation reform legislation.

In May 2004, we entered into nonbinding agreements in principle with representatives of the London Market insurance companies that, if implemented, would settle insurance disputes with substantially all the solvent London Market insurance companies for asbestos- and silica-related claims and all other claims under the applicable insurance policies. The agreements in principle with the London Market insurance companies are subject to board of directors' approval of all parties, agreement by all remaining London Market insurance companies, and an order by the bankruptcy court confirming the proposed plan of reorganization that has become final and nonappealable. Currently, we expect to receive cash payments during the years of 2005 through 2009.

We also have entered into agreements in principle with certain of our insolvent London Market insurance companies and with our solvent domestic insurance companies that, if implemented, would settle asbestos- and silica-related claims and all other claims under the applicable insurance policies and terminate all the applicable insurance policies. We are currently drafting the final settlement agreements with our insurers. The final settlement agreements with our remaining insurance companies would be subject to board of directors' approval of all parties, an order by the bankruptcy court approving the final settlement agreements, approval by the Federal-Mogul bankruptcy court (see "Federal-Mogul" below under Asbestos and Silica Obligations and Insurance Recoveries), approval by certain other parties , and our confirmation order becoming final and nonappealable.

These proposed settlements with our insurance companies are subject to numerous conditions similar to the conditions of the Equitas settlement, including the condition that the United States Congress does not pass national asbestos litigation reform legislation before January 5, 2005.

Under the terms of our announced insurance settlements and proposed insurance settlements, we expect to receive cash proceeds with a nominal amount of approximately $1.5 billion and with a present value of approximately $1.4 billion for our asbestos- and silica-related insurance receivables. Our December 31, 2003 estimate of our asbestos- and silica-related insurance receivables already included the charge for the settlement amount under the Equitas agreement reached in January 2004, as well as certain other probable settlements with companies for which we could reasonably estimate the amount of the settlement. During 2004, we reduced the amount recorded as insurance receivables for asbestos- and silica-related liabilities insured by domestic companies based upon proposed agreements in principle, resulting in pret ax charges to discontinued operations of approximately $686 million.

At September 30, 2004, the liability related to the 59.5 million shares of Halliburton common stock to be contributed to the trusts was revalued to $2.0 billion, an increase of $435 million from December 31, 2003, of which $190 million was recorded during the first quarter of 2004 and $245 million was recorded in the third quarter of 2004. The increase in value reflected the rise in Halliburton's stock price during the nine-month period.

During October 2004, we reached an agreement in principle with Federal-Mogul, our insurance companies, and another party sharing in the insurance coverage to obtain their consent and support of a partitioning of the insurance policies. Under the terms of the agreement in principle, DII Industries would be allocated 50% of the limits of any applicable insurance policy, and the remaining 50% of limits of the insurance policies would be allocated to the remaining policyholders. As part of the settlement, DII Industries agreed to pay $46 million in three installment payments. The first payment of $16 million will be paid on the same day that DII Industries funds the asbestos and silica trusts. The second and third payments of $15 million each will occur on the first and second anniversaries from the date of the first payment. We are currently attempting to finalize this agreement in principle so that we may also finalize the settlements with the London Market insurance companies and the domestic insurance companies. If we are able to finalize this agreement in principle and the related agreements in principle with our solvent insurers, we will be able to dismiss all of our remaining insurance coverage lawsuits concerning asbestos-related and silica-related matters. In the third quarter of 2004, we accrued $43 million, which represents the present value of the $46 million to be paid. The discount will be accreted as interest expense (classified as discontinued operations) over the life of the expected future cash payments beginning in the fourth quarter of 2004.

Government services in the Middle East. Our government services revenue related to Iraq totaled approximately $5.4 billion during the first nine months of 2004 and approximately $3.6 billion in 2003. The work we perform includes providing construction and services for, among other things:

- logistical support to the United States Army, including camp construction, operations and maintenance, food and dining services, and transportation services; and
- restoration of the Iraqi petroleum industry, including the assessment and repair of the oil infrastructure associated with the Iraqi southern oilfields.

The accelerated ramp-up in services in a war zone brought with it several challenges, including keeping our people safe, recruiting and retaining qualified personnel, identifying and retaining appropriate subcontractors, establishing the necessary internal control procedures associated with this type of business, and funding the increased working capital demands. We have received and expect to continue to receive heightened media, legislative, and regulatory attention regarding our work in Iraq, including the preliminary results of various audits by the Defense Contract Audit Agency (DCAA) related to our invoicing practices and our self-reporting of possible improper conduct by one or two of our former employees. The DCAA and the Army Materiel Command continue to withhold or recommend withholding amounts from our& nbsp;dining facility billings and invoices related to our LogCAP, Restore Iraqi Oil (RIO), and PCO Oil South project contracts. We have also been responding to various audit reports issued by the DCAA in regard to our estimating and accounting systems.

Barracuda-Caratinga project. In recent years, we have faced issues related to our Barracuda-Caratinga project, a multiyear construction project to build two converted supertankers which will be used as floating production, storage, and offloading units (FPSOs), 32 hydrocarbon production wells, 22 water injection wells, and all subsea flow lines, umbilicals, and risers necessary to connect the underwater wells to the FPSOs. In October 2004, the Barracuda vessel was moved offshore for sea trials and final inspections. This is a major milestone toward completion of the project, which is significantly behind the original schedule and is in a financial loss position. Also in October 2004, Kellogg Brown & Root, Inc. (Kellogg Brown & Root) and Petrobras, on behalf of the project owner, entered into a nonbinding agreement in principle. The October 2004 agreement in principle is the basis for settlement of the various claims between the parties and would amend existing agreements. Implementation of the agreement in principle requires final approval of the board of directors of Petrobras and Halliburton, the project lenders, and possibly the bankruptcy court that confirmed our proposed plan of reorganization. Discussions among all parties, including the project lenders, are underway. As of September 30, 2004, we recorded $407 million in pretax losses during 2004, which brings the inception-to-date pretax loss recorded on this project to $762 million. Approximately $310 million was recorded in the second quarter of 2004, resulting from a detailed review of the project indicating higher cost estimates, schedule delays, and increased contingencies for the balance of the project until completion. Approximately $97 million was recorded during the first quarter of 2004, resulting from the April 2004 agreement in principle with Petrobras, as well as adjustments to our estimates of costs expected to be incurred to complete the project.

Financing activities. The anticipated cash contribution to the asbestos and silica trusts later this year or in early 2005, the increased work in Iraq, and potential additional delays of certain billings related to work in Iraq have required us to raise substantial funds and could require us to raise additional funds in order to meet our current and potential future liabilities and working capital requirements. On January 26, 2004, we issued $500 million aggregate principal amount of senior notes due 2007 bearing interest at a floating rate equal to three-month LIBOR plus 0.75%, payable quarterly. In addition, we have entered into the following facilities:

- a secured master letter of credit facility (Master LC Facility) intended to provide an advance for letter of credit draws, if any, and to satisfy any cash collateralization rights of issuers of substantially all our then existing letters of credit during the pendency of the Chapter 11 proceedings of eight of our subsidiaries. The Master LC Facility allows advances until the earlier of December 31, 2004 or the exit date of the Chapter 11 proceedings of eight of our subsidiaries, with repayments due June 30, 2005;
- a secured $700 million three-year revolving credit facility for general working capital purposes which matures in October 2006;
- a secured $500 million 364-day revolving credit facility for general working capital purposes which matures in July 2005.

If our subsidiaries do not exit Chapter 11 proceedings until after December 31, 2004, we would expect to be able to extend the availability of the Master LC Facility.

As of September 30, 2004, we had issued a letter of credit for approximately $172 million under the $700 million revolver to replace an existing letter of credit expiring on our Barracuda-Caratinga project, which reduced the availability under the revolver to $528 million. There were no cash drawings under the $700 million revolver, or the $500 million 364-day revolver as of September 30, 2004. The total amount outstanding under the Energy Services Group accounts receivable securitization facility is $256 million as of September 30, 2004. The total amount of receivables outstanding under our KBR United States government receivable sale agreement as of September 30, 2004 was approximately $202 million. Subsequent to the third quarter of 2004, the KBR receivables were collected and the balance retired, and we are no t currently selling further receivables, although the facility continues to be available.

In addition, as early as January 2005, we may receive approximately $954 million of the funds that would be provided by the Equitas settlement and other insurance companies based on anticipated settlement agreements. We continue to maintain our investment grade credit ratings and believe we have sufficient cash and financing capacity to fund our asbestos and silica settlement obligations later this year or early 2005 and continue to grow our business.

Business focus. The outlook for our business continues to improve, particularly for our energy services and LNG businesses. As compared to the first nine months of 2003, ESG revenue increased in all geographic areas in the first nine months of 2004. Our ESG business has a strong correlation to worldwide rig activity and some correlation to oil and gas prices. Oil prices increased approximately 44% from the prior year quarter and gas prices increased approximately 12%. The United States land and international land and offshore rig counts increased significantly from the prior year. Customer spending in the third quarter of 2004 continued to increase, reflecting a stronger view that high commodity prices are sustainab le over a longer term. As our customers become more confident about the fundamentals underlying recent oil and gas prices, we anticipate further increases in spending both in the United States and internationally. Our government services operating income has increased 7% year-over-year in our Engineering and Construction Group for the first nine months of 2004, but is expected to be lower on a comparative basis in the remainder of the year. The two-year $1.2 billion contract for PCO Oil South and the five-year $1.5 billion military support contract offset a decline in work under our RIO contract, which was a more profitable contract. As a result of the reorganization of the Engineering and Construction Group, which became effective in the fourth quarter of 2004, we have redesigned our cost structure so that the portfolio of projects that we are currently executing will yield improved profitability. After DII Industries, Kellogg Brown & Root, and six other subsidiaries plan of reorganization to implement its proposed asbestos and silica settlement becomes effective, we expect to study and decide whether to separate KBR through a sale, a spin-off, or an initial public offering.

Following is a more detailed discussion of each of these subjects.

Asbestos and Silica Obligations and Insurance Recoveries

Prepackaged Chapter 11 proceedings. DII Industries, Kellogg Brown & Root, and six other subsidiaries filed Chapter 11 proceedings on December 16, 2003 in bankruptcy court in Pittsburgh, Pennsylvania. With the filing of the Chapter 11 proceedings and entry of an order of the bankruptcy court, all asbestos and silica personal injury claims and related lawsuits against Halliburton and our affected subsidiaries were stayed. See Note 13 to the condensed consolidated financial statements for more information.

Our subsidiaries sought Chapter 11 protection to avail themselves of the provisions of Sections 524(g) and 105 of the Bankruptcy Code which may be used to discharge current and future asbestos and silica personal injury claims against us and our subsidiaries. Upon the entry of a final and nonappealable order confirming the plan of reorganization, current and future asbestos and silica personal injury claims against us and our affiliates will be channeled into trusts established for the benefit of asbestos and silica claimants, thus releasing Halliburton and its affiliates from those claims.

A prepackaged Chapter 11 proceeding is one in which a debtor seeks approval of a plan of reorganization from affected creditors before filing for Chapter 11 protection. Prior to proceeding with the Chapter 11 filing, our affected subsidiaries solicited acceptances to a proposed plan of reorganization from known present asbestos and silica claimants. In the fourth quarter of 2003, valid votes were received from approximately 364,000 asbestos claimants and approximately 21,000 silica claimants, representing substantially all known claimants. Of the votes validly cast, over 98% of voting asbestos claimants and over 99% of voting silica claimants voted to accept the proposed plan of reorganization, meeting the voting requirements of Chapter 11 of the Bankruptcy Code for approval of the proposed plan. The preapproved p roposed plan of reorganization was filed as part of the Chapter 11 proceedings.

On July 21, 2004, the bankruptcy court entered an order, effective as of July 16, 2004, confirming the plan of reorganization to implement our proposed asbestos and silica settlement. Despite an appeal by certain of our insurance companies, on July 26, 2004, the United States District Court for the Western District of Pennsylvania affirmed the confirmation order. On August 3, 2004, certain insurance companies filed a motion to vacate the District Court's affirmation order in order to protect their appeal rights. If our previously announced agreements in principle with insurance companies are finalized and approved by the relevant bankruptcy courts, the insurance companies have agreed to dismiss their appeals. Due to efforts being made by our affected subsidiaries to complete these settlements with, among othe rs, the insurance companies that appealed the confirmation order, the parties and the District Court agreed to stay the affirmation order. We have filed motions with the bankruptcy court to request approval of the settlement agreements with substantially all of our insurance companies, and the bankruptcy court has agreed to consider the motions at a hearing scheduled for November 18, 2004. The insurance companies have agreed to join us in support of the motions. If the settlements with the insurance companies are approved by the relevant bankruptcy courts and the conditions to such settlements are satisfied, then we anticipate all appeals will be withdrawn. The affirmation order (and thus the plan of reorganization) will be final and nonappealable within 30 days after either the District Court favorably adjudicates the appeals or the appeals are withdrawn and the stay of the affirmation order is vacated.

The plan of reorganization, which is consistent with the definitive settlement agreements reached with our asbestos and silica personal injury claimants in early 2003, provides that, if and when an order confirming the proposed plan of reorganization becomes final and nonappealable, the following will be contributed to trusts for the benefit of current and future asbestos and silica personal injury claimants:

- approximately $2.3 billion in cash;
- 59.5 million shares of Halliburton common stock;
- a one-year non-interest-bearing note of $31 million for the benefit of asbestos claimants;
- a silica note with an initial payment into a silica trust of $15 million. Subsequently, the note provides that we will contribute an amount to the silica trust balance at the end of each year for the next 30 years to bring the silica trust balance to $15 million, $10 million, or $5 million based upon a formula which uses average yearly disbursements from the trust to determine that amount. The note also provides for an extension of the note for 20 additional years under certain circumstances. We have estimated the amount of this note to be approximately $24 million. We will periodically reassess our valuation of this note based upon our projections of the amounts we believe we will be required to fund into the s ilica trust; and
- insurance proceeds, if any, between $2.3 billion and $3.0 billion received by DII Industries and Kellogg Brown & Root. However, if the proposed settlements with our insurance companies are completed on the terms announced or proposed, insurance recoveries will not be contributed to the trusts.

We intend to fund the trusts no later than 30 days after the affirmation order becomes final and nonappealable.

In connection with reaching an agreement with representatives of asbestos and silica claimants to limit the cash required to settle pending claims to $2.775 billion, DII Industries paid $311 million to the claimants in December 2003. We also agreed to guarantee the payment of certain claims, and, in accordance with settlement agreements, we made additional payments of $119 million, plus an additional $4 million in lieu of interest, in June 2004. We may not be entitled to reimbursement for these payments if the proposed plan of reorganization does not become effective. We expect to pay an additional approximately $59 million in pending claims under these settlement agreements within 30 days after the plan of reorganizat ion becomes final and nonappealable.

Our plan of reorganization calls for a portion of our total asbestos and silica liability to be settled by contributing 59.5 million shares of Halliburton common stock into the trusts. We will adjust our asbestos and silica liability related to the shares if the average value of Halliburton common stock for the five days immediately prior to and including the end of each fiscal quarter has increased by 5% or more from the most recent valuation of the shares. As of September 30, 2004, we revalued our shares to approximately $2.0 billion ($33.48 per share), an increase of $435 million from December 31, 2003, of which $190 million was recorded in the first quarter of 2004 and $245 million was recorded in the third quarter of 2004. The value of the shares to be contributed was classified as a long-term liability on ou r condensed consolidated balance sheets, and the shares were not included in our calculation of basic or diluted earnings per share. If the shares had been included in the calculation as of the beginning of 2004, our diluted earnings per share from continuing operations would have been reduced by $0.05 for both the nine and three months ended September 30, 2004. When and if we receive final and nonappealable confirmation of our proposed plan of reorganization, we will:

- increase or decrease our asbestos and silica liability to value the 59.5 million shares of Halliburton common stock based on the value of Halliburton stock on the date of final and nonappealable confirmation of our proposed plan of reorganization;
- reclassify from a long-term liability to shareholders’ equity the final value of the 59.5 million shares of Halliburton common stock; and
- include the 59.5 million shares in our calculations of earnings per share on a prospective basis.

We understand that the United States Congress may consider adopting legislation that would establish a national trust fund as the exclusive means for recovery for asbestos-related disease. We are uncertain as to what contributions we would be required to make to a national trust, if any, although it is possible that they could be substantial and that they could continue for several years. Our level of participation in and contribution to a national trust could be greater or less than it otherwise would have been as a result of having subsidiaries that have filed Chapter 11 proceedings due to asbestos liability.

Recent insurance developments. In January 2004, we reached a comprehensive agreement with Equitas to settle our insurance claims against certain underwriters at Lloyd's of London, reinsured by Equitas. The settlement, if all conditions precedent are satisfied, will resolve all asbestos-related claims made against Lloyd’s underwriters by us, including those made by our subsidiaries affected by the Chapter 11 proceedings. Provided that the confirmation order becomes final and nonappealable and the current United States Congress does not pass national asbestos litigation reform legislation before Januar y 5, 2005, Equitas will pay us $575 million, representing approximately 60% of the applicable limits of liability that we believe DII Industries had substantial likelihood of recovering from Equitas. The first payment of $500 million, which is classified as a current receivable as of September 30, 2004, will occur within 15 working days of the later of January 5, 2005 or the date on which the confirmation order becomes final and nonappealable. A second payment of $75 million will be made 18 months after the first payment.

In May 2004, we entered into nonbinding agreements in principle with representatives of the London Market insurance companies that, if implemented, would settle insurance disputes with substantially all the solvent London Market insurance companies for asbestos- and silica-related claims and all other claims under the applicable insurance policies. The agreements in principle with the London Market insurance companies are subject to board of directors' approval of all parties, agreement by all remaining London Market insurance companies, and an order by the bankruptcy court confirming the plan of reorganization that has become final and nonappealable. Currently, we expect to receive cash payments during the years of 2005 through 2009.

We also have entered into agreements in principle with certain of our insolvent London Market company insurers and with our solvent domestic insurance companies that, if implemented, would settle asbestos- and silica-related claims and all other claims under the applicable insurance policies and terminate all the applicable insurance policies. We are currently drafting the final settlement agreements with our insurers. The final settlement agreements with our remaining insurance companies would be subject to board of directors' approval of all parties, an order by the bankruptcy court approving the final settlement agreements, approval by the Federal-Mogul bankruptcy court (see "Federal-Mogul" below), approval by certain other parties, and our confirmation order becoming final and nonappealable.

These proposed settlements with our insurance companies are subject to numerous conditions, similar to the conditions of the Equitas settlement, including the condition that the United States Congress does not pass national asbestos litigation reform legislation before January 5, 2005. Although we are working toward implementation of these proposed settlements, there can be no assurance that the transactions contemplated by these agreements in principle can be completed on the terms announced.

Under the terms of our announced insurance settlements and proposed insurance settlements, we expect to receive cash proceeds with a nominal amount of approximately $1.5 billion and with a present value of approximately $1.4 billion for our asbestos- and silica-related insurance receivables. The present value was determined by discounting the expected future cash payments with a discount rate implicit in the settlements which is approximately 5.5% related to the domestic insurance companies. Beginning in the third quarter of 2004, this discount is accreted as interest income (classified as discontinued operations) over the life of the expected future cash payments.

We have filed motions with the bankruptcy court to request approval of the settlement agreements with substantially all of our insurance companies, and the bankruptcy court has agreed to consider the motions at a hearing scheduled for November 18, 2004. The insurance companies have agreed to join us in support of the motions. Our December 31, 2003 estimate of our asbestos- and silica-related insurance receivables already included the charge for the settlement amount under the Equitas agreement reached in January 2004, as well as certain other probable settlements with companies for which we could reasonably estimate the amount of the settlement. During 2004, we reduced the amount recorded as insurance receivables for asbestos- and silica-related liabilities insured by domestic companies based upon proposed agreeme nts in principle, resulting in pretax charges to discontinued operations of approximately $686 million.

Federal-Mogul. A significant portion of the insurance coverage applicable to Worthington Pump, a former division of DII Industries, is alleged by Federal-Mogul (and others who formerly were associated with Worthington Pump prior to its acquisition by DII Industries) to be shared with them. In 2001, Federal-Mogul and a large number of its affiliated companies filed a voluntary petition for reorganization under Chapter 11 of the Bankruptcy Code in the bankruptcy court in Wilmington, Delaware. In response to Federal-Mogul's allegations of shared insurance coverage, DII Industries filed a lawsuit on December 7, 2001 in Federal-Mogul's Chapter 11 proceedings asserting DII Industries' rights to asbestos ins urance coverage under historic general liability policies issued to McGraw-Edison Company, Studebaker-Worthington, Inc. and its predecessor. The parties to this litigation have agreed to mediate this dispute. A number of insurance companies who have agreed to coverage-in-place agreements with DII Industries have suspended payment under the shared Worthington Pump policies until the Federal-Mogul bankruptcy court resolves the insurance issues. Consequently, the effect of the Federal-Mogul Chapter 11 proceedings on DII Industries' rights to access this shared insurance has been uncertain. During the first quarter of 2004, we reached an agreement with Federal-Mogul which resolved all disputes regarding the insurance coverage provided by Equitas.

During October 2004, we reached an agreement in principle with Federal-Mogul, our insurance companies, and another party sharing in the insurance coverage to obtain their consent and support of a partitioning of the insurance policies. Under the terms of the agreement in principle, DII Industries would be allocated 50% of the limits of any applicable insurance policy, and the remaining 50% of limits of the insurance policies would be allocated to the remaining policyholders. As part of the settlement, DII Industries agreed to pay $46 million in three installment payments. The first payment of $16 million will be paid on the same day that DII Industries funds the asbestos and silica trusts. The second and third payments of $15 million each will occur on the first and second anniversaries from the date of the first payment. We are currently attempting to finalize this agreement in principle so that we may also finalize the settlements with the London Market insurance companies and the domestic insurance companies. If we are able to finalize this agreement in principle and the related agreements in principle with our solvent insurers, we will be able to dismiss all of our remaining insurance coverage lawsuits concerning asbestos-related and silica-related matters. In the third quarter of 2004, we accrued $43 million, which represents the present value of the $46 million to be paid. The discount will be accreted as interest expense (classified as discontinued operations) over the life of the expected future cash payments beginning in the fourth quarter of 2004.

Assuming that the agreement in principle with Federal-Mogul is finalized, DII Industries and Federal-Mogul agree to share equally in recoveries from insolvent London-based insurance companies. To the extent that Federal-Mogul's recoveries from certain insolvent London-based insurance companies received on or before January 1, 2006 do not equal at least $4.5 million, DII Industries agreed to also pay to Federal-Mogul the difference between their recoveries from the insolvent London-based insurance companies and $4.5 million. Any recoveries received by Federal-Mogul from the insolvent London-based insurance companies after January 1, 2006 will be reimbursed back to DII Industries until such time as DII Industries is fully reimbursed for the amount of the payment.

United States Government Contract Work

We provide substantial work under our government contracts business to the United States Department of Defense and other governmental agencies, including worldwide United States Army logistics contracts, known as LogCAP, and contracts to rebuild Iraq's petroleum industry, known as RIO and PCO Oil South. Our government services revenue related to Iraq totaled approximately $1.4 billion and $5.4 billion for the three and nine months ended September 30, 2004. Our units operating in Iraq and elsewhere under government contracts such as LogCAP, RIO, and PCO Oil South consistently review the amounts charged and the services performed under these contracts. Our operations under these contracts are also regularly reviewed and audited by the Defense Contract Audit Agency (DCAA) and other governmental agencies. The DCA A serves in an advisory role to our customer. When issues are found during the governmental agency audit process, these issues are typically discussed and reviewed with us. The DCAA will then issue an audit report with their recommendations to our customer's contracting officer. We then will work with our customer to reach a resolution.

Fuel. In December 2003, the DCAA issued a preliminary audit report which alleged that we may have overcharged the Department of Defense by $61 million in importing fuel into Iraq. To the best of our knowledge and belief, the DCAA report was never finalized. The DCAA questioned costs associated with fuel purchases made in Kuwait that were more expensive than buying and transporting fuel from Turkey. We responded that we had maintained close coordination of the fuel mission with the Army Corps of Engineers (COE), which is our customer and oversees the project, throughout the life of the task order and that the COE had directed us to use the Kuwait sources. After a review, the COE concluded that we obtained a fair pric e for the fuel. However, Department of Defense officials thereafter referred the matter to the agency's inspector general, which we understand has commenced an investigation.

The DCAA has issued various audit reports related to task orders under the RIO contract, which reported $296 million in questioned and unsupported costs. The majority of these costs are associated with the humanitarian fuel mission. In these reports, the DCAA has compared fuel costs we incurred during the duration of the RIO contract in 2003 and early 2004 to fuel prices obtained by the Defense Energy Supply Center (DESC) in April 2004, when the fuel mission was transferred to that agency. We believe the conditions specified by the customer for fuel purchases are materially different under the DESC and RIO contracts, and therefore a direct comparison of costs is not valid. We are currently preparing responses to the COE contracting officer, which we believe will substantiate that the costs questioned by the DCAA are allowable and reimbursable.

Dining Facility and Administration Centers (DFACs). During 2003, the DCAA raised issues relating to our invoicing to the Army Materiel Command (AMC) for food services for soldiers and supporting civilian personnel in Iraq and Kuwait. We believe the issues raised by the DCAA relate to the difference between the number of troops the AMC directed us to support and the number of soldiers actually served at dining facilities for United States troops and supporting civilian personnel in Iraq and Kuwait. In the first quarter of 2004, we reviewed our DFAC subcontracts in our Iraq and Kuwait areas of operation and have billed and continue to bill for all current DFAC costs. During 2004, we received notice from the DCAA that it was recommending withholding a portion of our DFAC billings. For DFAC billings relating to subcontracts entered into prior to February 2004, the DCAA has recommended withholding 19.35% of the billings until it completes its audits. Subsequent to February 2004, we have renegotiated our DFAC subcontracts to address the specific issues raised by the DCAA and have advised the AMC and the DCAA of the new terms of the arrangements. To date, we have had no objection by the government to these new DFAC subcontract agreements. During the third quarter of 2004, we received notification that, for three Kuwait DFACs, the DCAA is recommending to our customer that costs be disallowed because the DCAA is not satisfied with the level of documentation provided by us. The amount withheld related to suspended and recommended disallowed DFAC costs for work performed under the pre February 2004 subcontracts and totaled approximately $216 million as of September 30, 2004. The amount currently withheld could change as the DCAA continues their audits of the remaining DFAC facilities. We are negotiating with our customer, the AMC, to resolve this issue. We can withhold a proportionate amount of these billings from our subcontractors and are currently doing so. See "Investigations" section below for further discussion.

Laundry. During the third quarter of 2004, we received notice from the DCAA that it is recommending withholding $16 million of subcontract costs related to the laundry service for one task order in southern Iraq for which it believes we and our subcontractors have not provided adequate levels of documentation supporting the quantity of the services provided. The DCAA has recommended that the cost be withheld pending receipt of additional explanation or documentation to support subcontract cost. We are working with the AMC to resolve this issue.

Investigations. On January 22, 2004, we announced the identification by our internal audit function of a potential overbilling of approximately $6 million by La Nouvelle Trading & Contracting Company, W.L.L. (La Nouvelle), one of our subcontractors, under the LogCAP contract in Iraq, for services performed during 2003. In accordance with our policy and government regulation, the potential overcharge was reported to the Department of Defense Inspector General’s office as well as to our customer, the AMC. On January 23, 2004, we issued a check in the amount of $6 million to the AMC to cover that potential overbilling while we conducted our own investigation into the matter. Later in the first quarter of 2004, we determined that the amount of overbilling was $4 million and the subcontractor billing should have been $2 million for the services provided. As a result, we paid La Nouvelle $2 million and have billed our customer that amount. We are continuing to investigate whether La Nouvelle paid, or attempted to pay, one or two of our former employees in connection with the billing. See Note 15 “Litigation brought by La Nouvelle” to the condensed consolidated financial statements for further discussion.

In October 2004, we reported to the Department of Defense Inspector General's office that two former employees in Kuwait may have had inappropriate contacts with individuals employed by or affiliated with two third-party subcontractors prior to the award of the subcontracts. The Inspector General’s office may investigate whether these two employees may have solicited and/or accepted payments from these third-party subcontractors while they were employed by us.

In October 2004, a civilian contracting official in the COE asked for a review of the process used by the COE for awarding some of the contracts to us. We understand that the Department of Defense Inspector General’s office may review the issues involved.

We understand that the United States Department of Justice, an Assistant United States Attorney based in Illinois, and others are investigating some matters relating to our government contract work. We also understand that former employees of KBR have received subpoenas and have given or may give grand jury testimony relating to some of these matters. If criminal wrongdoing were found, criminal penalties could range up to the greater of $500,000 in fines per count for a corporation, or twice the gross pecuniary gain or loss.

Withholding of payments. During 2004, the AMC issued a determination that a particular contract clause would cause it to withhold 15% from our invoices until our task orders under the LogCAP contract are definitized. We have advised the AMC that we disagree with this interpretation. The AMC has not implemented this withholding; however, it has requested additional information regarding the impact of the potential withholding on us and our subcontractors’ ability to provide troop support under the LogCAP contract. We have provided information in response to this request, but do not know whether or how this information will impact the AMC’s decision to implement the 15% withholding in the future. We do not b elieve the potential 15% withholding will have a significant or sustained impact on our liquidity because the withholding is temporary and ends once the definitization process is complete. During the third quarter of 2004, we and the AMC identified three senior management teams to facilitate negotiation under the LogCAP task orders, and these teams are working to negotiate outstanding issues and definitize task orders as quickly possible. We are continuing to work with our customer to resolve outstanding issues. To date, definitization proposals for 30 task orders totaling over $500 million have been agreed in principle.

As of September 30, 2004, the COE had withheld $76 million of our invoices related to a portion of our RIO contract pending completion of the definitization process. All ten definitization proposals required under this contract have been submitted by us and three have been agreed in principle. The remaining seven have been reviewed by the DCAA, and we are in the process of responding to our customer on the auditor’s questions. These withholdings represent the amount invoiced in excess of 85% of the amounts we have currently estimated to the COE to complete the tasks ordered. The COE also could withhold similar amounts from future invoices under our RIO contract until our task orders under the RIO contract are definitized. Approximately $4 million was withheld from our PCO Oil South project as of September 30, 2004. We do not believe the withholding will have a significant or sustained impact on our liquidity because the withholding is temporary and ends once the definitization process is complete.

We are working diligently with our customers to proceed with significant work when we have a fully definitized task order, which should limit withholdings on future task orders.

Report on estimating system. The DCAA issued an audit report to our corporate administrative contracting officer (CACO) dated August 4, 2004 stating that, in the DCAA's opinion, our estimating system is not adequate to produce proposals for our customer to negotiate final pricing on government contracts. The report states that the DCAA has identified approximately $1.8 billion in unsupported costs relating to proposals under our LogCAP contracts. An unsupported cost in an estimate is one in which the DCAA requires additional documentation before expressing an opinion on the acceptability of the estimate. While the alleged $1.8 billion in unsupported costs referenced in the DCAA report represents estimated costs rather than incurred and/or billed costs and the DCAA is not recommending that such amounts be withheld, the untimely resolution of unsupported cost issues could affect the definitization process. In October 2004, we developed a corrective action plan with the CACO and DCAA and believe we will be able to demonstrate that our estimating system is adequate for negotiating with our customer and that we have appropriate support for our proposals. Should the estimating system ultimately be judged inadequate, all proposals over $100,000 would be required to be reviewed by the DCAA. Currently, all of our proposals over $500,000 must be reviewed.

Report on purchasing system. As a result of a Contractor Purchasing System Review by the Defense Contract Management Agency (DCMA) during the second quarter of 2004, the DCMA granted the continued approval of our government contract purchasing system. The review was conducted due to the unprecedented level of support we currently provide the military in Iraq and Kuwait. The DCMA's approval letter, dated September 7, 2004, stated that our purchasing system's policies and practices are "effective and efficient, and provide adequate protection of the Government's interest."

The Balkans. We have had inquiries in the past by the DCAA and the civil fraud division of the United States Department of Justice into possible overcharges for work performed during 1996 through 2000 under a contract in the Balkans, which inquiry has not yet been completed by the Department of Justice. Based on an internal investigation, we credited our customer approximately $2 million during 2000 and 2001 related to our work in the Balkans as a result of billings for which support was not readily available. We believe that the preliminary Department of Justice inquiry relates to potential overcharges in connection with a part of the Balkans contract under which approximately $100 million in work was done. We beli eve that any allegations of overcharges would be without merit.

Barracuda-Caratinga Project

In June 2000, Kellogg Brown & Root entered into a contract with Barracuda & Caratinga Leasing Company B.V., the project owner, to develop the Barracuda and Caratinga crude oilfields, which are located off the coast of Brazil. The construction manager and project owner's representative is Petrobras, the Brazilian national oil company. When completed, the project will consist of two converted supertankers, Barracuda and Caratinga, which will be used as floating production, storage, and offloading units, commonly referred to as FPSOs. In addition, there will be 32 hydrocarbon production wells, 22 water injection wells, and all subsea flow lines, umbilicals, and risers necessary to connect the underwater wells to the FPSOs. The original completion date for the Barracuda vessel was December 2003, and the origin al completion date for the Caratinga vessel was April 2004. The project is significantly behind the original schedule, due in part to change orders from the project owner, and is in a financial loss position.

In October 2004, the Barracuda vessel was moved offshore for sea trials and final inspections. We expect the Caratinga vessel to begin sea trials and final inspections in December 2004. Pursuant to the October 2004 agreement in principle with Petrobras described below, the Barracuda vessel must be completed by March 31, 2006, and the Caratinga vessel must be completed by June 30, 2006. However, there can be no assurance that further delays will not occur.

Our performance under the contract is secured by:

- performance letters of credit, which together have available credit of approximately $272 million as of September 30, 2004 and represent approximately 10% of the contract amount, as amended to date by change orders;
- retainage letters of credit, which together have available credit of approximately $189 million as of September 30, 2004 and which will increase in order to continue to represent 10% of the cumulative cash amounts paid to us; and
- a guarantee of Kellogg Brown & Root’s performance under the agreement by Halliburton Company in favor of the project owner.

In October 2004, Kellogg Brown & Root and Petrobras, on behalf of the project owner, entered into a nonbinding agreement in principle. The October 2004 agreement in principle replaces an April 2004 agreement in principle, is the basis for settlement of the various claims between the parties, and would amend existing agreements. Implementation of the agreement in principle requires final approval of the Board of Directors of Petrobras and Halliburton, the project lenders, and possibly the bankruptcy court that confirmed our proposed plan of reorganization. Discussions among all parties, including the project lenders, are underway. The October 2004 agreement in principle provides for:

- the release of all claims of all parties that arise prior to the effective date of a final definitive agreement;
- the payment to us of $78 million as a result of change orders for remaining claims;
- payment by Petrobras of applicable value added taxes on the project, except for $8 million which has been paid by us;
- the performance by Petrobras of certain work under the original contract;
- the repayment on December 7, 2004 by Kellogg Brown & Root of a portion of $300 million of advance payments, without interest; and
- revised milestones and other dates, including settlement of liquidated damages and an extension of time to the FPSO final acceptance dates.

While negotiations are proceeding to reach a final agreement based on the provisions of the October 2004 agreement in principle, there can be no guarantee that an agreement will be achieved.

In the first quarter of 2004, we recorded a charge of $97 million resulting from the April 2004 agreement in principle with Petrobras, as well as adjustments to our estimates of costs expected to be incurred to complete the project. In June 2004, we recorded additional operating losses on our Barracuda-Caratinga project of approximately $310 million. The additional charge resulted from a detailed review of the project indicating higher cost estimates, schedule delays, and increased contingencies for the balance of the project until completion. Specifically, in the second quarter, with the integration phase of the Barracuda vessel we experienced a significant reduction in productivity and rework required from the vessel conversion. We took steps to mobilize more resources including specialized management personnel in both Houston and South America to oversee the final stages of the project. We conducted additional cost and schedule reviews of the remaining project activities, and we initiated several work process changes in an attempt to expedite work on the project.

As of September 30, 2004:

- the project was approximately 90% complete;

- we have recorded an inception-to-date pretax loss of $762 million related to the project, of which $310 million was recorded in the second quarter of 2004; $97 million was recorded in the first quarter of 2004; $238 million was recorded in 2003 ($55 million during the first quarter of 2003, $173 million during the second quarter of 2003 and $10 million in the fourth quarter of 2003); and $117 million was recorded in 2002;
- the losses recorded include an estimated $24 million in liquidated damages based on the October 2004 agreement in principle; and
- the probable unapproved claims were reduced from $114 million at December 31, 2003 to zero based upon the October 2004 agreement in principle.

Default provisions. In the event that we were determined to be in default under the contract, and if the project was not completed by us as a result of our default, the project owner may seek direct damages. Those damages could include completion costs in excess of the contract price and interest on borrowed funds, but would exclude consequential damages. The total damages could be up to $500 million plus the return of up to $300 million in advance payments previously received by us to the extent they have not been repaid. A termination of the contract by the project owner could have a material adverse effect on our financial condition and results of operations.

Cash flow considerations. The project owner has procured project finance funding obligations from various lenders to finance the payments due to us under the contract. In addition, the project financing includes borrowing capacity in excess of the original contract amount.

Under the loan documents, the availability date for loan draws expired December 1, 2003 and, therefore, the project owner drew down all remaining available funds on that date. As a condition to the draw-down of the remaining funds, the project owner was required to escrow the funds for the exclusive use of paying project costs. The availability of the escrowed funds can be suspended by the lenders if applicable conditions are not met. With limited exceptions, these funds may not be paid to Petrobras or its subsidiary, which is funding the drilling costs of the project, until all amounts due to us, including amounts due for the change orders as agreed in the October 2004 agreement in principle, are liquidated and paid. While this potentially reduces the risk that the funds would not be available for payment to us, we are not party to the arrangement between the lenders and the project owner and can give no assurance that there will be adequate funding to cover current or future claims and change orders.

We have now begun to fund operating cash shortfalls on the project and are obligated to fund total shortages over the remaining project life. That funding level assumes that, pursuant to amended project agreements implementing the October 2004 agreement in principle, neither we nor the project owner recover additional claims against the other. Estimated cash flows relating to the losses are as follows:

(Millions of dollars)		
Amount funded through September 30, 2004	$	330
Amount expected to be funded during the remainder of 2004, including repayment of a portion of $300 million advance payments		262
Amount expected to be funded during 2005		170
Total cash shortfalls	$	762

LIQUIDITY AND CAPITAL RESOURCES

We ended the third quarter of 2004 with cash and equivalents of $3.0 billion compared to $1.8 billion at December 31, 2003.

Significant uses of cash. Our liquidity and cash balance during the first nine months of 2004 have been significantly affected by our government services work in Iraq. However, our working capital requirements for our Iraq related work, excluding cash and equivalents, were down from $1.1 billion in the second quarter of 2004 to approximately $500 million at September 30, 2004.

In connection with reaching an agreement with representatives of asbestos and silica claimants to limit the cash required to settle pending claims to $2.775 billion, DII Industries paid $311 million to the claimants in December 2003. At that time, we also agreed to guarantee the payment of certain claims, and, in accordance with settlement agreements, we made additional payments of $119 million, plus an additional $4 million in lieu of interest, in June 2004. We may not be entitled to reimbursement for these payments if the proposed plan of reorganization does not become effective. We expect to pay an additional approximately $59 million in pending claims under these settlement agreements within 30 days after the proposed plan of reorganization becomes final and nonappealable.

Additionally, we reached an agreement in principle with Federal-Mogul, our insurance companies, and other parties sharing the insurance coverage in October 2004. As part of the agreement, DII Industries agreed to pay $46 million in three installments. The first payment of $16 million will be paid on the same day that DII Industries funds the asbestos and silica trusts. The second and third payments of $15 million each, will occur on the first and second anniversaries from the date of the first payment. See “Executive Overview - Asbestos and Silica Obligations and Insurance Recoveries” for more information regarding anticipated cash flows for asbestos and silica matters.

Capital expenditures of $422 million in the nine months ended September 30, 2004 were 14% higher than in the nine months ended September 30, 2003. Capital spending in the first nine months of 2004 continued to be primarily directed to the Energy Services Group for production optimization, drilling and formation evaluation, and manufacturing capacity. Capital spending for 2004 is expected to be approximately $575 million. We paid $165 million in dividends to our shareholders in the first nine months of 2004 and $164 million in the first nine months of 2003.

Two of the legal matters on which we have had developments during 2004 are the BJ Services Company patent litigation and Anglo-Dutch (Tenge). See Note 15 to the condensed consolidated financial statements for more information. In April 2004, we paid the $107 million judgment amount in the BJ Services patent litigation, including pre- and post-judgment interest with the funds that had been used to post the bond in the case. In April 2004, we also reached a settlement with the plaintiffs in the Anglo-Dutch litigation and made all payments pursuant to the settlement agreement. During the second quarter of 2004, we recovered the $25 million cash in lieu of bond deposit for the Anglo-Dutch litigation formerly included in restricted cash.

We currently have commitments to fund approximately $55 million to certain of our related companies. These commitments arose primarily during the start-up of these entities or due to losses incurred by them. We expect approximately $46 million of the commitments to be paid during the next year.

See “Executive Overview - Barracuda-Caratinga Project: Cash flow considerations” above for anticipated timing of cash flow items related to the Barracuda-Caratinga project.

Significant sources of cash. Our operations provided approximately $977 million in cash flow in the first nine months of 2004. In addition, our cash flow was supplemented by cash totaling $126 million from the sale of Surface Well Testing in August 2004 and $20 million from the sale of our remaining shares of National Oilwell, Inc. in February 2004.

In January 2004, we issued senior notes due 2007 totaling $500 million, which will primarily be used to fund the asbestos and silica liability settlement. Our combined short-term notes payable and long-term debt was 70% of total capitalization at September 30, 2004 and 58% of total capitalization at December 31, 2003.

In May 2004, we entered into an agreement to sell, assign, and transfer the entire title and interest in specified United States government accounts receivable of KBR to a third party. The face value of the receivables sold to the third party is reflected as a reduction of accounts receivable in our condensed consolidated balance sheets. The amount of receivables which can be sold under the facility varies based on the amount of eligible receivables at any given time and other factors. However, each receivable sold pursuant to this agreement must have a net face value (as defined in this agreement) of at least $500,000 and the maximum amount that may be outstanding under this agreement at any given time is $650 million. The total amount outstanding under this agreement as of September 30, 2004 was approximately $2 02 million. Subsequent to the third quarter of 2004, these receivables were collected and the balance retired, and we are not currently selling further receivables, although the facility continues to be available.

In June 2004, we sold undivided interests totaling $268 million under our Energy Services Group securitization facility. As of September 30, 2004, we have $256 million outstanding under this facility. See “Off Balance Sheet Risk” below for further discussion.

Future sources of cash. We have available to us significant sources of cash in the near term should we need them.

Asbestos and silica liability financing. In the fourth quarter of 2003, we entered into a secured $700 million three-year revolving credit facility for general working capital purposes. In July 2004, we entered into an additional secured $500 million 364-day revolving credit facility for general working capital purposes with terms substantially similar to our $700 million revolving credit facility. In September 2004, we issued a letter of credit for approximately $172 million under our $700 million revolver, which replaced an expiring letter of credit for our Barracuda-Caratinga project, which reduced our availability under the revolver to $528 million. There were no cash drawings under our $700 million revolver or the $500 million 364-day revolving credit facility as of September 30, 2004.

Asbestos and silica settlements with insurance companies. In January 2004, we reached a comprehensive agreement with Equitas to settle our insurance claims against certain underwriters at Lloyd’s of London, reinsured by Equitas, for asbestos- and silica-related claims and all other claims under the applicable insurance policies.

In May 2004, we entered into nonbinding agreements in principle with representatives of the London Market insurance companies that, if implemented, would settle insurance disputes with substantially all the solvent London Market insurance companies for asbestos- and silica-related claims and all other claims under the applicable insurance policies and terminate all the applicable insurance policies.

We have also entered into agreements in principle with certain of our insolvent London Market insurance companies and with our solvent domestic insurance companies that, if implemented, would settle asbestos- and silica-related claims and all other claims under the applicable insurance policies and terminate all the applicable insurance policies.

These proposed settlements with our insurance companies are subject to numerous conditions, similar to the conditions of the Equitas settlement, including the condition that the United States Congress does not pass national asbestos litigation reform legislation before January 5, 2005.

Under the terms of our announced insurance settlements and proposed insurance settlements, we expect to receive cash proceeds with a present value of approximately $1.4 billion for our asbestos- and silica-related insurance receivables.

See “Executive Overview - Asbestos and Silica Obligations and Insurance Recoveries” above for a discussion regarding the timing of payments related to these settlements.

BUSINESS ENVIRONMENT AND RESULTS OF OPERATIONS

We currently operate in over 100 countries throughout the world, providing a comprehensive range of discrete and integrated products and services to the energy industry and to other industrial and governmental customers. The majority of our consolidated revenue is derived from the sale of services and products, including engineering and construction activities. We sell services and products primarily to major, independent, and national oil and gas companies and the United States Government. These products and services are used throughout the energy industry from the earliest phases of exploration, development, and production of oil and gas resources through refining, processing, and marketing. These products and services are also used by the United States Army Materiel Command for logistical support of troops and the reconstruction of the Iraqi oil industry. Our five business segments are organized around how we manage the business: Drilling and Formation Evaluation, Fluids, Production Optimization, Landmark and Other Energy Services, and the Engineering and Construction Group. We sometimes refer to the combination of our Drilling and Formation Evaluation, Fluids, Production Optimization, and Landmark and Other Energy Services segments as the Energy Services Group.

The industries we serve are highly competitive with many substantial competitors for each segment. In the first nine months of 2004, based upon the location of the services provided and products sold, 22% of our total revenue was from the United States and 30% was from Iraq. In the first nine months of 2003, 30% of our total revenue was from the United States and 10% of our total revenue was from the United Kingdom. Revenue from Iraq in the first nine months of 2003 was less than 10% of our total revenue. No other country accounted for more than 10% of our revenue during these periods. Unsettled political conditions, social unrest, acts of terrorism, force majeure, war or other armed conflict, expropriation or other governmental actions, inflation, exchange controls, or currency devaluation may result in increased business risk in any one country. We believe the geographic diversification of our business activities reduces the risk that loss of business in any international country would be material to our consolidated results of operations.

Halliburton Company

Activity levels within our business segments are significantly impacted by the following:

- spending on upstream exploration, development, and production programs by major, independent, and national oil and gas companies;
- capital expenditures for downstream refining, processing, petrochemical, and marketing facilities by major, independent, and national oil and gas companies;
- military action by the United States; and
- government spending levels.

Also impacting our activity is the status of the global economy, which indirectly impacts oil and gas consumption, demand for petrochemical products, and investment in infrastructure projects.

Energy Services Group

Some of the more significant barometers of current and future spending levels of oil and gas companies are oil and gas prices, exploration and production expenditures by international and national oil companies, the world economy, and global stability, which together drive worldwide drilling activity. Our Energy Services Group financial performance is significantly affected by oil and gas prices and worldwide rig activity, which are summarized in the following tables. When these increase, it generally means increased work for our businesses. The table below presents average oil and gas prices.

	Three Months Ended September 30		Year Ended
Average Oil and Gas Prices	2004	2003	2003
West Texas Intermediate oil prices (dollars per barrel)	$ 43.48	$ 30.15	$ 31.14
Henry Hub gas prices (dollars per million cubic feet)	$ 5.46	$ 4.89	$ 5.63

Our customers' cash flow, in many instances, depends upon the revenue they generate from the sale of oil and gas. With higher prices, they may have more cash flow, which usually translates into higher exploration and production budgets. Sustained higher prices may also mean that oil and gas exploration in marginal areas can become attractive, so our customers may consider investing in such properties when prices are high. The opposite is true for lower oil and gas prices.

As of the third quarter of 2004, oil prices have continued their upward trend due to low petroleum inventory levels in the United States and Organization for Economic Cooperation and Development countries, uncertainties caused by potential disruption of crude supplies in Iraq, Russia, Nigeria, Norway, and Venezuela, and increased demand in the United States and Asia markets reflecting improved year-over-year economies. Reduction in crude oil inventories in the United States was also impacted by lost production in the Gulf of Mexico and delays in tanker vessel offloading resulting from Hurricane Ivan in September 2004. Natural gas prices have remained relatively high compared to 2003, but have weakened compared to the second quarter of 2004 due to more moderate summer temperatures putting downward pressure on price s.

The quarterly and yearly average rotary rig counts based on the Baker Hughes Incorporated rig count information are as follows:

	Three Months Ended September 30		Nine Months Ended September 30	
Average Rig Counts	2004	2003	2004	2003
Land vs. Offshore				
United States:				
Land	1,134	979	1,074	897
Offshore	95	109	96	109
Total	1,229	1,088	1,170	1,006
Canada:				
Land	321	378	348	356
Offshore	5	5	4	4
Total	326	383	352	360
International (excluding Canada):				
Land	613	557	587	540
Offshore	233	225	240	223
Total	846	782	827	763
Worldwide total	2,401	2,253	2,349	2,129
Land total	2,068	1,914	2,009	1,793
Offshore total	333	339	340	336

Average Rig Counts	Three Months Ended September 30		Nine Months Ended September 30	
	2004	2003	2004	2003
Oil vs. Gas				
United States:				
Oil	169	153	160	158
Gas	1,060	935	1,010	848
Total	1,229	1,088	1,170	1,006
Canada: *	326	383	352	360
International (excluding Canada):				
Oil	662	586	640	569
Gas	184	196	187	194
Total	846	782	827	763
Worldwide total	2,401	2,253	2,349	2,129

* Canadian rig counts by oil and gas were not available.

Most of our work in the Energy Services Group closely tracks the number of active rigs. As rig count increases or decreases, so does the total available market for our services and products. Further, our margins associated with services and products for offshore rigs are generally higher than those associated with land rigs.

The continuing high oil and gas prices in 2004 have helped to significantly increase worldwide rig count compared to 2003. The worldwide rig count increased 7% in the third quarter of 2004 compared to the third quarter of 2003. The United States rig count increased in the third quarter of 2004 primarily as a result of land gas drilling, as gas prices remained high due to economic demand growth, higher fuel oil prices that discourage switching to a lower-priced fuel source to minimize cost, and disruptions due to severe weather in the Gulf of Mexico. Rig counts in the Gulf of Mexico remained flat compared to the third quarter of 2003. Year-over-year, international rig count increased primarily in Latin America, Asia Pacific, and the Middle East, offset by declining rig counts in Europe. In Western Europe, oil compa ny dissatisfaction with high operating costs and inconsistent government policies continued to impede exploration and production recovery.

It is common practice in the United States oilfield services industry to sell services and products based on a price book and then apply discounts to the price book based upon a variety of factors. The discounts applied typically increase to partially or substantially offset price book increases in the weeks immediately following a price increase. The discount applied normally decreases over time if the activity levels remain strong. During periods of reduced activity, discounts normally increase, reducing the net revenue for our services; conversely, during periods of higher activity, discounts normally decline resulting in net revenue increasing for our services.

Our May 2004 United States price book increase of approximately 5% to 8% is taking hold with our customers. We were able to realize a significant portion of the benefit of the price increase in the third quarter of 2004. During the third quarter of 2004, our average discount was nearly 2% higher than the same period last year, with increases in completions and reservoir optimization, cementing, logging services, and production enhancement, partially offset by declines in directional drilling services, drilling fluids, and drill bit sales. Although we faced inflationary pressures in our cost base, we have worked diligently to minimize their impact and are maintaining a steady focus on our capital discipline. Subsequent to the third quarter of 2004, we implemented a United States price book increase of 11% in our pu mping services. We expect to realize most of the benefits of this increase in 2005.

Overall outlook

Demand for gas and oilfield services continued to be strong in the third quarter of 2004, with operators gaining confidence in a significantly higher commodity trading range. The outlook for our Energy Services Group remains strong as we do not anticipate any major shifts in the under-supply positions for oil and gas in the medium-term. Recently, the Energy Information Administration (EIA) revised upward its forecast of world oil demand to 2.6 million barrels per day reflecting a 3.3% growth over 2003. In 2005, the EIA expects global demand to slow to 2.6% as high world oil prices begin to slow the pace of world economic growth. United States petroleum demand in 2004 is projected to be 1.9% higher compared to 2003. In 2005, however, United States demand is projected to slow to 1.2% in response to the combined effe cts of slower economic growth and high crude oil and product prices. Responding to high crude oil prices, demand for residual fuel oil is projected to decline in 2004 and to remain flat in 2005.

Natural gas prices weakened in the third quarter as cooling demand levels and peak power demand remained well below normal. However, current and future natural gas prices increased in the latter half of September 2004 in response to natural gas production losses in the Gulf of Mexico caused by Hurricane Ivan. According to the EIA projections, Henry Hub prices are expected to average $6.10 per mcf in 2004 and $6.18 per mcf in 2005. With continuing high rates of drilling for natural gas in North America, 2005 domestic production is projected to grow by 1.4%. Steady, if modest, increases in liquefied natural gas imports, restrained export growth, and carryover of robust storage levels for the upcoming winter are expected to contribute to moderate improvements in natural gas supply through 2005.

Spears and Associates expects the United States rig count to average 1,193 rigs in 2004, up 2% from its June 2004 estimate. Offshore activity is expected to decline approximately 10% in 2004 compared to 2003. For Canada, Spears is predicting an average of 372 rigs in 2004, which is down 7% from its June 2004 projection. Growth in international drilling activity is expected to remain positive over the coming year. Spears expects the international rig count to rise 7% in 2004 to an average 813 rigs, with 10,932 new wells forecasted to be drilled through 2005. Given the current level of prices, the economic incentive to drill is expected to remain attractive.

Engineering and Construction Group

Our Engineering and Construction Group, operating as KBR, provides a wide range of services to energy and industrial customers and government entities worldwide. Engineering and construction projects are generally longer-term in nature than our Energy Services Group work and are impacted by more diverse drivers than short-term fluctuations in oil and gas prices and drilling activities.

Effective October 1, 2004, we restructured KBR into two divisions, the Energy and Chemicals division and the Government and Infrastructure division. As a result of the reorganization and in a continued effort to better position KBR for the future, we have made several strategic organizational changes. We have eliminated certain internal expenditures that were yielding unfavorable returns; we have refocused our research and development expenditures with emphasis on the more profitable liquefied natural gas (LNG) market; and, we are attempting to take appropriate steps to streamline the entire organization. We expect to complete our reorganization efforts in the fourth quarter of 2004 and benefit from the full impact of our reorganization in 2005.

Our government services opportunities continue to remain strong across all regions, with United States government spending in Iraq outpacing other markets. Area security has continued to challenge the reconstruction of Iraq, and the handover from coalition forces to the interim Iraqi government has heightened uncertainty in this post-transition period. If stability is achieved in the coming months, we expect further contracting of the reconstruction plans and much activity in the engineering and construction industry in the Middle East. Due to our presence and performance in Iraq, we believe KBR is well-positioned to be awarded future work in the area. Other more traditional government markets and opportunities ranging from government services, outsourcing, and privatization will continue to mature and may present competitive opportunities.

Forecast LNG market growth remains strong in a range of 7% to 10% annual growth through 2010, with demand indicated to double in the period through 2015. Significant numbers of LNG liquefaction plant and LNG receiving terminal projects are proposed worldwide and are in various stages of development. Committed LNG liquefaction engineering, procurement, and construction projects are now yielding 13% compounded annual growth in worldwide LNG liquefaction capacity. This trend is expected to continue through 2007.

Outsourcing of operations and maintenance work by industrial and energy companies has been increasing worldwide. Even greater opportunities in this area are anticipated as the aging infrastructure in United States refineries and chemical plants require more maintenance and repairs to minimize production downtime. More stringent industry safety standards and environmental regulations also tend to lead to higher maintenance standards and costs. Higher feedstock prices have driven a recession market with many chemical plants running at a loss; several closures and minimum new construction is planned. In the refining industry, worldwide spending is shifting from capital expenditures to maintenance as refineries age and grow in complexity.

Engineering and construction contracts can be broadly categorized as either fixed-price, sometimes referred to as lump-sum, or cost-reimbursable contracts. Some contracts can involve both fixed-price and cost-reimbursable elements. Fixed-price contracts are for a fixed sum to cover all costs and any profit element for a defined scope of work. Fixed-price contracts entail more risk to us as we must predetermine both the quantities of work to be performed and the costs associated with executing the work.

Cost-reimbursable contracts include contracts where the price is variable based upon actual costs incurred for time and materials, or for variable quantities of work priced at defined unit rates. Profit elements on cost-reimbursable contracts may be based upon a percentage of costs incurred and/or a fixed amount. Cost-reimbursable contracts are generally less risky, since the owner retains many of the risks. While fixed-price contracts involve greater risk, they also potentially are more profitable for the contractor, since the owners pay a premium to transfer many risks to the contractor.

The approximate percentages of revenue attributable to fixed-price and cost-reimbursable Engineering and Construction Group segment contracts are as follows:

	Fixed-price	Cost-reimbursable
Nine months ended September 30, 2004	11%	89%
Year ended December 31, 2003	24%	76%

RESULTS OF OPERATIONS IN 2004 COMPARED TO 2003

Third Quarter of 2004 Compared with the Third Quarter of 2003

REVENUE:	Third Quarter		Increase/	Percentage
(Millions of dollars)	2004	2003	(Decrease)	Change
Drilling and Formation Evaluation	$ 450	$ 433	$ 17	4%
Fluids	618	510	108	21
Production Optimization	886	726	160	22
Landmark and Other Energy Services	154	136	18	13
Total Energy Services Group	2,108	1,805	303	17
Engineering and Construction Group	2,682	2,343	339	15
Total revenue	$ 4,790	$ 4,148	$ 642	16%
Geographic - Energy Services Group segments only:				
Drilling and Formation Evaluation:				
North America	$ 158	$ 149	$ 9	6%
Latin America	70	70	-	-
Europe/Africa	93	75	18	24
Middle East/Asia	129	139	(10)	(7)
Subtotal	450	433	17	4
Fluids:				
North America	288	244	44	18
Latin America	94	69	25	36
Europe/Africa	130	108	22	20
Middle East/Asia	106	89	17	19
Subtotal	618	510	108	21
Production Optimization:				
North America	475	351	124	35
Latin America	83	87	(4)	(5)
Europe/Africa	189	148	41	28
Middle East/Asia	139	140	(1)	(1)
Subtotal	886	726	160	22
Landmark and Other Energy Services:				
North America	48	47	1	2
Latin America	48	18	30	167
Europe/Africa	30	25	5	20
Middle East/Asia	28	46	(18)	(39)
Subtotal	154	136	18	13
Total Energy Services Group revenue	$ 2,108	$ 1,805	$ 303	17%

OPERATING INCOME (LOSS):	Third Quarter		Increase/	Percentage
(Millions of dollars)	2004	2003	(Decrease)	Change
Drilling and Formation Evaluation	$ 62	$ 45	$ 17	38%
Fluids	113	55	58	106
Production Optimization	222	118	104	88
Landmark and Other Energy Services	17	(48)	65	135
Total Energy Services Group	414	170	244	144
Engineering and Construction Group	(50)	49	(99)	(202)
General corporate	(22)	(15)	(7)	(47)
Operating income	$ 342	$ 204	$ 138	68%
Geographic - Energy Services Group segments only:				
Drilling and Formation Evaluation:				
North America	$ 28	$ 16	$ 12	75%
Latin America	6	8	(2)	(25)
Europe/Africa	15	5	10	200
Middle East/Asia	13	16	(3)	(19)
Subtotal	62	45	17	38
Fluids:				
North America	57	23	34	148
Latin America	20	14	6	43
Europe/Africa	20	-	20	NM
Middle East/Asia	16	18	(2)	(11)
Subtotal	113	55	58	106
Production Optimization:				
North America	135	54	81	150
Latin America	21	24	(3)	(13)
Europe/Africa	43	13	30	231
Middle East/Asia	23	27	(4)	(15)
Subtotal	222	118	104	88
Landmark and Other Energy Services:				
North America	8	(62)	70	113
Latin America	5	5	-	-
Europe/Africa	1	10	(9)	(90)
Middle East/Asia	3	(1)	4	NM
Subtotal	17	(48)	65	135
Total Energy Services Group operating income	$ 414	$ 170	$ 244	144%

NM - Not Meaningful

The increase in consolidated revenue for the third quarter of 2004 compared to the third quarter of 2003 was attributable to activity in our government services projects, primarily work in the Middle East, and improved sales of our Energy Services Group products and services. International revenue was 75% of consolidated revenue in the third quarter of 2004 and 74% of consolidated revenue in the third quarter of 2003, with the increase attributable to our government services projects abroad. Revenue from the United States Government for all geographic areas was approximately $1.6 billion, or 34% of consolidated revenue, for the third quarter of 2004. Revenue from the United States Government during the same period in 2003 represented 27% of consolidated revenue.

The consolidated operating income increase in the third quarter of 2004 compared to the third quarter of 2003 was attributable to stronger performance in our Energy Services Group due to increased worldwide rig counts and pricing improvements in the United States since the third quarter of 2003. The table below provides certain significant items included in segment operating income in the third quarters of 2004 and 2003.

	Three Months Ended September 30	
(Millions of dollars except per share data)	2004	2003
Production Optimization:		
Surface Well Testing gain on sale	$ 40	$ -
Landmark and Other Energy Services:		
Anglo-Dutch lawsuit	-	(77)
Engineering and Construction Group:		
Algerian gas processing plant income (loss)	(48)	4
Restructuring charge	(18)	-

We estimate that our third quarter of 2004 consolidated results suffered a combined $7 million negative impact due to Hurricane Ivan in the Gulf of Mexico and the labor strike in Norway. During the third quarter of 2004, Iraq-related work contributed approximately $1.4 billion to consolidated revenue and $4 million to consolidated operating income, less than a 1% margin before corporate costs and taxes. Following is a discussion of our results of operations by reportable segment.

Drilling and Formation Evaluation revenue increased $17 million in the third quarter of 2004 compared to the third quarter of 2003. Drilling services contributed $10 million to the revenue increase, driven largely by new contract activity in the North Sea, despite slowdowns from the labor strike in Norway, and increased directional drilling and logging-while-drilling activity in Canada. Improvements in drilling services revenue were partially offset by lower direct sales to China compared to the prior year quarter and activity declines in Saudi Arabia and Malaysia. Adding to segment revenue growth was an increase of $4 million in drill bits sales, primarily due to direct sales in the Caspian Sea reg ion and increased fixed cutter and near bit reamer sales in China. Logging and perforating services revenue was flat compared to the third quarter of 2003, with increased revenue from higher land rig activity and improved pricing in the United States offset by reduced activity in all other geographic regions. On a geographic basis, segment revenue was negatively impacted by a $9 million decline in Gulf of Mexico revenue where rig count remained constant but Hurricane Ivan disrupted current year quarter performance. International revenue was 71% of total segment revenue in the third quarter of 2004 and the third quarter of 2003.

Segment increase in operating income primarily reflects a $10 million increase in drilling services, largely due to an $11 million impact of change in depreciation policy, a surge in lost-in-hole work in the United Kingdom and new contract awards in Norway, offset by a negative impact of large direct sales in China in the prior year quarter. Logging and perforating services and drill bit sales collectively contributed $6 million to improved segment results on increased land rig activity in the United States and volume-driven results and effective cost reduction actions in Europe/Africa. Segment results in the Middle East/Asia region were negatively impacted by lower direct sales and start-up costs related to recent contract awards.

Fluids increase in revenue compared to the third quarter of 2003 was driven by a $57 million increase in revenue from cementing activities, which benefited from increased land rig activity and gas pipeline capacity improvements in the United States and direct sales into China. Pricing improvements on cementing products and services also contributed to higher revenue from the United States and Canada. Drilling fluids sales increased $48 million over the third quarter of 2003, attributable to continued high activity in southern and offshore Mexico, strengthening gas-driven activity in the United States and Canada, and new contracts in Europe and Africa. Drilling fluids revenue in the Gulf of Mexico wa s negatively impacted by Hurricane Ivan. The Fluids segment realized strong revenue increases across all geographic regions. International revenue was 58% of total segment revenue in the third quarter of 2004 compared to 56% in the third quarter of 2003.

The Fluids segment increase in operating income compared to the third quarter of 2003 resulted from a $29 million increase in cementing services due to higher land rig activity and improved pricing in North America and a $27 million increase in drilling fluids. Drilling fluids operating income benefited from increased land gas drilling activity in North America, cost reduction initiatives implemented in the Gulf of Mexico in the first half of 2004, and strengthening in Europe/Africa, particularly the North Sea. Also positively impacting drilling fluids operating income by $2 million in the current quarter was the absence of equity losses from the Enventure expandable casing joint venture, which is now accounted for on the cost basis since reducing our ownership in the first quarter of 2004.

Production Optimization increase in revenue compared to the third quarter of 2003 resulted primarily from a $136 million revenue improvement in production enhancement services, predominantly in North America. Production enhancement revenue benefited from increased rig activity in the United States, improved efficiencies with crew and equipment utilization in Canada, and improved pricing coupled with changes in product and service mix across North America. Production enhancement revenue also improved in Europe/Africa as a result of increased rigless services while rig count was substantially down compared to the third quarter of 2003. Revenue from completions and reservoir optimization product sales and services was essentially flat, with improved activity in the North Sea, Angola, and the Gulf of Mexico offset by reduced sand control completions activity in Nigeria and lost revenue due to the sale of our surface well test operation in August 2004. WellDynamics contributed $10 million to the segment revenue increase. International revenue was 52% of total segment revenue in the third quarter of 2004 compared to 57% in the third quarter of 2003.

Production Optimization operating income increase compared to the third quarter of 2003 reflects a $40 million pretax gain on the sale of our Surface Well Testing operations in August 2004. The remaining increase was primarily driven by production enhancement services, with improved operating income of $54 million, largely derived from increased land rig activity, higher equipment utilization, and improved pricing in the United States. Operating income from completions and reservoir optimization product sales and services was flat, while equity earnings from our Subsea 7 joint venture increased $7 million over the third quarter of 2003.

Landmark and Other Energy Services increase in revenue compared to the third quarter of 2003 was largely attributable to new integrated solutions contracts in Mexico and improved equity earnings in subsea operations, partially offset by reduced project management work in Iraq. Additionally, Landmark Graphics third quarter of 2004 revenue increased 3% over the 2003 third quarter due primarily to increased product sales in Asia Pacific and the United States. International revenue was 71% of total segment revenue in the third quarter of 2004 compared to 68% in the third quarter of 2003.

Segment operating income increased $65 million from a loss position in the third quarter of 2003, which included a $77 million charge related to the Anglo-Dutch lawsuit. Also impacting segment operating income in the current year quarter were lower service margins and charges of $3 million for severance and facility closure costs in Landmark Graphics.

Engineering and Construction Group increase in revenue compared to the third quarter of 2003 primarily reflects approximately $500 million in government services activity increases in the Middle East. Additionally, segment revenue increased $123 million from progress on a crude oil facility in Canada, an offshore management project in Kazakhstan, an olefins project in Africa, and activities at our shipyard in the United Kingdom. Partially offsetting the increases were $275 million lower revenue earned on the Barracuda-Caratinga project in Brazil, the Belanak project in Indonesia, a gas project in Nigeria, maintenance projects in the United States, and project completions in Europe, the United States , and offshore Mexico.

Engineering and Construction Group posted an operating loss of $50 million in the third quarter of 2004 compared to operating income of $49 million in the third quarter of 2003. The lower results are primarily attributable to cost increases on a gas processing plant project in Algeria resulting in a $48 million charge, and charges related to several joint venture infrastructure projects in Europe and Africa regions. Included in the current year quarter loss were restructuring and other related costs of $18 million due to reorganization of the business into two divisions effective October 1, 2004: Energy and Chemicals, and Government and Infrastructure. A $61 million reduction for estimated liquidated damages on the Barracuda-Caratinga project, as a result of the October 2004 agreement in principle, was offset by t he increased costs on the project, associated with accelerating the work to be completed to meet the revised schedule. Included in prior year quarter results were losses on hydrocarbon projects in Europe and the Middle East, offshore projects in Asia Pacific and lower income on oil and gas projects nearing completion in Western Africa.

General corporate expenses were $22 million in the third quarter of 2004 compared to $15 million in the same period of 2003. The increase in expenses primarily reflects financing fees on outstanding credit facilities and legal and professional fees.

NONOPERATING ITEMS

Interest expense increased $18 million in the third quarter of 2004 compared to the third quarter of 2003, due primarily to interest on $1.05 billion senior floating and fixed notes issued in October 2003 and $500 million senior floating rate notes issued in January 2004.

Interest income increased $6 million in the third quarter of 2004 compared to the third quarter of 2003, attributable to higher average daily cash balances during the quarter.

Foreign currency gains, net for the third quarter of 2004 were $1 million compared to a loss of $17 million for the same period of 2003. The loss in the third quarter of 2003 was primarily due to losses in the United Kingdom and Mexico.

Provision for income taxes of $111 million resulted in an effective tax rate of 37% in the third quarter of 2004, compared to an effective tax rate of 39% in the third quarter of 2003. The tax rate for the third quarter of 2004 was primarily due to a reduction of current taxes in foreign jurisdictions.

Loss from discontinued operations, net of tax in the third quarter of 2004 primarily reflects a $245 million pretax charge for the September 30, 2004 revaluation of the 59.5 million shares of Halliburton common stock to be contributed to the asbestos and silica claimant trusts as part of the proposed settlement. Also included is a $43 million accrual for payment related to our October 2004 agreement in principle with Federal-Mogul and $6 million pretax charge related to the write-down of the insurance receivable for asbestos- and silica-related liabilities. Discontinued operations loss of $34 million, net of tax, in the third quarter of 2003 reflects professional fees associated with the proposed as bestos and silica settlement and a $10 million allowance for an estimated portion of uncollectible amounts related to the insurance receivables purchased from Harbison-Walker in connection with their Chapter 11 reorganization proceeding.

RESULTS OF OPERATIONS IN 2004 COMPARED TO 2003

First Nine Months of 2004 Compared with the First Nine Months of 2003

REVENUE: *(Millions of dollars)*	First Nine Months 2004	First Nine Months 2003	Increase/ (Decrease)	Percentage Change
Drilling and Formation Evaluation	$ 1,317	$ 1,226	$ 91	7%
Fluids	1,707	1,508	199	13
Production Optimization	2,391	2,045	346	17
Landmark and Other Energy Services	413	417	(4)	(1)
Total Energy Services Group	5,828	5,196	632	12
Engineering and Construction Group	9,437	5,611	3,826	68
Total revenue	$ 15,265	$ 10,807	$ 4,458	41%
Geographic - Energy Services Group segments only:				
Drilling and Formation Evaluation:				
North America	$ 451	$ 414	$ 37	9%
Latin America	206	191	15	8
Europe/Africa	254	238	16	7
Middle East/Asia	406	383	23	6
Subtotal	1,317	1,226	91	7
Fluids:				
North America	806	742	64	9
Latin America	246	181	65	36
Europe/Africa	375	333	42	13
Middle East/Asia	280	252	28	11
Subtotal	1,707	1,508	199	13
Production Optimization:				
North America	1,229	999	230	23
Latin America	241	233	8	3
Europe/Africa	499	418	81	19
Middle East/Asia	422	395	27	7
Subtotal	2,391	2,045	346	17
Landmark and Other Energy Services:				
North America	143	143	-	-
Latin America	88	47	41	87
Europe/Africa	83	103	(20)	(19)
Middle East/Asia	99	124	(25)	(20)
Subtotal	413	417	(4)	(1)
Total Energy Services Group revenue	$ 5,828	$ 5,196	$ 632	12%

OPERATING INCOME (LOSS): *(Millions of dollars)*	First Nine Months 2004	First Nine Months 2003	Increase/ (Decrease)	Percentage Change
Drilling and Formation Evaluation	$ 164	$ 160	$ 4	3%
Fluids	250	178	72	40
Production Optimization	425	298	127	43
Landmark and Other Energy Services	60	(51)	111	218
Total Energy Services Group	899	585	314	54
Engineering and Construction Group	(342)	(118)	(224)	(190)
General corporate	(66)	(50)	(16)	(32)
Operating income	$ 491	$ 417	$ 74	18%
Geographic - Energy Services Group segments only:				
Drilling and Formation Evaluation:				
North America	$ 69	$ 56	$ 13	23%
Latin America	20	23	(3)	(13)
Europe/Africa	24	36	(12)	(33)
Middle East/Asia	51	45	6	13
Subtotal	164	160	4	3
Fluids:				
North America	131	72	59	82
Latin America	44	39	5	13
Europe/Africa	42	30	12	40
Middle East/Asia	33	37	(4)	(11)
Subtotal	250	178	72	40
Production Optimization:				
North America	260	149	111	74
Latin America	40	54	(14)	(26)
Europe/Africa	58	35	23	66
Middle East/Asia	67	60	7	12
Subtotal	425	298	127	43
Landmark and Other Energy Services:				
North America	38	(71)	109	154
Latin America	14	1	13	NM
Europe/Africa	-	10	(10)	(100)
Middle East/Asia	8	9	(1)	(11)
Subtotal	60	(51)	111	218
Total Energy Services Group operating income	$ 899	$ 585	$ 314	54%

NM - Not Meaningful

The increase in consolidated revenue for the first nine months of 2004 compared to the first nine months of 2003 was largely attributable to activity in our government services projects, primarily work in the Middle East, and, to a lesser extent, increased sales of our Energy Services Group products and services. International revenue was 78% of consolidated revenue in the first nine months of 2004 and 70% of consolidated revenue in the first nine months of 2003, with the increase attributable to our government services projects abroad. Revenue from the United States Government for all geographic areas was approximately $6.1 billion, or 40% of consolidated revenue, for the first nine months of 2004. Revenue from the United States Government during the same period in 2003 represented approximately 16% of consolidat ed revenue.

The increase in consolidated operating income was primarily due to stronger performance in our Energy Services Group resulting from increased worldwide rig counts, and pricing improvements in the United States in the current year. The table below provides certain significant items included in segment operating income in the first nine months of 2004 and 2003.

	Nine Months Ended September 30	
(Millions of dollars except per share data)	2004	2003
Production Optimization:		
HMS gain on sale	$ -	$ 24
Surface Well Testing gain on sale	40	-
Drilling and Formation Evaluation:		
Mono Pumps gain on sale	-	36
Landmark and Other Energy Services:		
Anglo-Dutch lawsuit	13	(77)
Wellstream loss on sale	-	(15)
Engineering and Construction Group:		
Algerian gas processing plant income (loss)	(46)	8
Restructuring charge	(18)	-
Barracuda-Caratinga project loss	(407)	(228)

We estimate that our consolidated results in the first nine months of 2004 suffered a combined $7 million negative impact due to Hurricane Ivan in the Gulf of Mexico and the labor strike in Norway. During the first nine months of 2004, Iraq-related work contributed approximately $5.4 billion to consolidated revenue and $64 million to consolidated operating income, a 1.2% margin before corporate costs and taxes. Following is a discussion of our results of operations by reportable segment.

Drilling and Formation Evaluation revenue improvement compared to the first nine months of 2003 was largely driven by a $52 million increase in logging and perforating services due to higher land rig activity and pricing improvements in the United States and direct sales to China. Drill bits revenue increased $19 million, benefiting from increases in land rig activity, improved pricing, and market penetration with fixed cutter and roller cone bits primarily in the United States, as well as sales growth in the Caspian Sea region. Drilling services contributed $15 million to the segment revenue increase, resulting principally from new contracts in Norway and higher activity in Canada and Venezuela, pa rtially offset by a substantial decline in logging-while-drilling activity in the Gulf of Mexico. The segment saw strong revenue increases across all geographic regions compared to the first nine months of 2003. International revenue was 72% of total segment revenue in the first nine months of 2004 and 2003.

Operating income for the segment increased $4 million in the first nine months of 2004 compared to the first nine months of 2003. Logging and perforating services contributed $26 million to the increase, due to improved pricing and land rig activity in the United States and direct sales in China. Improved results of $10 million in drilling services benefited from lower depreciation expense in the 2004 nine-month period compared to 2003 due to extending asset lives in the second quarter of 2004. Sale of drill bits contributed $3 million to improved segment results on higher revenue in the United States and Asia. The first nine months of 2003 included a $36 million pretax gain on the disposition of Mono Pumps in the first quarter of 2003.

Fluids revenue increase compared to the first nine months of 2003 was driven by a $132 million improvement in revenue from cementing activities, due primarily to increased land rig count and pricing improvements in the United States and start-up activity on recent contract awards in Mexico and Norway. Drilling fluids contributed $54 million to the segment revenue increase, resulting largely from new land work in Mexico and new contracts in the United States and the North Sea. Increases in segment revenue were partially offset by significantly decreased activity in the Gulf of Mexico. International revenue was 58% of total segment revenue in the first nine months of 2004 compared to 55% in the first nine months of 2003.

The Fluids segment operating income increase compared to the first nine months of 2003 resulted from a cementing services increase of $50 million and a drilling fluids increase of $14 million. These improved results occurred primarily in the United States due to increased land rig activity, improved pricing, and new customer business. Segment operating income in the first nine months of 2004 was substantially impacted by reduced activity in the Gulf of Mexico, especially in the higher margin deepwater market.

Production Optimization increase in revenue compared to the first nine months of 2003 was largely attributable to production enhancement services, which yielded $292 million in higher revenue. This was driven by higher average rig count in the United States, increased activity and improved crew utilization in Canada and Russia, and increased activity in Algeria and Gabon. Completions and reservoir optimization services contributed $37 million to the segment revenue increase on improved activity in the North Sea, Eurasia, and Algeria. WellDynamics, which has been consolidated since the first quarter of 2004, contributed $30 million. These gains were negatively impacted by a significant reduction of c ompletions activity in Nigeria and a $15 million decline compared to 2003 in revenue from our surface well test operations, primarily attributable to its sale in the third quarter of 2004. International revenue was 54% of total segment revenue in the first nine months of 2004 compared to 55% in the first nine months of 2003.

Production Optimization operating income for the first nine months of 2004 increased $127 million as compared to the first nine months of 2003. Included in the results were pretax gains of $24 million from the sale of Halliburton Measurement Systems in the second quarter of 2003 and $40 million from the sale of our Surface Well Testing product and service line in the third quarter of 2004. Production enhancement services contributed $103 million to the segment increase, primarily on fall-through of increased activity in the United States and Canada, offset by declines in Mexico and Brazil. Completions and reservoir optimization increase of $15 million primarily reflects higher sales of completions and sand control products in the United Kingdom and Norway and a more favorable product mix in Eurasia and the Far Eas t, offset by a significant reduction in sand control tool sales in Nigeria in the current year nine-month period. Segment results were also negatively impacted by a decrease of $9 million in equity income from our Subsea 7 joint venture, largely attributable to changes in estimated project costs and claims recoveries.

Landmark and Other Energy Services revenue decrease compared to the first nine months of 2003 was due to a decline in subsea operations in the first half of 2004 and the absence of $11 million of revenue from Wellstream prior to the sale of this business in the first quarter of 2003. The segment revenue decrease was partially offset by a $9 million increase in Landmark Graphics revenue from greater hardware and services sales in India, higher software sales in China, and new contracts in Mexico. International revenue was 68% of total segment revenue in the first nine months of 2004 compared to 69% in the first nine months of 2003.

Segment operating income increased $111 million from a loss position in the first nine months of 2003. Contributing to this increase was a $77 million charge related to the Anglo-Dutch lawsuit in the third quarter of 2003, a $15 million pretax loss on the disposition of Wellstream in the first quarter of 2003, a $13 million release of legal liability accruals in the first quarter of 2004 pertaining to the April 2004 Anglo-Dutch settlement, and increased integrated solutions operating income stemming from higher commodity prices.

Engineering and Construction Group increase in revenue compared to the first nine months of 2003 was due primarily to an approximate $4.1 billion increase in government services activity in the Middle East, and, to a lesser extent, a $477 million increase in other government projects and projects in Canada, the United States, the United Kingdom, and South Africa. The revenue increase was partially offset by lower revenue of $738 million on the Barracuda-Caratinga project in Brazil, the Belanak project in Indonesia, and completion of refining facilities in the United States, gas projects in Africa , an offshore project in Mexico, and a hydrocarbon project in Europe.

Engineering and Construction group operating loss for the first nine months of 2004 was $342 million compared to a $118 million loss in the first nine months of 2003. Included in the 2004 results was a loss on the Barracuda-Caratinga project of $407 million compared to a $228 million loss in 2003. A $61 million reduction for estimated liquidated damages on the Barracuda-Caratinga project, as a result of the October 2004 agreement in principle, was offset by the increased costs on the projects associated with accelerating the work to be completed to meet the revised schedule. Results for the current year nine-month period also include $18 million in restructuring and other related charges for reorganization of the business into two divisions. In addition, several joint venture infrastructure projects in the Europe and Africa region and a gas project in Algeria were negatively affected by projected cost increases. The operating loss in the first nine months of 2004 was partially offset by increased income on government projects. Also included in the 2003 nine-month results were losses on hydrocarbon projects in Europe and the Middle East.

General corporate expenses for the first nine months of 2004 were $66 million compared to $50 million for the first nine months of 2003. General corporate expenses for the first nine months of 2004 included a $7.5 million charge related to a settlement with the SEC, financing fees on outstanding credit facilities, Sarbanes-Oxley compliance expenses, and increased spending on media relations.

NONOPERATING ITEMS

Interest expense increased $75 million in the first nine months of 2004 compared to the same period in 2003, due primarily to interest on $1.2 billion convertible notes issued in June 2003, $1.05 billion senior floating and fixed notes issued in October 2003, and $500 million senior floating rate notes issued in January 2004.

Interest income increased $8 million in the first nine months of 2004 compared to the same period in 2003, primarily attributable to higher average daily cash balances during the third quarter of 2004.

Foreign currency losses, net for the first nine months of 2004 were $9 million compared to a loss of $4 million for the same period of 2003. The losses in 2004 were primarily due to losses in Indonesia and devaluation of the Eurodollar.

Provision for income taxes of $131 million resulted in an effective tax rate of 37% in the first nine months of 2004, compared to an effective tax rate of 40% in the first nine months of 2003. The tax rate for the first nine months of 2004 was attributable to lower tax benefits on Barracuda-Caratinga charges, offset by reduction of current taxes in foreign jurisdictions. The tax rate for the first nine months of 2003 was partially the result of the tax effect on the gain from the sale of our Mono Pumps business and loss from the sale of Wellstream. These transactions included $14 million of realized cumulative translation loss, which is not deductible for tax purposes.

Loss from discontinued operations, net of tax in the first nine months of 2004 included a $686 million pretax charge related to the write-down of the insurance receivable for asbestos- and silica-related liabilities, $435 million in pretax charges for the revaluation of 59.5 million shares of Halliburton common stock to be contributed to the asbestos and silica claimant trusts as part of the proposed settlement, a $43 million payment related to our October 2004 agreement in principle with Federal-Mogul, and an $11 million pretax charge related to the delayed-draw term facility, which expired in June 2004. The loss from discontinued operations, net of tax, was $58 million in the first nine months of 2003.

Cumulative effect of change in accounting principle, net for the first nine months of 2003 was an $8 million after-tax charge, or $0.02 per diluted share, related to our January 1, 2003 adoption of Financial Accounting Standards Board Statement No. 143, “Accounting for Asset Retirement Obligations.”

OFF BALANCE SHEET RISK

In April 2004, the expiration date for our Energy Services Group accounts receivable securitization facility was extended to April 2005. We have the ability to sell up to $300 million under this facility. As of September 30, 2004, we had sold $256 million undivided ownership interest to unaffiliated companies.

In May 2004, we entered into an agreement to sell, assign, and transfer the entire title and interest in specified United States government accounts receivable of KBR to a third party. The face value of the receivables sold to the third party is reflected as a reduction of accounts receivable in our condensed consolidated balance sheets. The amount of receivables which can be sold under the agreement varies based on the amount of eligible receivables at any given time and other factors, and the maximum amount that may be sold and outstanding under this agreement at any given time is $650 million. The total amount of receivables outstanding under this agreement as of September 30, 2004 was approximately $202 million. Subsequent to the third quarter of 2004, these receivables were collected and the balance retired, and we are not currently selling further receivables, although the facility continues to be available.

ENVIRONMENTAL MATTERS

We are subject to numerous environmental, legal, and regulatory requirements related to our operations worldwide. In the United States, these laws and regulations include, among others:

- the Comprehensive Environmental Response, Compensation, and Liability Act;
- the Resources Conservation and Recovery Act;
- the Clean Air Act;
- the Federal Water Pollution Control Act; and
- the Toxic Substances Control Act.

In addition to the federal laws and regulations, states and other countries where we do business may have numerous environmental, legal, and regulatory requirements by which we must abide. We evaluate and address the environmental impact of our operations by assessing and remediating contaminated properties in order to avoid future liabilities and comply with environmental, legal, and regulatory requirements. On occasion, we are involved in specific environmental litigation and claims, including the remediation of properties we own or have operated, as well as efforts to meet or correct compliance-related matters. Our Health, Safety and Environment group has several programs in place to maintain environmental leadership and to prevent the occurrence of environmental contamination.

We do not expect costs related to these remediation requirements to have a material adverse effect on our consolidated financial position or our results of operations. Our accrued liabilities for environmental matters were $38 million as of September 30, 2004 and $31 million as of December 31, 2003. The liability covers numerous properties and no individual property accounts for more than $5 million of the liability balance. In some instances, we have been named a potentially responsible party by a regulatory agency, but in each of those cases, we do not believe we have any material liability. We have subsidiaries that have been named as potentially responsible parties along with other third parties for 14 federal and state superfund sites for which we have established a liability. As of September 30, 2004, those 14 sites accounted for approximately $10 million of our total $38 million liability.

FORWARD-LOOKING INFORMATION AND RISK FACTORS

The Private Securities Litigation Reform Act of 1995 provides safe harbor provisions for forward-looking information. Forward-looking information is based on projections and estimates, not historical information. Some statements in this Form 10-Q are forward-looking and use words like "may," "may not," "believes," "do not believe," "expects," "do not expect," "anticipates," "do not anticipate," and other expressions. We may also provide oral or written forward-looking information in other materials we release to the public. Forward-looking information involves risks and uncertainties and reflects our best judgment based on current information. Our results of operations can be affected by inaccurate assumptions we make or by known or un known risks and uncertainties. In addition, other factors may affect the accuracy of our forward-looking information. As a result, no forward-looking information can be guaranteed. Actual events and the results of operations may vary materially.

We do not assume any responsibility to publicly update any of our forward-looking statements regardless of whether factors change as a result of new information, future events, or for any other reason. You should review any additional disclosures we make in our press releases and Forms 10-K, 10-Q, and 8-K filed with the United States Securities and Exchange Commission (SEC). We also suggest that you listen to our quarterly earnings release conference calls with financial analysts.

While it is not possible to identify all factors, we continue to face many risks and uncertainties that could cause actual results to differ from our forward-looking statements and potentially materially and adversely affect our financial condition and results of operations, including risks relating to:

Asbestos and Silica Liability

Our ability to complete our proposed settlement and plan of reorganization

On July 21, 2004, the bankruptcy court entered an order, effective as of July 16, 2004, confirming the plan of reorganization to implement our proposed asbestos and silica settlement. Despite an appeal by certain of our insurance companies, on July 26, 2004, the United States District Court for the Western District of Pennsylvania affirmed the confirmation order. On August 3, 2004, certain insurance companies filed a motion to vacate the District Court's affirmation order in order to protect their appeal rights. If our previously announced agreements in principle with insurance companies are finalized and approved by the relevant bankruptcy courts, the insurance companies have agreed to dismiss their appeals. Due to efforts being made by our affected subsidiaries to complete these settlements with, among othe rs, the insurance companies that appealed the confirmation order, the parties and the District Court agreed to stay the affirmation order. We have filed motions with the bankruptcy court to request approval of the settlement agreements with substantially all of our insurance companies, and the bankruptcy court has agreed to consider the motions at a hearing scheduled for November 18, 2004. The insurance companies have agreed to join us in support of the motions. If the settlements with the insurance companies are approved by the relevant bankruptcy courts and the conditions to such settlements are satisfied, then we anticipate all appeals will be withdrawn. The affirmation order (and thus the plan of reorganization) will be final and nonappealable within 30 days after either the District Court favorably adjudicates the appeals or the appeals are withdrawn and the stay of the affirmation order is vacated.

Completion of the proposed plan of reorganization is also conditioned on continued availability of financing on terms acceptable to us in order to allow us to fund the cash amounts to be paid in the plan of reorganization. There can be no assurance that such conditions will be met.

Effect of inability to complete a plan of reorganization

If the currently proposed plan of reorganization does not become effective and the Chapter 11 proceedings are not dismissed, the Debtors could propose a new plan of reorganization. Chapter 11 permits a company to remain in control of its business, protected by a stay of all creditor action, while that company attempts to negotiate and confirm a plan of reorganization with its creditors. However, it is uncertain for how long a period of time the bankruptcy court would permit the debtors to retain their exclusive right to file an amended plan of reorganization. If the Debtors are unsuccessful in obtaining confirmation of the currently proposed plan of reorganization or an amended plan of reorganization, the assets of the Debtors could be liquidated in the Chapter 11 proceedings, a third party may obtain the right to file a plan of reorganization, the Chapter 11 proceedings could be converted to proceedings under Chapter 7 of the United States Bankruptcy Code or the cases could be dismissed. In the event of a liquidation of the Debtors, or a plan of reorganization proposed by a third party, Halliburton could lose its controlling interest in DII Industries and Kellogg Brown & Root. Moreover, if the plan of reorganization is not confirmed and the Debtors have insufficient assets to pay the creditors, Halliburton's assets could be drawn into the liquidation proceedings because Halliburton guarantees certain of the Debtors' obligations.

Proposed federal legislation may affect our liability and agreements

We understand that the United States Congress may consider adopting legislation that would establish a national trust fund as the exclusive means for recovery for asbestos-related disease. We are uncertain as to what contributions we would be required to make to a national trust, if any, although it is possible that they could be substantial and that they could continue for several years. Our level of participation in and contribution to a national trust could be greater or less than it otherwise would have been as a result of having subsidiaries that have filed Chapter 11 proceedings due to asbestos liabilities.

Under the terms of our announced insurance settlements and proposed insurance settlements, we expect to receive cash proceeds with a nominal amount of approximately $1.5 billion and with a present value of approximately $1.4 billion for our asbestos- and silica-related insurance receivables. However, one of the conditions to the effectiveness of our announced and proposed insurance settlements is or, with respect to the proposed settlements, is expected to be, that no law shall be passed by the United States Congress that relates to, regulates, limits, or controls the prosecution of asbestos claims in United States state or federal courts or any other forum. If national asbestos litigation legislation in the form presently being considered is passed by the United States Congress on or before January 5, 2005 and be comes law, and our plan of reorganization has become final and nonappealable before passage of the new legislation, we would not receive the $1.4 billion in cash provided by these settlements, but we would retain the rights we currently have against our insurance companies, which includes coverage with a face amount of more than $3 billion.

Possible remaining asbestos and silica exposure

An effective plan of reorganization and injunctions under Sections 524(g) and 105 of the United States Bankruptcy Code may not apply to protect against all asbestos and silica claims asserted against us in jurisdictions outside the United States. For example, while we have historically not received a significant number of claims outside the United States, any such future claims would be subject to the applicable legal system of the jurisdiction where the claim was made. The enforceability of injunctions under the United States Bankruptcy Code in such jurisdictions is uncertain. In addition, the Section 524(g) injunction would not apply to some claims under worker's compensation arrangements. Although we do not believe that we have material exposure to foreign or worker's compensation claims, there can be no assurance that material claims would not be made in the future. Further, to our knowledge, the constitutionality of an injunction under Section 524(g) of the United States Bankruptcy Code has not been tested in a court of law. We can provide no assurance that, if the constitutionality is challenged, the injunction would be upheld.

In addition, although we would have other significant affirmative defenses, the injunctions issued under the United States Bankruptcy Code may not cover all silica personal injury claims arising as a result of future silica exposure after the effective date of the proposed plan of reorganization. Moreover, the proposed plan of reorganization does not resolve claims for property damage as a result of materials containing asbestos. Accordingly, although we have historically received no such claims, claims could still be made as to damage to property or property value as a result of asbestos-containing products having been used in a particular property or structure.

Insurance recoveries

In January 2004, we reached a comprehensive agreement with Equitas to settle our insurance claims against certain underwriters at Lloyd's of London, reinsured by Equitas, for asbestos- and silica-related claims and all other claims under the applicable insurance policies. There are conditions to completion of the settlement with Equitas, and there can be no assurance that this settlement will be completed on the terms announced. We are also negotiating settlement agreements with other insurance companies.

In May 2004, we entered into nonbinding agreements in principle with representatives of the London Market insurance companies that, if implemented, would settle insurance disputes with substantially all the solvent London Market insurance companies for asbestos- and silica-related claims and all other claims under the applicable insurance policies. The agreements in principle with the London Market insurance companies are subject to board of directors' approval of all parties, agreement by all remaining London Market insurance companies, and an order by the bankruptcy court confirming the plan of reorganization that has become final and nonappealable.

We also have entered into agreements in principle with certain of our insolvent London Market company insurers and with our solvent domestic insurance companies that, if implemented, would settle asbestos- and silica-related claims and all other claims under the applicable insurance policies and terminate all the applicable insurance policies. We are currently drafting the final settlement agreements with our insurers. The final settlement agreements with our remaining insurance companies would be subject to board of directors' approval of all parties, an order by the bankruptcy court approving the final settlement agreements, approval by the Federal-Mogul bankruptcy court (see "Federal-Mogul" below), approval by certain other parties, and our confirmation order becoming final and nonappealable.

These proposed settlements with our insurance companies are subject to numerous conditions, similar to the conditions of the Equitas settlement, including the condition that the United States Congress does not pass national asbestos litigation reform legislation before January 5, 2005.

Under the terms of our announced insurance settlements and proposed insurance settlements, we expect to receive cash proceeds with a nominal amount of approximately $1.5 billion and with a present value of approximately $1.4 billion for our asbestos- and silica-related insurance receivables. The present value was determined by discounting the expected future cash payments with a discount rate implicit in the settlements which is approximately 5.5% related to the domestic insurance companies. Beginning in the third quarter of 2004, this discount is accreted as interest income (classified as discontinued operations) over the life of the expected future cash payments.

Our December 31, 2003 estimate of our asbestos- and silica-related insurance receivables already included the charge for the settlement amount under the Equitas agreement reached in January 2004, as well as certain other probable settlements with companies for which we could reasonably estimate the amount of the settlement. During 2004, we reduced the amount recorded as insurance receivables for asbestos- and silica-related liabilities insured by domestic companies based upon proposed agreements in principle, resulting in pretax charges to discontinued operations of approximately $686 million.

Federal-Mogul. A significant portion of the insurance coverage applicable to Worthington Pump, a former division of DII Industries, is alleged by Federal-Mogul (and others who formerly were associated with Worthington Pump prior to its acquisition by DII Industries) to be shared with them. In 2001, Federal-Mogul and a large number of its affiliated companies filed a voluntary petition for reorganization under Chapter 11 of the Bankruptcy Code in the bankruptcy court in Wilmington, Delaware. In response to Federal-Mogul's allegations of shared insurance coverage, DII Industries filed a lawsuit on December 7, 2001 in Federal-Mogul's Chapter 11 proceedings asserting DII Industries' rights to asbestos ins urance coverage under historic general liability policies issued to McGraw-Edison Company, Studebaker-Worthington, Inc. and its predecessor. The parties to this litigation have agreed to mediate this dispute. A number of insurance companies who have agreed to coverage-in-place agreements with DII Industries have suspended payment under the shared Worthington Pump policies until the Federal-Mogul bankruptcy court resolves the insurance issues. Consequently, the effect of the Federal-Mogul Chapter 11 proceedings on DII Industries' rights to access this shared insurance has been uncertain. During the first quarter of 2004, we reached an agreement with Federal-Mogul which resolved all disputes regarding the insurance coverage provided by Equitas.

During October 2004, we reached an agreement in principle with Federal-Mogul, our insurance companies, and another party sharing in the insurance coverage to obtain their consent and support of a partitioning of the insurance policies. Under the terms of the agreement in principle, DII Industries would be allocated 50% of the limits of any applicable insurance policy, and the remaining 50% of limits of the insurance policies would be allocated to the remaining policyholders. As part of the settlement, DII Industries agreed to pay $46 million in three installment payments. The first payment of $16 million will be paid on the same day that DII Industries funds the asbestos and silica trusts. The second and third payments of $15 million each will occur on the first and second anniversaries from the date of the first payment. We are currently attempting to finalize this agreement in principle so that we may also finalize the settlements with the London Market insurance companies and the domestic insurance companies. If we are able to finalize this agreement in principle and the related agreements in principle with our solvent insurers, we will be able to dismiss all of our remaining insurance coverage lawsuits concerning asbestos-related and silica-related matters. In the third quarter of 2004, we accrued $43 million, which represents the present value of the $46 million to be paid. The discount will be accreted as interest expense (classified as discontinued operations) over the life of the expected future cash payments beginning in the fourth quarter of 2004.

Assuming that the agreement in principle with Federal-Mogul is finalized, DII Industries and Federal-Mogul agree to share equally in recoveries from insolvent London-based insurance companies. To the extent that Federal-Mogul's recoveries from certain insolvent London-based insurance companies received on or before January 1, 2006 do not equal at least $4.5 million, DII Industries agreed to also pay to Federal-Mogul the difference between their recoveries from the insolvent London-based insurance companies and $4.5 million. Any recoveries received by Federal-Mogul from the insolvent London-based insurance companies after January 1, 2006 will be reimbursed back to DII Industries until such time as DII Industries is fully reimbursed for the amount of the payment.

Although we are working toward implementation of these announced and proposed insurance settlements, there can be no assurance that such settlements can be completed on the terms as either announced or proposed. In addition, if we are unable to complete our announced and proposed insurance settlements, we may be unable to recover, or we may be delayed in recovering, insurance reimbursements related to asbestos and silica claims due to, among other things:

- the inability or unwillingness of insurance companies to timely reimburse for claims in the future;
- disputes as to documentation requirements for DII Industries, Kellogg Brown & Root, or other subsidiaries in order to recover claims paid;
- the inability to access insurance policies shared with, or the dissipation of shared insurance assets by, Harbison-Walker Refractories Company, Federal-Mogul, or others;

- the possible insolvency or reduced financial viability of our insurance companies;
- the cost of litigation to obtain insurance reimbursement; and
- possible adverse court decisions as to our rights to obtain insurance reimbursement.

Effect of Chapter 11 proceedings on our business and operations

Because our financial condition and our results of operations depend on distributions from our subsidiaries, any prolonged Chapter 11 proceedings of those subsidiaries, including DII Industries and Kellogg Brown & Root, may have a negative impact on our cash flow and distributions from those subsidiaries. These subsidiaries are not able to make distributions of profits to Halliburton during the Chapter 11 proceedings without court approval. In addition, extension of the Chapter 11 proceedings could materially and adversely affect the ability of our subsidiaries in Chapter 11 proceedings to obtain new orders from current or prospective customers. As a result of any prolonged Chapter 11 proceedings, some current and prospective customers, suppliers, and other vendors may assume that our subsidiaries are financia lly weak and will be unable to honor obligations, making those customers, suppliers, and other vendors reluctant to do business with our subsidiaries. In particular, some governments may be unwilling to conduct business with a subsidiary in a Chapter 11 proceeding. Consequently, our financial condition and results of operations could be materially and adversely affected.

Further, prolonged Chapter 11 proceedings could materially and adversely affect the relationship that DII Industries, Kellogg Brown & Root, and their subsidiaries involved in the Chapter 11 proceedings have with their customers, suppliers, and employees, which in turn could materially and adversely affect their competitive positions, financial conditions, and results of operations. A weakening of their financial conditions and results of operations could materially and adversely affect their ability to implement the plan of reorganization.

Legal Matters

United States government contract work

We provide substantial work under our government contracts business to the United States Department of Defense and other governmental agencies, including worldwide United States Army logistics contracts, known as LogCAP, and contracts to rebuild Iraq’s petroleum industry, known as RIO and PCO Oil South. Our government services revenue related to Iraq totaled approximately $1.4 billion and $5.4 billion for the three and nine months ended September 30, 2004. Our units operating in Iraq and elsewhere under government contracts such as LogCAP, RIO, and PCO Oil South consistently review the amounts charged and the services performed under these contracts. Our operations under these contracts are also regularly reviewed and audited by the Defense Contract Audit Agency (DCAA) and other governmental agencies. The DCA A serves in an advisory role to our customer. When issues are found during the governmental agency audit process, these issues are typically discussed and reviewed with us. The DCAA will then issue an audit report with their recommendations to our customer’s contracting officer. We then will work with our customer to reach a resolution.

Fuel. In December 2003, the DCAA issued a preliminary audit report which alleged that we may have overcharged the Department of Defense by $61 million in importing fuel into Iraq. To the best of our knowledge and belief, the DCAA report was never finalized. The DCAA questioned costs associated with fuel purchases made in Kuwait that were more expensive than buying and transporting fuel from Turkey. We responded that we had maintained close coordination of the fuel mission with the Army Corps of Engineers (COE), which is our customer and oversees the project, throughout the life of the task order and that the COE had directed us to use the Kuwait sources. After a review, the COE concluded that we obtained a fair pric e for the fuel. However, Department of Defense officials thereafter referred the matter to the agency’s inspector general, which we understand has commenced an investigation.

The DCAA has issued various audit reports related to task orders under the RIO contract, which reported $296 million in questioned and unsupported costs. The majority of these costs are associated with the humanitarian fuel mission. In these reports, the DCAA has compared fuel costs we incurred during the duration of the RIO contract in 2003 and early 2004 to fuel prices obtained by the Defense Energy Supply Center (DESC) in April 2004, when the fuel mission was transferred to that agency. We believe the conditions specified by the customer for fuel purchases are materially different under the DESC and RIO contracts, and therefore a direct comparison of costs is not valid. We are currently preparing responses to the COE contracting officer, which we believe will substantiate that the costs questioned by the DCAA a re allowable and reimbursable.

Dining Facility and Administration Centers (DFACs). During 2003, the DCAA raised issues relating to our invoicing to the Army Materiel Command (AMC) for food services for soldiers and supporting civilian personnel in Iraq and Kuwait. We believe the issues raised by the DCAA relate to the difference between the number of troops the AMC directed us to support and the number of soldiers actually served at dining facilities for United States troops and supporting civilian personnel in Iraq and Kuwait. In the first quarter of 2004, we reviewed our DFAC subcontracts in our Iraq and Kuwait areas of operation and have billed and continue to bill for all current DFAC costs. During 2004, we received notice from the DCAA that it was recommending withholding a portion of our DFAC billings. For DFAC billings relating to subcontracts entered into prior to February 2004, the DCAA has recommended withholding 19.35% of the billings until it completes its audits. Subsequent to February 2004, we have renegotiated our DFAC subcontracts to address the specific issues raised by the DCAA and have advised the AMC and the DCAA of the new terms of the arrangements. To date, we have had no objection by the government to these new DFAC subcontract agreements. During the third quarter of 2004, we received notification that, for three Kuwait DFACs, the DCAA is recommending to our customer that costs be disallowed because the DCAA is not satisfied with the level of documentation provided by us. The amount withheld related to suspended and recommended disallowed DFAC costs for work performed prior to February 2004 and totaled approximately $216 million as of September 30, 2004. The amount currently withheld could change as the DCAA continues their au dits of the remaining DFAC facilities. We are negotiating with our customer, the AMC, to resolve this issue. We can withhold a proportionate amount of these billings from our subcontractors and are currently doing so. See “Investigations” section below for further discussion.

Laundry. During the third quarter of 2004, we received notice from the DCAA that it is recommending withholding $16 million of subcontract costs related to the laundry service for one task order in southern Iraq for which it believes we and our subcontractors have not provided adequate levels of documentation supporting the quantity of the services provided. The DCAA has recommended that the cost be withheld pending receipt of additional explanation or documentation to support subcontract cost. We are working with the AMC to resolve this issue.

Investigations. On January 22, 2004, we announced the identification by our internal audit function of a potential overbilling of approximately $6 million by La Nouvelle Trading & Contracting Company, W.L.L. (La Nouvelle), one of our subcontractors, under the LogCAP contract in Iraq, for services performed during 2003. In accordance with our policy and government regulation, the potential overcharge was reported to the Department of Defense Inspector General’s office as well as to our customer, the AMC. On January 23, 2004, we issued a check in the amount of $6 million to the AMC to cover that potential overbilling while we conducted our own investigation into the matter. Later in the first quarter of 2004, we determined that the amount of overbilling was $4 million and the subcontractor billing should have been $2 million for the services provided. As a result, we paid La Nouvelle $2 million and have billed our customer that amount. We are continuing to investigate whether La Nouvelle paid, or attempted to pay, one or two of our former employees in connection with the billing. See Note 15 “Litigation brought by La Nouvelle” to the condensed consolidated financial statements for further discussion.

In October 2004, we reported to the Department of Defense Inspector General's office that two former employees in Kuwait may have had inappropriate contacts with individuals employed by or affiliated with two third-party subcontractors prior to the award of the subcontracts. The Inspector General's office may investigate whether these two employees may have solicited and/or accepted payments from these third-party subcontractors while they were employed by us.

In October 2004, a civilian contracting official in the COE asked for a review of the process used by the COE for awarding some of the contracts to us. We understand that the Department of Defense Inspector General's office may review the issues involved.

We understand that the United States Department of Justice, an Assistant United States Attorney based in Illinois, and others are investigating some matters relating to our government contract work. We also understand that former employees of KBR have received subpoenas and have given or may give grand jury testimony relating to some of these matters. If criminal wrongdoing were found, criminal penalties could range up to the greater of $500,000 in fines per count for a corporation, or twice the gross pecuniary gain or loss.

Withholding of payments. During 2004, the AMC issued a determination that a particular contract clause would cause it to withhold 15% from our invoices until our task orders under the LogCAP contract are definitized. We have advised the AMC that we disagree with this interpretation. The AMC has not implemented this withholding; however, it has requested additional information regarding the impact of the potential withholding on us and our subcontractors' ability to provide troop support under the LogCAP contract. We have provided information in response to this request, but do not know whether or how this information will impact the AMC's decision to implement the 15% withholding in the future. We do not b elieve the potential 15% withholding will have a significant or sustained impact on our liquidity because the withholding is temporary and ends once the definitization process is complete. During the third quarter of 2004, we and the AMC identified three senior management teams to facilitate negotiation under the LogCAP task orders, and these teams are working to negotiate outstanding issues and definitize task orders as quickly as possible. We are continuing to work with our customer to resolve outstanding issues. To date, definitization proposals for 30 task orders totaling over $500 million have been agreed in principle.

As of September 30, 2004, the COE had withheld $76 million of our invoices related to a portion of our RIO contract pending completion of the definitization process. All ten definitization proposals required under this contract have been submitted by us and three have been agreed in principle. The remaining seven have been reviewed by the DCAA, and we are in the process of responding to our customer on the auditor's questions. These withholdings represent the amount invoiced in excess of 85% of the amounts we have currently estimated to the COE to complete the tasks ordered. The COE also could withhold similar amounts from future invoices under our RIO contract until our task orders under the RIO contract are definitized. Approximately $4 million was withheld from our PCO Oil South project as of September 30, 2004. We do not believe the withholding will have a significant or sustained impact on our liquidity because the withholding is temporary and ends once the definitization process is complete.

We are working diligently with our customers to proceed with significant work when we have a fully definitized task order, which should limit withholdings on future task orders.

Report on estimating system. The DCAA issued an audit report to our corporate administrative contracting officer (CACO) dated August 4, 2004 stating that, in the DCAA's opinion, our estimating system is not adequate to produce proposals for our customer to negotiate final pricing on government contracts. The report states that the DCAA has identified approximately $1.8 billion in unsupported costs relating to proposals under our LogCAP contracts. An unsupported cost in an estimate is one in which the DCAA requires additional documentation before expressing an opinion on the acceptability of the estimate. While the alleged $1.8 billion in unsupported costs referenced in the DCAA report represents estimated costs rather than incurred and/or billed costs and the DCAA is not recommending that such amounts be withheld, the untimely resolution of unsupported cost issues could affect the definitization process. In October 2004, we developed a corrective action plan with the CACO and DCAA and believe we will be able to demonstrate that our estimating system is adequate for negotiating with our customer and that we have appropriate support for our proposals. Should the estimating system ultimately be judged inadequate, all proposals over $100,000 would be required to be reviewed by the DCAA. Currently, all of our proposals over $500,000 must be reviewed.

Report on purchasing system. As a result of a Contractor Purchasing System Review by the Defense Contract Management Agency (DCMA) during the second quarter of 2004, the DCMA granted the continued approval of our government contract purchasing system. The review was conducted due to the unprecedented level of support we currently provide the military in Iraq and Kuwait. The DCMA's approval letter, dated September 7, 2004, stated that our purchasing system's policies and practices are "effective and efficient, and provide adequate protection of the Government's interest."

The Balkans. We have had inquiries in the past by the DCAA and the civil fraud division of the United States Department of Justice into possible overcharges for work performed during 1996 through 2000 under a contract in the Balkans, which inquiry has not yet been completed by the Department of Justice. Based on an internal investigation, we credited our customer approximately $2 million during 2000 and 2001 related to our work in the Balkans as a result of billings for which support was not readily available. We believe that the preliminary Department of Justice inquiry relates to potential overcharges in connection with a part of the Balkans contract under which approximately $100 million in work was done. We beli eve that any allegations of overcharges would be without merit.

Nigerian joint venture

The SEC is conducting a formal investigation into payments made in connection with the construction and subsequent expansion by TSKJ of a multibillion dollar natural gas liquefaction complex and related facilities at Bonny Island in Rivers State, Nigeria. The United States Department of Justice is also conducting an investigation. TSKJ is a private limited liability company registered in Madeira, Portugal whose members are Technip SA of France, Snamprogetti Netherlands B.V., which is an affiliate of ENI SpA of Italy, JGC Corporation of Japan, and Kellogg Brown & Root, each of which owns 25% of the venture.

The SEC and the Department of Justice have been reviewing these matters in light of the requirements of the United States Foreign Corrupt Practices Act. We have produced documents to the SEC both voluntarily and pursuant to a subpoena, and intend to make our employees available to the SEC for testimony. In addition, we understand that the SEC has issued a subpoena to A. Jack Stanley, who most recently served as a consultant and chairman of Kellogg Brown & Root, and to other current and former Kellogg Brown & Root employees. We further understand that the Department of Justice has invoked its authority under a sitting grand jury to obtain letters rogatory for the purpose of obtaining information abroad.

TSKJ and other similarly owned entities entered into various contracts to build and expand the liquefied natural gas project for Nigeria LNG Limited, which is owned by the Nigerian National Petroleum Corporation, Shell Gas B.V., Cleag Limited (an affiliate of Total), and Agip International B.V. Commencing in 1995, TSKJ entered into a series of agency agreements in connection with the Nigerian project. We understand that a French magistrate has officially placed Jeffrey Tesler, an agent of TSKJ, under investigation for corruption of a foreign public official. In Nigeria, a legislative committee of the National Assembly and the Economic and Financial Crimes Commission, which is organized as part of the executive branch of the government, are also investigating these matters. Our representatives have met with the Fre nch magistrate and Nigerian officials and expressed our willingness to cooperate with those investigations. In October 2004, representatives of TSKJ voluntarily testified before the Nigerian legislative committee.

As a result of our continuing investigation into these matters, information has been uncovered suggesting that, commencing at least 10 years ago, the members of TSKJ considered payments to Nigerian officials. We provided this information to the United States Department of Justice, the SEC, the French magistrate, and the Nigerian Economics and Financial Crimes Commission. We also notified the other owners of TSKJ of the recently uncovered information and asked each of them to conduct their own investigation.

We understand from the ongoing governmental and other investigations that payments may have been made to Nigerian officials. In addition, we understand that, at our request, TSKJ has suspended the receipt of services from and payments to TSKJ's agent, Tri-Star Investments, of which Jeffrey Tesler is a principal, and is considering instituting legal proceedings to declare all agency agreements with Tri-Star terminated and to recover all amounts previously paid under those agreements.

We understand that the Department of Justice has expanded its investigation to include whether Mr. Stanley may have received payments in connection with bidding practices on certain foreign projects. We also understand that the matters under investigation by the Department of Justice involve parties other than Kellogg Brown & Root and M.W. Kellogg, a joint venture in which Kellogg Brown & Root has a 55% interest, cover an extended period of time, in some cases significantly before our acquisition of Dresser Industries, including M. W. Kellogg in 1998, and possibly include the construction of a fertilizer plant in Nigeria in the early 1990's and the activities of agents and service providers.

In June 2004, we terminated all relationships with Mr. Stanley and another consultant and former employee of M.W. Kellogg. The terminations occurred because of violations of our Code of Business Conduct that allegedly involve the receipt of improper personal benefits in connection with TSKJ's construction of the natural gas liquefaction facility in Nigeria.

There can be no assurance that any governmental investigation or our investigation of these matters will not conclude that violations of applicable laws have occurred.

Office of Foreign Assets Control inquiry

We have a Cayman Islands subsidiary with operations in Iran, and other European subsidiaries that manufacture goods destined for Iran and/or render services in Iran. The United States imposes trade restrictions and economic embargoes that prohibit United States incorporated entities and United States citizens and residents from engaging in commercial, financial, or trade transactions with some foreign countries, including Iran, unless authorized by the Office of Foreign Assets Control (OFAC) of the United States Treasury Department or exempted by statute.

We received and responded to an inquiry in mid-2001 from the OFAC with respect to operations in Iran by a Halliburton subsidiary that is incorporated in the Cayman Islands. The OFAC inquiry requested information with respect to compliance with the Iranian Transaction Regulations. These regulations prohibit United States citizens, including United States corporations and other United States business organizations, from engaging in commercial, financial, or trade transactions with Iran, unless authorized by OFAC or exempted by statute. Our 2001 written response to OFAC stated that we believed that we were in full compliance with applicable sanction regulations. In January 2004, we received a follow-up letter from OFAC requesting additional information. We responded fully to this request on March 19, 2004. We underst and this matter has now been referred by OFAC to the Department of Justice. In July 2004, we received a grand jury subpoena from an Assistant United States District Attorney requesting the production of documents. We are cooperating with the government's investigation and have responded to the subpoena, producing documents on September 16, 2004.

Separate from the OFAC inquiry, we completed a study in 2003 of our activities in Iran during 2002 and 2003 and concluded that these activities were in full compliance with applicable sanction regulations. These sanction regulations require isolation of entities that conduct activities in Iran from contact with United States citizens or managers of United States companies.

We have been asked to and could be required to respond to other questions and inquiries about operations in countries with trade restrictions and economic embargoes.

Liquidity

Working capital requirements related to Iraq work

We expect a general decline in our working capital requirements during the fourth quarter of 2004, primarily due to the transfer of the civilian fuel delivery work to the Defense Energy Support Center, the completion of the RIO project, and the leveling off of LogCAP project work after the initial ramp-up in 2003. As described in “Legal Matters - Audits and inquiries about government contracts work” above, it is possible that we may, or may be required to, withhold additional invoicing or make refunds to our customer related to the DCAA’s review of additional aspects of our services, some of which could be substantial, until these matters are resolved. This could materially and adversely affect our liquidity.

Credit facilities

The plan of reorganization through which the proposed settlement would be implemented will require us to contribute approximately $2.3 billion in cash to the trusts established for the benefit of asbestos and silica claimants pursuant to the United States Bankruptcy Code. We may need to finance additional amounts in connection with the settlement.

In connection with the proposed plan of reorganization, in the fourth quarter of 2003 we entered into:

- a secured master letter of credit facility (Master LC Facility) intended to provide an advance for letter of credit draws, if any, and satisfy any cash collateralization rights of issuers of substantially all our then existing letters of credit during the pendency of the Chapter 11 proceedings. The Master LC Facility allows advances until the earlier of December 31, 2004 or the exit date of our Chapter 11 proceedings, with repayments due June 30, 2005; and
- a secured $700 million three-year revolving credit facility for general working capital purposes, which matures in October 2006.

In July 2004, we entered into an additional secured $500 million 364-day revolving credit facility for general working capital purposes with terms substantially similar to our $700 million revolving credit facility.

Advances under the Master LC Facility will remain available until the earlier of December 31, 2004 or when an order confirming the proposed plan of reorganization becomes final and nonappealable. On such date, all advances outstanding under the Master LC Facility, if any, will become term loans payable in full on June 30, 2005, unless prepaid prior to such date, and all undrawn facility letters of credit shall cease to be subject to the terms of the Master LC Facility. If our subsidiaries do not exit Chapter 11 proceedings until after December 31, 2004, we would expect to be able to extend the availability of the Master LC Facility.

We experience increased working capital requirements from time to time associated with our business. An increased demand for working capital could affect our liquidity needs and could impair our ability to finance the proposed settlement on acceptable terms.

Letters of credit

We entered into a master letter of credit facility (Master LC Facility) in the fourth quarter of 2003 that was intended to replace any cash collateralization rights of issuers of substantially all our then existing letters of credit during the pendency of the Chapter 11 proceedings of DII Industries, Kellogg Brown & Root, and our other filing subsidiaries. The Master LC Facility is now in effect and governs at least 90% of the face amount of our outstanding letters of credit that were existing at the time we entered into the Master LC Facility.

Under the Master LC Facility, if any letters of credit that are covered by the facility are drawn on or before December 31, 2004, the facility will provide the cash needed for such draws, as well as for any collateral or reimbursement obligations, in respect thereof, with any such borrowings being converted into term loans. However, with respect to the letters of credit that are not subject to the Master LC Facility, we could be subject to reimbursement and cash collateral obligations. In addition, if the proposed plan of reorganization does not become effective by December 31, 2004 and we are unable to negotiate a renewal or extension of the Master LC Facility, the letters of credit that are now governed by that facility will be governed by the arrangements with the banks that existed prior to the effectiveness o f the facility. In many cases, those pre-existing arrangements impose reimbursement and/or cash collateral obligations on us and/or our subsidiaries.

Uncertainty may also hinder our ability to access new letters of credit in the future. This could impede our liquidity and/or our ability to conduct normal operations.

Credit ratings

Investment grade ratings are BBB- or higher for Standard & Poor's and Baa3 or higher for Moody's. Our current ratings are one level above BBB- on Standard & Poor's and one level above Baa3 on Moody's. In December 2003, Standard & Poor's revised its credit watch listing for us from "negative" to "developing" in response to our announcement that DII Industries, Kellogg Brown & Root, and other of our subsidiaries filed Chapter 11 proceedings to implement the proposed asbestos and silica settlement. In May 2004, Moody's Investors Service confirmed its ratings, but revised its outlook from "positive" to "stable."

If our debt rating falls below investment grade, we will be required to provide additional collateral to secure our credit facilities. With respect to the outstanding letters of credit that are not subject to the Master LC Facility or the $700 million three-year revolver, we may be in technical breach of the bank agreements governing those letters of credit and we may be required to reimburse the bank for any draws or provide cash collateral to secure those letters of credit. In addition, if the proposed plan of reorganization does not become effective by December 31, 2004 and we are unable to negotiate a renewal or extension of the terms of the Master LC Facility, advances under our Master LC Facility will no longer be available and will no longer override the reimbursement, cash collateral, or other agreements o r arrangements relating to any of the letters of credit that existed prior to the effectiveness of the Master LC Facility or have been issued under the facility since. In that event, we may be required to provide reimbursement for any draws or cash collateral to secure our or our subsidiaries' obligations under arrangements in place prior to our entering into the Master LC Facility.

In addition, our elective deferral compensation plan has a provision which states that if the Standard & Poor's credit rating falls below BBB, the amounts credited to participants' accounts will be paid to participants in a lump sum within 45 days. At September 30, 2004, this amount was approximately $56 million.

In the event our debt ratings are lowered by either agency, we may have to issue additional debt or equity securities or obtain additional credit facilities in order to meet our liquidity needs. We anticipate that any such new financing or credit facilities would not be on terms as attractive as those we have currently and that we would also be subject to increased costs of capital and interest rates. We also may be required to provide cash collateral to obtain surety bonds or letters of credit, which would reduce our available cash or require additional financing. Further, if we are unable to obtain financing for our proposed plan of reorganization on terms that are acceptable to us, we may be unable to complete the proposed plan of reorganization.

Geopolitical and International Events

International and Political Events

A significant portion of our revenue is derived from our non-United States operations, which exposes us to risks inherent in doing business in each of the more than 100 other countries in which we transact business. The occurrence of any of the risks described below could have a material adverse effect on our consolidated results of operations and consolidated financial condition.

Our operations in more than 100 countries other than the United States accounted for approximately 78% of our consolidated revenue during the first nine months of 2004 and 73% of our consolidated revenue during 2003. Operations in countries other than the United States are subject to various risks peculiar to each country. With respect to any particular country, these risks may include:

- expropriation and nationalization of our assets in that country;
- political and economic instability;
- social unrest, acts of terrorism, force majeure, war, or other armed conflict;
- inflation;
- currency fluctuations, devaluations, and conversion restrictions;
- confiscatory taxation or other adverse tax policies;
- governmental activities that limit or disrupt markets, restrict payments, or limit the movement of funds;
- governmental activities that may result in the deprivation of contract rights; and
- trade restrictions and economic embargoes imposed by the United States and other countries, including current restrictions on our ability to provide products and services to Iran and Syria, which are significant producers of oil and gas.

Due to the unsettled political conditions in many oil-producing countries and countries in which we provide governmental logistical support, our revenue and profits are subject to the adverse consequences of war, the effects of terrorism, civil unrest, strikes, currency controls, and governmental actions. Countries where we operate that have significant amounts of political risk include: Afghanistan, Algeria, Indonesia, Iran, Iraq, Nigeria, Russia, and Venezuela. In addition, military action or continued unrest in the Middle East could impact the supply and pricing for oil and gas, disrupt our operations in the region and elsewhere, and increase our costs for security worldwide.

In addition, investigations by governmental authorities (see “Legal Matters - Nigerian joint venture” above), as well as the social, economic, and political climate in Nigeria, could materially and adversely affect our Nigerian business and operations. Our facilities and our employees are also under threat of attack in some countries where we operate, including Iraq and Saudi Arabia. In September 2004, the Federal Republic of Nigeria issued a directive banning Halliburton Energy Services Nigeria Limited, one of our subsidiaries, from receiving contracts from the Nigerian government or from companies controlled by the Nigerian government. We believe this directive to have been issued as a result of an adverse reaction in Nigeria to the theft of radioactive material that we used in wireline logging operati ons. We are currently working with the Nigerian government to obtain a lifting of the ban.

Military Action, Other Armed Conflicts, or Terrorist Attacks

Military action in Iraq, increasing military tension involving North Korea, as well as the terrorist attacks of September 11, 2001 and subsequent terrorist attacks, threats of attacks, and unrest, have caused instability in the world’s financial and commercial markets and have significantly increased political and economic instability in some of the geographic areas in which we operate. Acts of terrorism and threats of armed conflicts in or around various areas in which we operate, such as the Middle East and Indonesia, could limit or disrupt markets and our operations, including disruptions resulting from the evacuation of personnel, cancellation of contracts, or the loss of personnel or assets.

Such events may cause further disruption to financial and commercial markets and may generate greater political and economic instability in some of the geographic areas in which we operate. In addition, any possible reprisals as a consequence of the war with and ongoing military action in Iraq, such as acts of terrorism in the United States or elsewhere, could materially and adversely affect us in ways we cannot predict at this time.

Taxation

We have operations in more than 100 countries other than the United States and as a result are subject to taxation in many jurisdictions. Therefore, the final determination of our tax liabilities involves the interpretation of the statutes and requirements of taxing authorities worldwide. Foreign income tax returns of foreign subsidiaries, unconsolidated affiliates, and related entities are routinely examined by foreign tax authorities. These tax examinations may result in assessments of additional taxes or penalties or both. Additionally, new taxes, such as the proposed excise tax in the United States targeted at heavy equipment of the type we own and use in our operations, could negatively affect our results of operations.

Foreign Exchange and Currency Risks

A sizable portion of our consolidated revenue and consolidated operating expenses are in foreign currencies. As a result, we are subject to significant risks, including:

- foreign exchange risks resulting from changes in foreign exchange rates and the implementation of exchange controls such as those experienced in Argentina in late 2001 and early 2002; and
- limitations on our ability to reinvest earnings from operations in one country to fund the capital needs of our operations in other countries.

We conduct business in countries that have nontraded or “soft” currencies which, because of their restricted or limited trading markets, may be more difficult to exchange for “hard” currency. We may accumulate cash in soft currencies and we may be limited in our ability to convert our profits into United States dollars or to repatriate the profits from those countries.

We selectively use hedging transactions to limit our exposure to risks from doing business in foreign currencies. For those currencies that are not readily convertible, our ability to hedge our exposure is limited because financial hedge instruments for those currencies are nonexistent or limited. Our ability to hedge is also limited because pricing of hedging instruments, where they exist, is often volatile and not necessarily efficient.

In addition, the value of the derivative instruments could be impacted by:

- adverse movements in foreign exchange rates;
- interest rates;
- commodity prices; or
- the value and time period of the derivative being different than the exposures or cash flows being hedged.

Customers and Business

Exploration and Production Activity

Demand for our services and products depends on oil and natural gas industry activity and expenditure levels that are directly affected by trends in oil and natural gas prices.

Demand for our products and services is particularly sensitive to the level of development, production, and exploration activity of, and the corresponding capital spending by, oil and natural gas companies, including national oil companies. Prices for oil and natural gas are subject to large fluctuations in response to relatively minor changes in the supply of and demand for oil and natural gas, market uncertainty, and a variety of other factors that are beyond our control. Any prolonged reduction in oil and natural gas prices will depress the level of exploration, development, and production activity, often reflected as changes in rig counts. Lower levels of activity result in a corresponding decline in the demand for our oil and natural gas well services and products that could have a material adverse effect on our revenue and profitability. Factors affecting the prices of oil and natural gas include:

- governmental regulations;
- global weather conditions;
- worldwide political, military, and economic conditions, including the ability of OPEC to set and maintain production levels and prices for oil;
- the level of oil production by non-OPEC countries;
- economic growth in China and India;

- the policies of governments regarding the exploration for and production and development of their oil and natural gas reserves;
- the cost of producing and delivering oil and gas;
- potential acceleration of development of alternative fuels; and
- the level of demand for oil and natural gas, especially demand for natural gas in the United States.

Historically, the markets for oil and gas have been volatile and are likely to continue to be volatile in the future. Spending on exploration and production activities and capital expenditures for refining and distribution facilities by large oil and gas companies have a significant impact on the activity levels of our businesses.

Barracuda-Caratinga Project

See Note 3 to the condensed consolidated financial statements for a discussion of this project and the October 2004 agreement in principle and "Fixed-Price Engineering and Construction Projects" below.

If the October 2004 agreement in principle between us and Petrobras is not implemented, we would remain subject to the November 2003 agreements in which the project owner agreed to:

- pay $69 million to settle a portion of our claims, thereby reducing the amount of probable unapproved claims to $114 million;
- extend the original project completion dates and other milestone dates, reducing our exposure to liquidated damages; and
- delay Kellogg Brown & Root's repayment of approximately $300 million in advance payments until December 2004, although we and the project owner did not resolve whether Kellogg Brown & Root would be obligated to pay interest on this amount.

In addition, we would remain subject to the following risks under the November 2003 agreements:

Unapproved Claims. We have asserted claims for compensation substantially in excess of the $114 million of probable unapproved claims, as well as claims for additional time to complete the project before liquidated damages become applicable. The project owner and Petrobras asserted claims against us that are in addition to the project owner's potential claims for liquidated damages. In the November 2003 agreements, the parties agreed to arbitrate these remaining disputed claims. In addition, we agreed to cap our financial recovery to a maximum of $375 million, and the project owner and Petrobras agreed to cap their recovery to a maximum of $380 million plus liquidated damages.

Liquidated Damages. In the event that any portion of the project delay is determined to be attributable to us and any phase of the project is completed after the milestone dates specified in the contract, we could be required to pay liquidated damages. These damages were initially (prior to the November 2003 agreements) calculated on an escalating basis rising ultimately to approximately $1 million per day of delay caused by us, subject to a total cap on liquidated damages of 10% of the final contract amount, yielding a cap of approximately $268 million as of September 30, 2004.

Under the November 2003 agreements, the project owner granted an extension of time to the original completion dates and other milestone dates that average approximately 12 months. In addition, the project owner agreed to delay any attempt to assess the original liquidated damages against us for project delays beyond 12 months and up to 18 months and delay any drawing of letters of credit with respect to such liquidated damages until the earliest of December 7, 2004, the completion of any arbitration proceedings or the resolution of all claims between the project owner and us. Although the November 2003 agreements do not delay the drawing of letters of credit for liquidated damages for delays beyond 18 months, our master letter of credit facility will provide funding for any such draw before December 31, 2004, exce pt for the $172 million letter of credit issued in September 2004 which is governed by our $700 million three-year revolving credit facility. The November 2003 agreements also provide for a separate liquidated damages calculation of $450,000 per day for each of the Barracuda and the Caratinga vessels if delayed beyond 18 months from the original schedule. That amount is subject to the total cap on liquidated damages of 10% of the final contract amount. Based upon the November 2003 agreements and our September 2004 project forecasts, we estimate that if we were to be completely unsuccessful in our claims for additional time, we would be obligated to pay approximately $165 million in liquidated damages, of which $24 million has been included in our cost estimates. There can be no assurance that further project delays will not occur.

Value added taxes. On December 16, 2003, the State of Rio de Janeiro issued a decree recognizing that Petrobras is entitled to a credit for the value added taxes paid on the project. The decree also provided that value added taxes that may have become due on the project, but which had not yet been paid could be paid in January 2004 without penalty or interest. In response to the decree, Petrobras agreed to:

- directly pay the value added taxes due on all imports on the project (including Petrobras' January 2004 payment of approximately $150 million); and
- reimburse us for value added taxes paid on local purchases, of which approximately $100 million will become due during 2004.

Since the credit to Petrobras for these value added taxes is on a delayed basis, the issue of whether we must bear the cost of money for the period from payment by Petrobras until receipt of the credit has not been determined under the November 2003 agreement.

The validity of the December 2003 decree has now been challenged in court in Brazil. Our legal advisers in Brazil believe that the decree will be upheld. If it is overturned or rescinded, or the Petrobras credits are lost for any other reason not due to Petrobras, the issue of who must ultimately bear the cost of the value added taxes will have to be determined based upon the law prior to the December 2003 decree. We believe that the value added taxes are reimbursable under the contract and prior law, but, until the December 2003 decree was issued, Petrobras and the project owner had been contesting the reimbursability of up to $227 million of value added taxes. There can be no assurance that we will not be required to pay all or a portion of these value added taxes. In addition, penalties and interest of $40 mill ion to $100 million could be due if the December 2003 decree is invalidated. We have paid $8 million for these amounts as of September 30, 2004.

Governmental and Capital Spending

Our business is directly affected by changes in governmental spending and capital expenditures by our customers. Some of the changes that may materially and adversely affect us include:

- a decrease in the magnitude of governmental spending and outsourcing for military and logistical support of the type that we provide. For example, the current level of government services being provided in the Middle East may not continue for an extended period of time;
- an increase in the magnitude of governmental spending and outsourcing for military and logistical support, which can materially and adversely affect our liquidity needs as a result of additional or continued working capital requirements to support this work;
- a decrease in capital spending by governments for infrastructure projects of the type that we undertake;

- the consolidation of our customers, which has:
    - caused customers to reduce their capital spending, which has in turn reduced the demand for our services and products; and
    - resulted in customer personnel changes, which in turn affects the timing of contract negotiations and settlements of claims and claim negotiations with engineering and construction customers on cost variances and change orders on major projects;
- adverse developments in the business and operations of our customers in the oil and gas industry, including write-downs of reserves and reductions in capital spending for exploration, development, production, processing, refining, and pipeline delivery networks; and
- ability of our customers to timely pay the amounts due us.

Customers

Both our Energy Services Group and KBR depend on a limited number of significant customers. While, except for the United States Government, none of these customers represented more than 10% of consolidated revenue in any period presented. The loss of one or more significant customers could have a material adverse effect on our business and our consolidated results of operations.

Acquisitions, Dispositions, Investments, and Joint Ventures

We may actively seek opportunities to maximize efficiency and value through various transactions, including purchases or sales of assets, businesses, investments or contractual arrangements or joint ventures. These transactions would be intended to result in the realization of savings, the creation of efficiencies, the generation of cash or income, or the reduction of risk. Acquisition transactions may be financed by additional borrowings or by the issuance of our common stock. These transactions may also affect our consolidated results of operations.

These transactions also involve risks and we cannot ensure that:

- any acquisitions would result in an increase in income;
- any acquisitions would be successfully integrated into our operations;
- any disposition would not result in decreased earnings, revenue, or cash flow;
- any dispositions, investments, acquisitions, or integrations would not divert management resources; or
- any dispositions, investments, acquisitions, or integrations would not have a material adverse effect on our results of operations or financial condition.

We conduct some operations through joint ventures, where control may be shared with unaffiliated third parties. As with any joint venture arrangement, differences in views among the joint venture participants may result in delayed decisions or in failures to agree on major issues. We also cannot control the actions of our joint venture partners, including any nonperformance, default, or bankruptcy of our joint venture partners. These factors could potentially materially and adversely affect the business and operations of the joint venture and, in turn, our business and operations.

Fixed-Price Engineering and Construction Projects

We contract to provide services either on a time-and-materials basis or on a fixed-price basis, with fixed-price (or lump-sum) contracts accounting for approximately 11% of KBR’s revenue for the first nine months of 2004 and 24% for the year ended December 31, 2003. We bear the risk of cost overruns, operating cost inflation, labor availability and productivity, and supplier and subcontractor pricing and performance in connection with projects covered by fixed-price contracts. Our failure to estimate accurately the resources and time required for a fixed-price project, or our failure to complete our contractual obligations within the time frame and costs committed, could have a material adverse effect on our business, results of operations, and financial condition.

Environmental Requirements

Our businesses are subject to a variety of environmental laws, rules, and regulations in the United States and other countries, including those covering hazardous materials and requiring emission performance standards for facilities. For example, our well service operations routinely involve the handling of significant amounts of waste materials, some of which are classified as hazardous substances. We also store, transport, and use radioactive and explosive materials in certain of our operations. Environmental requirements include, for example, those concerning:

- the containment and disposal of hazardous substances, oilfield waste, and other waste materials;
- the importation and use of radioactive materials;
- the use of underground storage tanks; and
- the use of underground injection wells.

Environmental and other similar requirements generally are becoming increasingly strict. Sanctions for failure to comply with these requirements, many of which may be applied retroactively, may include:

- administrative, civil, and criminal penalties;
- revocation of permits to conduct business; and
- corrective action orders, including orders to investigate and/or clean up contamination.

Failure on our part to comply with applicable environmental requirements could have a material adverse effect on our consolidated financial condition. We are also exposed to costs arising from environmental compliance, including compliance with changes in or expansion of environmental requirements, such as the potential regulation in the United States of our Energy Services Group's hydraulic fracturing services and products as underground injection, which could have a material adverse effect on our business, financial condition, operating results, or cash flows.

We are exposed to claims under environmental requirements and, from time to time such claims have been made against us. In the United States, environmental requirements and regulations typically impose strict liability. Strict liability means that in some situations we could be exposed to liability for cleanup costs, natural resource damages, and other damages as a result of our conduct that was lawful at the time it occurred or the conduct of prior operators or other third parties. Liability for damages arising as a result of environmental laws could be substantial and could have a material adverse effect on our consolidated results of operations.

Changes in environmental requirements may negatively impact demand for our services. For example, oil and natural gas exploration and production may decline as a result of environmental requirements (including land use policies responsive to environmental concerns). Such a decline, in turn, could have a material adverse effect on us.

Intellectual Property Rights

We rely on a variety of intellectual property rights that we use in our products and services. We may not be able to successfully preserve these intellectual property rights in the future and these rights could be invalidated, circumvented, or challenged. In addition, the laws of some foreign countries in which our products and services may be sold do not protect intellectual property rights to the same extent as the laws of the United States. Our failure to protect our proprietary information and any successful intellectual property challenges or infringement proceedings against us could materially and adversely affect our competitive position.

Technology

The market for our products and services is characterized by continual technological developments to provide better and more reliable performance and services. If we are not able to design, develop, and produce commercially competitive products and to implement commercially competitive services in a timely manner in response to changes in technology, our business and revenue could be materially and adversely affected and the value of our intellectual property may be reduced. Likewise, if our proprietary technologies, equipment and facilities, or work processes become obsolete, we may no longer be competitive and our business and revenue could be materially and adversely affected.

Systems

Our business could be materially and adversely affected by problems encountered in the installation of a new financial system to replace the current systems for our Engineering and Construction Group.

Technical Personnel

Many of the services that we provide and the products that we sell are complex and highly engineered and often must perform or be performed in harsh conditions. We believe that our success depends upon our ability to employ and retain technical personnel with the ability to design, utilize, and enhance these products and services. In addition, our ability to expand our operations depends in part on our ability to increase our skilled labor force. The demand for skilled workers is high and the supply is limited. A significant increase in the wages paid by competing employers could result in a reduction of our skilled labor force, increases in the wage rates that we must pay, or both. If either of these events were to occur, our cost structure could increase, our margins could decrease, and our growth potential coul d be impaired.

Weather

Our businesses could be materially and adversely affected by severe weather, particularly in the Gulf of Mexico where we have significant operations. Repercussions of severe weather conditions may include:

- evacuation of personnel and curtailment of services;
- weather-related damage to offshore drilling rigs resulting in suspension of operations;
- weather-related damage to our facilities;
- inability to deliver materials to jobsites in accordance with contract schedules; and
- loss of productivity.

Because demand for natural gas in the United States drives a disproportionate amount of our Energy Services Group’s United States business, warmer than normal winters in the United States are detrimental to the demand for our services to gas producers.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

We are exposed to financial instrument market risk from changes in foreign currency exchange rates, interest rates, and, to a limited extent, commodity prices. We selectively manage these exposures through the use of derivative instruments to mitigate our market risk from these exposures. The objective of our risk management is to protect our cash flows related to sales or purchases of goods or services from market fluctuations in currency rates. Our use of derivative instruments includes the following types of market risk:

- volatility of the currency rates;
- time horizon of the derivative instruments;
- market cycles; and
- the type of derivative instruments used.

In the third quarter of 2004, we entered into numerous cash flow hedges to manage foreign currency exposures related to our Barracuda-Caratinga project. Included in “Other comprehensive income” on the September 30, 2004 condensed consolidated balance sheet are unrealized gains related to these currency hedges. In the first quarter of 2004, we entered into derivative instruments, including put options, swaps, and collared options, as cash flow hedges against price variability of oil and natural gas. At September 30, 2004, the fair value of these instruments was not material.

We do not use derivative instruments for trading purposes. We do not consider any of these risk management activities to be material.

Item 4. Controls and Procedures

In accordance with Exchange Act Rules 13a-15 and 15d-15, we carried out an evaluation, under the supervision and with the participation of management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of September 30, 2004 to provide reasonable assurance that information required to be disclosed in our reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission’s rules and forms. Our disclosure controls and procedure s include controls and procedures designed to ensure that information required to be disclosed in reports filed or submitted under the Exchange Act is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

There has been no change in our internal controls over financial reporting that occurred during the three months ended September 30, 2004 that has materially affected, or is reasonably likely to materially affect, our internal controls over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

Information relating to various commitments and contingencies is described in "Management's Discussion and Analysis of Financial Condition and Results of Operations," in "Forward-Looking Information and Risk Factors," and in Notes 3, 12, 13, 14, and 15 to the condensed consolidated financial statements.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Following is a summary of our repurchases of our common stock during the three-month period ended September 30, 2004.

Period	Total Number of Shares Purchased (a)	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares That May Yet Be Purchased Under Plans or Programs (b)
July 1-31	16,701	$ 29.51	-	-
August 1-31	12,430	$ 30.36	-	-
September 1-30	14,909	$ 29.46	-	-
Total	44,040	$ 29.73	-	22,385,700

(a) All of the shares repurchased during the three-month period ended September 30, 2004 were acquired from employees in connection with the settlement of income tax and related benefit withholding obligations arising from vesting in restricted stock grants. These share purchases were not part of a publicly announced program to purchase common shares.

(b) On April 25, 2000, our Board of Directors approved plans to implement a share repurchase program for up to 44 million shares of our common stock.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Submission of Matters to a Vote of Security Holders

None.

Item 5. Other Information

None.

Item 6. Exhibits

*	10.1	Halliburton Company Benefit Restoration Plan, as amended and restated effective January 1, 2004.
*	10.2	Halliburton Company 2002 Employee Stock Purchase Plan, as amended and restated September 9, 2004.
*	10.3	Employment Agreement (Andrew R. Lane).

*	12	Statement of Computation of Ratio of Earnings to Fixed Charges.
*	31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
*	31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
**	32.1	Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
**	32.2	Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

* Filed with this Form 10-Q
** Furnished with this Form 10-Q

SIGNATURES

As required by the Securities Exchange Act of 1934, the registrant has authorized this report to be signed on behalf of the registrant by the undersigned authorized individuals.

HALLIBURTON COMPANY

/s/ C. Christopher Gaut	/s/ Mark A. McCollum
C. Christopher Gaut Executive Vice President and Chief Financial Officer	Mark A. McCollum Senior Vice President and Chief Accounting Officer

Date: November 5, 2004

HALLIBURTON COMPANY
2002 EMPLOYEE STOCK PURCHASE PLAN

AS AMENDED AND RESTATED SEPTEMBER 9, 2004

1. *Purpose*. The HALLIBURTON COMPANY 2002 EMPLOYEE STOCK PURCHASE PLAN (the "Plan") is intended to provide an incentive for eligible employees of HALLIBURTON COMPANY (the "Company") and certain of its subsidiaries to acquire or increase a proprietary interest in the Company through the purchase of shares of the Company's common stock. The Plan is intended to qualify as an "employee stock purchase plan" under Section 423 of the Internal Revenue Code of 1986, as amended (the "Code"). The provisions of the Plan shall be construed in a manner consistent with t he requirements of that section of the Code.

2. *Definitions*. Where the following words and phrases are used in the Plan, they shall have the respective meanings set forth below, unless the context clearly indicates to the contrary:

"Board" means the Board of Directors of the Company.

"Committee" means the Board or a committee of members of the Board appointed by the Board to administer this Plan.

"Company" means Halliburton Company and, where required by the context, shall include any Participating Company.

"Corporate Change" means one of the following events: (i) the merger, consolidation, or other reorganization of the Company in which the outstanding Stock is converted into or exchanged for a different class of securities of the Company, a class of securities of any other issuer (except a direct or indirect wholly owned subsidiary of the Company), cash or other property; (ii) the sale, lease or exchange of all or substantially all of the assets of the Company to any other corporation or entity (except a direct or indirect wholly owned subsidiary of the Company); or (iii) the adoption by the stockholders of the Company of a plan of liquidation or dissolution.

"Eligible Compensation" means an employee's regular straight-time earnings or base salary, determined before giving effect to any elective salary reduction or deferral agreements and including vacation, sick time and short-term disability pay, but excluding overtime, incentive compensation, bonuses, special payments, commissions, severance pay, long-term disability pay, geographical coefficients, shift differential and any other items of compensation.

"Eligible Employee" means, as of each Enrollment Date, each employee of the Company or a Participating Company who, as of such Enrollment Date, has completed a six-month period of service with the Company and/or its Subsidiaries (service with an acquired entity or operation shall be credited for this purpose), but excluding (i) employees who are employed in a foreign country whose laws or regulations effectively prohibit participation in the Plan and (ii) employees who are customarily employed by the Company less than twenty (20) hours per week or less than five (5) months in any calendar year. Additionally, the Committee may also determine that a designated group of highly compensated employees are ineligible to participate in the Plan so long as the group fits within the definition of "highly compensated employee" in Code Section 414(q).

"Enrollment Date" means the first day of each Purchase Period.

"Exchange Act" means the Securities Exchange Act of 1934, as amended.

"Fair Market Value" shall mean the closing price for a share of Stock on the New York Stock Exchange (or if the Stock is not then listed on such exchange, such other national securities exchange on which the Stock is then listed) for the last Trading Day on the date of such determination, as reported on the New York Stock Exchange (or such other national securities exchange) Composite Tape or such other source as the Committee deems reliable, or if no prices are reported on that date, on the last preceding date on which such prices are so reported.

"Participating Company" means any present or future parent corporation or Subsidiary of the Company that participates in the Plan pursuant to paragraph 4.

"Purchase Date" means the last Trading Day of each Purchase Period.

"Purchase Period" means a period of approximately six months beginning on (i) the first Trading Day on or after each July 1 and ending on the last Trading Day in the period ending the following December 31, or (ii) the first Trading Day on or after each January 1 and ending on the last Trading Day in the period ending the following June 30. The first Purchase Period shall begin on the first Trading Day on or after July 1, 2002. The Committee shall have the power to change the duration of Purchase Periods (including the commencement dates thereof) with respect to future offerings without stockholder approval if such change is announced at least five days prior to the scheduled beginning of the first Purchase Period to be affected thereafter.

"Purchase Price" means an amount equal to 85% of the Fair Market Value of a share of Stock on the Enrollment Date or on the Purchase Date, whichever is lower, subject to adjustment pursuant to paragraph 13.

"Stock" means the Company's common stock, par value $2.50 per share.

"Subsidiary" means a corporation, domestic or foreign, which is a "subsidiary" of the Company, as defined in section 424(f) of the Code, whether or not such corporation exists or is hereafter organized or acquired by the Company or a subsidiary.

"Trading Day" means a day on which the principal national stock exchange on which the Stock is traded is open for trading.

3. *Administration of the Plan*. The Plan shall be administered by the Committee. Subject to the provisions of the Plan, the Committee shall interpret the Plan, make such rules as it deems necessary for the proper administration of the Plan, and make all other determinations necessary or advisable for the administration of the Plan and the purchase of Stock under the Plan, including without limitation establishing the exchange ratio applicable to amounts withheld in a currency other than U.S. dollars. In addition, the Committee shall correct any defect or supply any omission or reconcile any inconsist ency in the Plan, or in any stock purchase right granted under the Plan, correct any mistakes in the administration of the Plan in the manner and to the extent that the Committee deems necessary or desirable to effectuate the intent of the Plan. The Committee shall, in its sole discretion, make such decisions or determinations and take such actions, and all such decisions, determinations and actions taken or made by the Committee pursuant to this and the other paragraphs of the Plan shall be conclusive on all parties. The Committee shall not be liable for any decision, determination or action taken in good faith in connection with the administration of the Plan. The Committee shall have the authority to delegate routine day-to-day administration of the Plan to such officers and employees of the Company as the Committee deems appropriate.

4. *Participating Companies*. The Committee may designate any present or future parent corporation of the Company or Subsidiary that is eligible by law to participate in the Plan as a Participating Company by written instrument delivered to the designated Participating Company. Such written instrument shall specify the effective date of such designation and shall become, as to such designated Participating Company and employees in its employment, a part of the Plan. The terms of the Plan may be modified as applied to the Participating Company only to the extent permitted under Section 423 of the Code. Transfer of employment among the Company and Participating Companies shall not be considered a termination of employment hereunder. Any Participating Company may, by appropriate action of its Board of Directors, terminate its participation in the Plan. Moreover, the Committee may, in its discretion, terminate a Participating Company's Plan participation in the Plan at any time. The Participating Companies at any time shall be listed on Attachment A hereto as it may be amended from time to time by the Committee.

5. *Eligibility*. Subject to the further provisions hereof, all Eligible Employees as of an Enrollment Date shall be eligible to participate in the Plan with respect to the Purchase Period beginning as of such date.

6. *Stock Subject to the Plan*. Subject to the provisions of paragraph 13, the aggregate number of shares of Stock which may be sold under the Plan shall not exceed 12,000,000 shares, which shares may be authorized but unissued shares or treasury shares, including shares bought on the open market or otherwise for purposes of the Plan.

7. *Stock Purchase Rights.*

(a) *Grant of Stock Purchase Rights.* On each Enrollment Date the Company shall grant a stock purchase right to each Eligible Employee who elects to participate in the Plan for the Purchase Period beginning on such date. Subject to subparagraphs 7(f) and (g), the number of shares of Stock subject to a stock purchase right for a participant shall be equal to the quotient of (i) the aggregate payroll deductions withheld on behalf of such participant during the Purchase Period, plus any amounts carried over from the prior Purchase Period, divided by (ii) the Purchase Price of the Stock applicable to the Purchase Period; provided, however, that the maximum number of shares of Stock that may be subject to any stock purchase right for a participant during any Purchase Period may not exceed 10,000 shares (subject to adjustment as provided in paragraph 13). No fractional shares shall be purchased; any payroll deductions accumulated in a participant's account and not applied to the purchase of whole shares shall be retained in the participant's account and applied in the next Purchase Period, subject to withdrawal by the participant pursuant to paragraph 9.

(b) *Election to Participate; Payroll Deduction Authorization.* An Eligible Employee may participate in the Plan only by means of payroll deduction. Except as provided in subparagraph 7(f), each Eligible Employee who elects to participate in the Plan shall deliver to the Company, within the time period prescribed by the Committee, a payroll deduction authorization in the form prescribed by the Company, whereby he gives notice of his election to participate in the Plan as of the next following Enrollment Date, and whereby he designates an integral percentage (except as provided below) to be deducted f rom his Eligible Compensation for each pay period paid during the Purchase Period and paid into the Plan for his account. The designated percentage may not be less than 1% nor exceed 10%; provided, however, the minimum contribution per pay period shall be $10.

(c) *Changes in Payroll Authorization.* All payroll deductions made for a participant shall be credited to his account under the Plan. A participant may discontinue his participation in the Plan as provided in paragraph 9 hereof, or may increase or decrease the rate of his payroll deductions during the Purchase Period by completing or filing with the Company a new payroll deduction authorization form authorizing a change in his payroll rate. The Committee may, in its discretion, limit the number of payroll rate changes during any Purchase Period. The change in rate shall be effective with the first f ull payroll period following five business days after the Company's receipt of the new payroll deduction authorization form unless the Company elects to process a given change in payroll rate earlier. A participant's payroll deduction authorization form shall remain in effect for successive Purchase Periods unless terminated as provided in paragraph 9 hereof.

(d) *Automatic Payroll Reduction*. Notwithstanding the foregoing, to the extent necessary to comply with subparagraphs 7(f) and (g) hereof, a participant's payroll deductions may be decreased to 0% at any time during a Purchase Period. Payroll deductions shall recommence at the rate provided in such participant's payroll deduction authorization form at the beginning of the first Purchase Period that is scheduled to end in the following calendar year, unless terminated by the participant as provided in paragraph 9 hereof.

(e) *Tax Withholding*. At the time the stock purchase right is exercised, in whole or in part, or at the time some or all of the Stock issued under the Plan is disposed of, the participant must make adequate provision for the Company's federal, state or other tax withholding obligations, if any, that arise upon the exercise of the stock purchase right or the disposition of the Stock. At any time, the Company may, but shall not be obligated to, withhold from the participant's compensation the amount necessary for the Company to meet applicable withholding obligations, including without limit ation any withholding required to make available to the Company any tax deductions or benefits attributable to the sale or early disposition of Stock purchased by the participant.

(f) *$25,000 Limitation.* Notwithstanding anything in the Plan to the contrary, no employee shall be granted a stock purchase right under the Plan which permits his rights to purchase Stock under the Plan and under all other employee stock purchase plans of the Company and its parent corporation and Subsidiaries to accrue at a rate which exceeds $25,000 of Fair Market Value of Stock (determined at the time such stock purchase right is granted) for each calendar year in which such stock purchase right is outstanding at any time (within the meaning of Section 423(b)(8) of the Code). Any payroll deducti ons in excess of the amount specified in the foregoing sentence shall be returned to the participant as soon as administratively feasible after the next following Enrollment Date.

(g) *Special Restriction on Participation.* Any provisions of the Plan to the contrary notwithstanding, no Eligible Employee shall be granted a stock purchase right under the Plan to the extent that, immediately after the grant, such Eligible Employee (or any other person whose stock would be attributed to such Eligible Employee pursuant to Section 424(d) of the Code) would own capital stock of the Company and/or hold outstanding options to purchase such stock possessing 5% or more of the total combined voting power or value of all classes of the capital stock of the Company, its parent corporation o r any Subsidiary.

8. *Exercise of Stock Purchase Rights.*

(a) *General Statement.* Subject to the limitations set forth in paragraph 7, unless a participant withdraws from the Plan as provided in paragraph 9, each participant in the Plan automatically and without any act on his part shall be deemed to have exercised his stock purchase right on each Purchase Date to the extent of his unused payroll deductions under the Plan and to the extent the issuance of Stock to such participant upon such exercise is lawful.

(b) *Delivery of Shares to Custodian.* As soon as practicable after each Purchase Date, the Company shall deliver to a custodian selected by the Committee one or more certificates representing (or shall otherwise cause to be credited to the account of such custodian) the aggregate number of whole shares of Stock with respect to which stock purchase rights were exercised on such Purchase Date of all of the participating employees hereunder. Such custodian shall keep accurate records of the beneficial interests of each participant in such shares by means of participant accounts under the Plan, and shal l provide each participant with periodic statements with respect thereto as may be directed by the Committee. The Committee may require that shares be retained with such custodian, or other designated broker or agent for a designated period of time and/or may establish other procedures to permit tracking of disqualifying dispositions of such shares. If the Company is required to obtain from any U.S. commission or agency authority to issue any such shares, the Company shall seek to obtain such authority. Inability of the Company to obtain from any commission or agency (whether U.S. or foreign) authority which counsel for the Company deems necessary for the lawful issuance of any such shares shall relieve the Company from liability to any participant in the Plan except to return to him the amount of his payroll deductions under the Plan which would have otherwise been used upon exercise of the relevant stock purchase right.

(c) *Withdrawal of Shares.* A participant may, at any time, in such form and manner as established by the custodian, direct the custodian to deliver to the participant all or part of the shares held by the custodian in his account or to sell such shares and deliver to the participant the proceeds therefrom, less applicable expenses.

(d) *Dividends.* With respect to an individual's Stock held by the custodian pursuant to subparagraph 8(b), the participant may elect in writing or electronically to instruct the custodian to automatically reinvest in additional shares of Stock for such participant's account any cash dividends received by the custodian and attributable to such Stock and custodian shall, in accordance with procedures adopted by the custodian, facilitate the participant's voting rights attributable to shares held in a participant's account. The custodian shall establish procedures for both written a nd electronic elections by participants.

9. *Withdrawal from the Plan.*

(a) *General Statement.* Any participant may withdraw in whole from the Plan at any time that is five or more days prior to the Purchase Date relating to a particular Purchase Period. Partial withdrawals shall not be permitted. A participant who wishes to withdraw from the Plan must timely deliver to the Company a notice of withdrawal in a form prepared by the Company. The Company, promptly as practical following the receipt of the notice of withdrawal, shall refund to the participant the amount of his payroll deductions under the Plan which have not yet been used to purchase shares upon the exercise of his stock purchase rights; and thereupon, automatically and without any further act on his part, his payroll deduction authorization and his interest in unexercised stock purchase rights under the Plan shall terminate in full.

(b) *Leave of Absence.* A participant who goes on a leave of absence shall be deemed to have elected to withdraw from the Plan.

(c) *Eligibility Following Withdrawal.* A participant who withdraws from the Plan shall be eligible to participate again in the Plan upon expiration of the Purchase Period during which he withdrew (provided that he is otherwise an Eligible Employee at such later time).

10. *Termination of Eligible Employment.* If the employment of a participant with the Company terminates for any reason whatsoever or the participant ceases to be an Eligible Employee, then his participation in the Plan automatically and without any act on his part shall terminate as of the date of such termination of employment or change in status. The Company shall promptly refund to him (or his estate or personal representative, as the case may be) the amount of his payroll deductions under the Plan which have not yet been used to purchase Stock, and thereupon his interest in unexercised stock purc hase rights under the Plan shall terminate in full.

11. *Restriction Upon Assignment of Stock Purchase Rights*. A stock purchase right granted under the Plan shall not be transferable otherwise than by will or the laws of descent and distribution. Each stock purchase right shall be exercisable, during a participant's lifetime, only by the participant to whom granted. The Company shall not recognize and shall be under no duty to recognize any assignment or purported assignment by an employee of any of his stock purchase rights under the Plan.

12. *No Shareholder Rights or Privileges Until Exercise of Stock Purchase Rights*. With respect to shares of Stock subject to a stock purchase right, a participant shall not be deemed to be a shareholder, and he shall not have any of the rights or privileges of a shareholder, until such stock purchase right has been exercised and shares delivered pursuant to subparagraph 8(b).

13. *Changes in Stock; Adjustments*. Whenever any change is made in the Stock, by reason of a stock dividend or by reason of subdivision, stock split, reverse stock split, recapitalization, reorganization, combination, reclassification of shares or other similar change, appropriate action will be taken by the Committee to adjust any or all of (i) the number and type of shares subject to the Plan, (ii) the number and type of shares subject to outstanding stock purchase rights and (iii) the Purchase Price with respect to any of the foregoing.

In the event of a Corporate Change, unless a successor corporation assumes or substitutes new stock purchase rights (within the meaning of Section 424(a) of the Code) for all stock purchase rights then outstanding, (i) the Purchase Date for all stock purchase rights then outstanding shall be accelerated to a date fixed by the Committee prior to the effective date of the Corporate Change and (ii) upon such effective date any unexercised stock purchase rights shall expire and the Company promptly shall refund to each participant the amount of such participant's payroll deductions under the Plan which have not yet been used to purchase Stock.

14. *Use of Funds; No Interest Paid*. All funds received or held by the Company under the Plan shall be included in the general funds of the Company free of any trust or other restriction, and may be used for any corporate purpose. No interest shall be paid to any participant on amounts credited to his account.

15. *Term of the Plan*. The Plan shall be effective July 1, 2002, provided the Plan is approved by the shareholders of the Company prior to such date. If not sooner terminated under the provisions of paragraph 16, the Plan shall automatically terminate upon and no further payroll deductions shall be made and no further stock purchase rights shall be granted after the date all of the shares of Stock reserved for issuance under the Plan, as increased and/or adjusted from time to time, have been sold under the Plan. If on the final Purchase Date there is an insufficient number of shares of Stock availabl e for all purchases under stock purchase rights exercised on such date, the number of available shares shall be prorated among the then purchasing participants in an equitable manner as determined by the Committee based on their deductions for such Purchase Period and all remaining amounts shall be returned to the participants.

16. *Amendment or Termination of the Plan*. The Board in its discretion may terminate the Plan at any time with respect to any Stock for which stock purchase rights have not theretofore been granted. The Board shall have the right to alter or amend the Plan or any part thereof from time to time; provided, however, that, except as provided below, no change in any stock purchase right theretofore granted may be made that would materially impair the stock purchase rights of the participant without the consent of such participant. In the event the Board determines that the ongoing operation of the Plan ma y result in unfavorable financial accounting consequences, the Board may, in its discretion and, to the extent necessary or desirable, modify or amend the Plan to reduce or eliminate such accounting consequence including, but not limited to (i) altering the Purchase Price for any Purchase Period including a Purchase Period underway at the time of the change in Purchase Price; and (ii) shortening any Purchase Period so that Purchase Period ends on a new Purchase Date, including a Purchase Period underway at the time of the Board action.

17. *Securities Laws*. The Company shall not be obligated to issue any Stock pursuant to any stock purchase right granted under the Plan at any time when the offer, issuance or sale of shares covered by such stock purchase right has not been registered under the Securities Act of 1933, as amended, or does not comply with such other state, federal or foreign laws, rules or regulations, or the requirements of any stock exchange upon which the Stock may then be listed, as the Company or the Committee deems applicable and, in the opinion of legal counsel for the Company, there is no exemption from the req uirements of such laws, rules, regulations or requirements available for the offer, issuance and sale of such shares. Further, all Stock acquired pursuant to the Plan shall be subject to the Company's policies concerning compliance with securities laws and regulations, as such policies may be amended from time to time. The terms and conditions of stock purchase rights granted hereunder to, and the purchase of shares by, persons subject to Section 16 of the Exchange Act shall comply with any applicable provisions of Rule 16b-3. As to such persons, the Plan shall be deemed to contain, and such stock purchase rights shall contain, and the shares issued upon exercise thereof shall be subject to, such additional conditions and restrictions as may be required from time to time by Rule 16b-3 to qualify for the maximum exemption from Section 16 of the Exchange Act with respect to Plan transactions.

18. *No Restriction on Corporate Action*. Nothing contained in the Plan shall be construed to prevent the Company or any Subsidiary from taking any corporate action that is deemed by the Company or such Subsidiary to be appropriate or in its best interest, whether or not such action would have an adverse effect on the Plan or any stock purchase right granted under the Plan. No employee, beneficiary or other person shall have any claim against the Company or any Subsidiary as a result of any such action.

19. *Miscellaneous Provisions.*

(a) *Number and Gender.* Wherever appropriate herein, words used in the singular shall be considered to include the plural and words used in the plural shall be considered to include the singular. The masculine gender, where appearing in the Plan, shall be deemed to include the feminine gender.

(b) *Headings.* The headings and subheadings in the Plan are included solely for convenience, and if there is any conflict between such headings or subheadings and the text of the Plan, the text shall control.

(c) *Not a Contract of Employment.* The adoption and maintenance of the Plan shall not be deemed to be a contract between the Company or any Participating Company and any person or to be consideration for the employment of any person. Participation in the Plan at any given time shall not be deemed to create the right to participate in the Plan, or any other arrangement permitting an employee of the Company or any Participating Company to purchase Stock at a discount, in the future. The stock purchase rights and obligations under any participant's terms of employment with the Company or any Parti cipating Company shall not be affected by participation in the Plan. Nothing herein contained shall be deemed to give any person the right to be retained in the employ of the Company or any Participating Company or to restrict the right of the Company or any Participating Company to discharge any person at any time, nor shall the Plan be deemed to give the Company or any Participating Company the right to require any person to remain in the employ of the Company or such Participating Company or to restrict any person's right to terminate his employment at any time. The Plan shall not afford any participant any additional right to compensation as a result of the termination of such participant's employment for any reason whatsoever.

(d) *Compliance with Applicable Laws.* The Company's obligation to offer, issue, sell or deliver Stock under the Plan is at all times subject to all approvals of and compliance with any governmental authorities (whether domestic or foreign) required in connection with the authorization, offer, issuance, sale or delivery of Stock as well as all federal, state, local and foreign laws. Without limiting the scope of the preceding sentence, and notwithstanding any other provision in the Plan, the Company shall not be obligated to grant stock purchase rights or to offer, issue, sell or deliver Stock u nder the Plan to any employee who is a citizen or resident of a jurisdiction the laws of which, for reasons of its public policy or otherwise, prohibit the Company from taking any such action with respect to such employee.

(e) *Severability.* If any provision of the Plan shall be held illegal or invalid for any reason, said illegality or invalidity shall not affect the remaining provisions hereof; instead, each provision shall be fully severable and the Plan shall be construed and enforced as if said illegal or invalid provision had never been included herein.

(f) *Governing Law.* All provisions of the Plan shall be construed in accordance with the laws of Delaware except to the extent preempted by federal law.

HALLIBURTON COMPANY

BENEFIT RESTORATION PLAN

AS AMENDED AND RESTATED

EFFECTIVE JANUARY 1, 2004

TABLE OF CONTENTS

HALLIBURTON COMPANY

BENEFIT RESTORATION PLAN

Halliburton Company, having heretofore established the Halliburton Company Benefit Restoration Plan, amends and restates the Halliburton Company Benefit Restoration Plan to read as follows and to be effective in accordance with the provisions of Article XII hereof.

ARTICLE I

Purpose of the Plan

The purpose of the Halliburton Company Benefit Restoration Plan is to provide a vehicle to restore qualified plan benefits which are reduced as a result of limitations on contributions imposed under the Internal Revenue Code or due to participation in other company sponsored plans and to defer compensation that would otherwise be treated as excessive employee remuneration within the meaning of Section 162(m) of the Internal Revenue Code.

ARTICLE II
Definitions

Where the following words and phrases appear in the Plan, they shall have the respective meanings set forth below, unless their context clearly indicates to the contrary.

(A) **Account:** An individual account for each Participant on the books of such Participant's Employer to which is credited amounts allocated for the benefit of such Participant pursuant to the provisions of Article IV, Paragraphs (A) and (B), amounts transferred to the Plan from other deferred comp ensation plans, and interest credited pursuant to the provisions of Article IV, Paragraph (D).

(B) **Administrative Committee:** The administrative committee appointed by the Compensation Committee to administer the Plan.

(C) **Allocation Year**: The calendar year for which an allocation is made to a Participant's Account pursuant to Article IV.

(D) **Board:** The Board of Directors of the Company.

(E) **Code:** The Internal Revenue Code of 1986, as amended.

(F) **Compensation Committee:** The Compensation Committee of the Board.

(G) **Company:** Halliburton Company.

(H) **Employee:** Any employee of an Employer. The term does not include independent contractors or persons who are retained by an Employer as consultants only.

(I) **Employer:** The Company and any Subsidiary designated as an Employer in accordance with the provisions of Article III of the Plan.

(J) **ERISA:** The Employee Retirement Income Security Act of 1974, as amended.

(K) **Participant:** An Employee whose compensation from the Employers for an Allocation Year is in excess of the limit set forth in Section 401 (a)(17) of the Code for such Allocation Year or who has made elective deferrals for such Allocation Year under the Halliburton Elective Deferral Plan. The foregoing notwithstanding, an Employee whose employment with an Employer is terminat ed prior to the last day of an Allocation Year for any reason other than death, disability or retirement in accordance with the terms of his or her Employer's retirement policy shall not be eligible to participate in the Plan for such Allocation Year and, accordingly, such Employee's Account shall not be credited with any allocation under Article IV, Paragraph (A) for such Allocation Year.

(L) **Plan:** The Halliburton Company Benefit Restoration Plan, as amended and restated January 1, 2004, and as the same may thereafter be amended from time to time.

(M) **Subsidiary:** At any given time, a company (whether a corporation, partnership, limited liability company or other form of entity) in which the Company or any other of its Subsidiaries or both owns, directly or indirectly, an aggregate equity interest of 80% or more.

(N) **Termination of Service:** Severance from employment with an Employer for any reason other than a transfer between Employers.

(O) **Trust:** Any trust created pursuant to the provisions of Article IX.

(P) **Trust Agreement:** The agreement establishing the Trust.

(Q) **Trustee:** The trustee of the Trust.

(R) **Trust Fund:** Assets under the Trust as may exist from time to time.

ARTICLE III

Administration of the Plan

(A) The Compensation Committee shall appoint an Administrative Committee to administer, construe and interpret the Plan. Such Administrative Committee, or such successor Administrative Committee as may be duly appointed by the Compensation Committee, shall serve at the pleasure of the Compensation Committee. Decisions of the Administrative Committee, with respect to any matter involving the Plan, shall be final and binding on the Company, its shareholders, each Employer and all officers and other executives of the Employers. For purposes of the Employee Retirement Income Security Act of 1974, the Administrative Committee shall be the Plan "a dministrator" and shall be the "named fiduciary" with respect to the general administration of the Plan.

(B) The Administrative Committee shall maintain complete and adequate records pertaining to the Plan, including but not limited to Participants' Accounts, amounts transferred to the Trust, reports from the Trustee and all other records which shall be necessary or desirable in the proper administration of the Plan. The Administrative Committee shall furnish the Trustee such information as is required to be furnished by the Administrative Committee or the Company pursuant to the Trust Agreement.

(C) The Company (the "Indemnifying Party") hereby agrees to indemnify and hold harmless the members of the Administrative Committee (the "Indemnified Parties") against any losses, claims, damages or liabilities to which any of the Indemnified Parties may become subject to the extent that such losses, claims, damages or liabilities or actions in respect thereof arise out of or are based upon any act or omission of the Indemnified Party in connection with the administration of this Plan (including any act or omission of such Indemnified Party constituting negligence, but excluding any act or omission of such Indemnified Party constituting gros s negligence or willful misconduct), and will reimburse the Indemnified Party for any legal or other expenses reasonably incurred by him or her in connection with investigating or defending against any such loss, claim, damage, liability or action.

(D) Promptly after receipt by the Indemnified Party under the preceding paragraph of notice of the commencement of any action or proceeding with respect to any loss, claim, damage or liability against which the Indemnified Party believes he or she is indemnified under the preceding paragraph, the Indemnified Party shall, if a claim with respect thereto is to be made against the Indemnifying Party under such paragraph, notify the Indemnifying Party in writing of the commencement thereof; provided, however, that the omission so to notify the Indemnifying Party shall not relieve it from any liabilit y which it may have to the Indemnified Party to the extent the Indemnifying Party is not prejudiced by such omission. If any such action or proceeding shall be brought against the Indemnified Party, and it shall notify the Indemnifying Party of the commencement thereof, the Indemnifying Party shall be entitled to participate therein, and, to the extent that it shall wish, to assume the defense thereof, with counsel reasonably satisfactory to the Indemnified Party, and, after notice from the Indemnifying Party to the Indemnified Party of its election to assume the defense thereof, the Indemnifying Party shall not be liable to such Indemnified Party under the preceding paragraph for any legal or other expenses subsequently incurred by the Indemnified Party in connection with the defense thereof other than reasonable costs of investigation or reasonable expenses of actions taken at the written request of the Indemnifying Party. The Indemnifying Party shall not be liable for any compromise or settlement of any s uch action or proceeding effected without its consent, which consent will not be unreasonably withheld.

(E) The Administrative Committee may designate any Subsidiary as an Employer by written instrument delivered to the Secretary of the Company and the designated Employer. Such written instrument shall specify the effective date of such designated participation, may incorporate specific provisions relating to the operation of the Plan which apply to the designated Employer only and shall become, as to such designated Employer and its employees, a part of the Plan. Each designated Employer shall be conclusively presumed to have consented to its designation and to have agreed to be bound by the terms of the Plan and any and all amendments thereto upon its submission of information to the Administrative Committee required by the terms of or with respect to the Plan; provided, however, that the terms of the Plan may be modified so as to increase the obligations of an Employer only with the consent of such Employer, which consent shall be conclusively presumed to have been given by such Employer upon its submission of any information to the Administrative Committee required by the terms of or with respect to the Plan. Except as modified by the Administrative Committee in its written instrument, the provisions of this Plan shall be applicable with respect to each Employer separately, and amounts payable hereunder shall be paid by the Employer which employs the particular Participant, if not paid from the Trust Fund.

(F) No member of the Administrative Committee shall have any right to vote or decide upon any matter relating solely to himself or herself under the Plan or to vote in any case in which his or her individual right to claim any benefit under the Plan is particularly involved. In any case in which an Administrative Committee member is so disqualified to act and the remaining members cannot agree, the Compensation Committee shall appoint a temporary substitute member to exercise all the powers of the disqualified member concerning the matter in which he or she is disqualified.

ARTICLE IV

Allocations Under the Plan,
<u>Participation in the Plan and Selection for Awards</u>

(A) The Administrative Committee shall determine for each Allocation Year which Participants' allocations of Employer contributions (other than matching contributions) under qualified defined contribution plans sponsored by the Employers have been reduced for such Allocation Year by reason of the application of Section 401 (a)(17) or Section 415 of the Code, or any combination of such Sections, or by reason of elective deferrals under the Halliburton Elective Deferral Plan, and shall allocate to the credit of each such Participant under the Plan an amount equal to the amount of such reductions applicable to such Participant. In addition, the Administrative Committee shall allocate to the credit of each Participant under the Plan the amount of Employer matching contributions that would have been allocated to such Participant's account under Employer's qualified defined contribution plan with respect to (i) the amount of such Participant's compensation (as such term is defined in Employer's qualified defined contribution plan) deferred under the Halliburton Elective Deferral Plan for such Allocation Year and (ii) the amount of such compensation not so deferred that is in excess of the compensation limit under Section 401 (a)(17) of the Code for such Allocation Year.

(B) The Compensation Committee may, in its discretion, allocate to the credit of a Participant under the Plan all or any part of any remuneration payable by the Employer to such Participant which would otherwise be treated as excessive employee remuneration within the meaning of Section 162(m) of the Code for any Allocation Year, rather than paying such excessive remuneration to such Participant.

(C) Allocations to Participants under the Plan shall be made by crediting their respective Account on the books of their Employers as of the last day of the Allocation Year, except that an allocation under Paragraph (B) shall be credited to a Participant on the date the amount would have been paid to the Participant had it not been deferred pursuant to the provisions of Paragraph (B). Accounts of Participants shall also be credited with interest as of the last day of each Allocation Year, at the rate set forth in Paragraph (D) below, on the average monthly credit balance of the Account being calculated by using the balance of each Account on the first day of each month. Prior to Termination of Service, the annual interest shall accumulate as a part of the Account balance. After Termination of Service, the annual interest for such Allocation Year may be paid as more particularly set forth hereinafter in Article VII, Paragraph (C).

(D) Interest shall be credited on amounts allocated to Participants' Account at the rate of 10% per annum.

ARTICLE V

Non-Assignability of Awards

No Participant shall have any right to commute, encumber, pledge, transfer or otherwise dispose of or alienate any present or future right or expectancy which he or she may have at any time to receive payments of any allocations made to such Participant, all such allocations being expressly hereby made non-assignable and non-transferable; provided, however, that nothing in the Article shall prevent transfer (A) by will, (B) by the applicable laws of descent and distribution or (C) pursuant to an order that satisfies the requirements for a "qualified domestic relations order" as such term is defined in section 206(d)(3)(B) of the ERISA and section 414(p)(1)(A) of the Code, including an order that requires distributions to an alternate payee prior to a Participant's "earliest retirement age" as such term is defined in section 206(d)(3)(E)(ii) of the ERISA and section 414(p)(4)(B) of the Code. Attempts to transfer or assign by a Participant (other than in accordance with the preceding sentence) shall, in the sole discretion of the Compensation Committee after consideration of such facts as it deems pertinent, be grounds for terminating any rights of such Participant to any awards allocated to but not previously paid over to such Participant.

ARTICLE VI

Vesting

All amounts credited to a Participant’s Account shall be fully vested and not subject to forfeiture for any reason except as provided in Article V.

ARTICLE VII

Distribution of Awards

(A) Upon Termination of Service of a Participant the Administrative Committee (i) shall certify to the Trustee or the treasurer of the Employer, as applicable, the amount credited to the Participant's Account on the books of each Employer for which the Participant was employed at a time when he or she earned an award hereunder, (ii) shall determine whether the payment of the amount credited to the Participant's Account under the Plan is to be paid directly by the applicable Employer, from the Trust Fund, if any, or by a combination of such sources (except to the extent the provisions of the Trust Agreement if any, specify payment from the Trust Fund) and (iii) shall determine and certify to the Trustee or the treasurer of the Employer, as applicable, the method of payment of the amount credited to a Participant's Account, selected by the Administrative Committee from among the following alternatives:

(1) A single lump sum payment upon Termination of Service;

(2) A payment of one-half of the Participant's balance upon Termination of Service, with payment of the additional one-half to be made on or before the last day of a period of one year following Termination; or

(3) Payment in monthly installments over a period not to exceed ten years with such payments to commence upon Termination of Service.

The above notwithstanding, if the total amount credited to the Participant's Account upon Termination of Service is less than $50,000, such amount shall always be paid in a single lump sum payment upon Termination of Service.

(B) The Trustee or the treasurer of the Employer, as applicable, shall thereafter make payments of awards in the manner and at the times so designated, subject, however, to all of the other terms and conditions of this Plan and the Trust Agreement if any. This Plan shall be deemed to authorize the payment of all or any portion of a Participant's award from the Trust Fund to the extent such payment is required by the provisions of the Trust Agreement, if any.

(C) Interest on the second half of a payment under Paragraph (A)(2) above shall be paid with the final payment, while interest on payments under Paragraph (A)(3) above may be paid at each year end or may be paid as a part of a level monthly payment computed by the Administrative Committee through the use of such methodologies as the Administrative Committee shall select from time to time for such purpose.

(D) If a Participant shall die while in the service of an Employer, or after Termination of Service and prior to the time when all amounts payable to him or her under the Plan have been paid to such Participant, any remaining amounts payable to the Participant hereunder shall be payable to the estate of the Participant. The Administrative Committee shall cause the Trustee or the treasurer of the Employer, as applicable, to pay to the estate of the Participant all of the awards then standing to his or her credit in a lump sum or in such other form of payment consistent with the alternative methods of payment set forth above as the Administrat ive Committee shall determine after considering such facts and circumstances relating to the Participant and his or her estate as it deems pertinent.

(E) If the Plan is terminated pursuant to the provisions of Article X, the Compensation Committee may, at its election and in its sole discretion, cause the Trustee or the treasurer of the Employer, as applicable, to pay to all Participants all of the awards then standing to their credit in the form of lump sum payments.

ARTICLE VIII

Nature of Plan

This Plan constitutes a mere promise by the Employers to make benefit payments in the future and Participants have the status of general unsecured creditors of the Employers. Further, the adoption of this Plan and any setting aside of amounts by the Employers with which to discharge their obligations hereunder shall not be deemed to create a trust; legal and equitable title to any funds so set aside shall remain in the Employers, and any recipient of benefits hereunder shall have no security or other interest in such funds. Any and all funds so set aside shall remain subject to the claims of the general creditors of the Employers, present and future. This provision shall not require the Employers to set aside any funds, but the Employers may set aside such funds if they choose to do so.

ARTICLE IX

Funding of Obligation

Article VIII above to the contrary notwithstanding, the Employers may fund all or part of their obligations hereunder by transferring assets to a trust if the provisions of the trust agreement creating the Trust require the use of the Trust's assets to satisfy claims of an Employer's general unsecured creditors in the event of such Employer’s insolvency and provide that no Participant shall at any time have a prior claim to such assets. Any transfers of assets to a trust may be made by each Employer individually or by the Company on behalf of all Employers. The assets of the Trust shall not be deemed to be assets of this Plan.

ARTICLE X

Amendment or Termination of Plan

The Compensation Committee shall have the power and right from time to time to modify, amend, supplement, suspend or terminate the Plan as it applies to each Employer, provided that no such change in the Plan may deprive a Participant of the amounts allocated to his or her Account or be retroactive in effect to the prejudice of any Participant and the interest rate applicable to amounts credited to Participants' Accounts for periods subsequent to Termination of Service shall not be reduced below 6% per annum. Any such modification, amendment, supplement suspension or termination shall be in writing and signed by a member of the Compensation Committee.

ARTICLE XI

General Provisions

(A) No Participant shall have any preference over the general creditors of an Employer in the event of such Employer’s insolvency.

(B) Nothing contained herein shall be construed to give any person the right to be retained in the employ of an Employer or to interfere with the right of an Employer to terminate the employment of any person at any time.

(C) If the Administrative Committee receives evidence satisfactory to it that any person entitled to receive a payment hereunder is, at the time the benefit is payable, physically, mentally or legally incompetent to receive such payment and to give a valid receipt therefor, and that an individual or institution is then maintaining or has custody of such person and that no guardian, committee or other representative of the estate of such person has been duly appointed, the Administrative Committee may direct that such payment thereof be paid to such individual or institution maintaining or having custody of such person, and the receipt of suc h individual or institution shall be valid and a complete discharge for the payment of such benefit.

(D) Payments to be made hereunder may, at the written request of the Participant, be made to a bank account designated by such Participant, provided that deposits to the credit of such Participant in any bank or trust company shall be deemed payment into his or her hands.

(E) Wherever any words are used herein in the masculine, feminine or neuter gender, they shall be construed as though they were also used in another gender in all cases where they would so apply, and whenever any words are used herein in the singular or plural form, they shall be construed as though they were also used in the other form in all cases where they would so apply.

(F) THIS PLAN SHALL BE CONSTRUED AND ENFORCED UNDER THE LAWS OF THE STATE OF TEXAS EXCEPT TO THE EXTENT PREEMPTED BY FEDERAL LAW.

ARTICLE XII

Effective Date

This amendment and restatement of the Plan shall be effective from and after January 1, 2004 and shall continue in force during subsequent years unless amended or revoked by action of the Compensation Committee.

HALLIBURTON COMPANY

By ______________________________

EXECUTIVE EMPLOYMENT AGREEMENT

This Executive Employment Agreement ("Agreement"), is entered into by and between Halliburton Energy Services, a division of Halliburton Energy Services, Inc. ("Employer") and Andrew R. Lane ("Employee"), to be effective on January 1, 1999 (the "Effective Date").

W I T N E S S E T H:

WHEREAS, Employee is currently employed by Employer; and

WHEREAS, Employer is desirous of continuing the employment of Employee after the Effective Date pursuant to the terms and conditions and for the consideration set forth in this Agreement, and Employee is desirous of continuing in the employ of Employer pursuant to such terms and conditions and for such consideration.

NOW, THEREFORE, for and in consideration of the mutual promises, covenants, and obligations contained herein, Employer and Employee agree as follows:

ARTICLE 1: EMPLOYMENT AND DUTIES:

1.1. Employer agrees to employ Employee, and Employee agrees to be employed by Employer, beginning as of the Effective Date and continuing until the date of termination of Employee's employment pursuant to the provisions of Article 3 (the "Term"), subject to the terms and conditions of this Agreement.

1.2. Beginning as of the Effective Date, Employee shall be employed as Divisional Vice President for Production Enhancement/Completion Product Services/Specialty Services. Employee agrees to serve in the assigned position or in such other executive capacities as may be requested from time to time by Employer and to perform diligently and to the best of Employee's abilities the duties and services appertaining to such pos itions as reasonably determined by Employer, as well as such additional or different duties and services appropriate to such positions which Employee from time to time may be reasonably directed to perform by Employer.

1.3. Employee shall at all times comply with and be subject to such policies and procedures as Halliburton Company (“Halliburton”) or Employer may establish from time to time, including, without limitation, the Halliburton Company Code of Business Conduct (the "Code of Business Conduct").

1.4. Employee shall, during the period of Employee's employment by Employer, devote Employee's full business time, energy, and best efforts to the business and affairs of Employer. Employee may not engage, directly or indirectly, in any other business, investment, or activity that interferes with Employee's performance of Employee's duties hereunder, is contrary to the interest of Halliburton or any of its affiliated subsidiaries and divisions, including Employer (collectively, the “Halliburton Entities” or, individually, a “Halliburton Entity”), or requires any significant porti on of Employee's business time. The foregoing notwithstanding, the parties recognize and agree that Employee may engage in passive personal investments and other business activities which do not conflict with the business and affairs of the Halliburton Entities or interfere with Employee's performance of his or her duties hereunder. Employee may not serve on the board of directors of any entity other than a Halliburton Entity during the Term without the approval thereof in accordance with Halliburton’s policies and procedures regarding such service. Employee shall be permitted to retain any compensation received for approved service on any unaffiliated corporation’s board of directors.

1.5. Employee acknowledges and agrees that Employee owes a fiduciary duty of loyalty, fidelity and allegiance to act at all times in the best interests of the Employer and the other Halliburton Entities and to do no act which would, directly or indirectly, injure any such entity's business, interests, or reputation. It is agreed that any direct or indirect interest in, connection with, or benefit from any outside activities, particularly commercial activities, which interest might in any way adversely affect Employer, or any Halliburton Entity, involves a possible conflict of interest. In keeping wi th Employee's fiduciary duties to Employer, Employee agrees that Employee shall not knowingly become involved in a conflict of interest with Employer or the Halliburton Entities, or upon discovery thereof, allow such a conflict to continue. Moreover, Employee shall not engage in any activity which might involve a possible conflict of interest without first obtaining approval in accordance with Halliburton's policies and procedures.

1.6 Nothing contained herein shall be construed to preclude the transfer of Employee's employment to another Halliburton Entity ("Subsequent Employer") as of, or at any time after, the Effective Date and no such transfer shall be deemed to be a termination of employment for purposes of Article 3 hereof; provided, however, that, effective with such transfer, all of Employer's obligations hereunder shall be assumed by and be binding upon, and all of Employer's rights hereunder shall be assigned to, such Subsequent Employer and the defined term "Employer" as used herein shall thereafter be deemed amend ed to mean such Subsequent Employer. Except as otherwise provided above, all of the terms and conditions of this Agreement, including without limitation, Employee's rights and obligations, shall remain in full force and effect following such transfer of employment.

ARTICLE 2: COMPENSATION AND BENEFITS:

2.1. Employee's base salary during the Term shall be not less than $124,296 per annum which shall be paid in accordance with the Employer's standard payroll practice for its executives. Employee's base salary may be increased from time to time with the approval of the Compensation Committee of Halliburton's Board of Directors (the "Compensation Committee") or its delegate, as applicable. Such increased base salary shall become the minimum base salary under this Agreement and may not be decreased thereafter wit hout the written consent of Employee.

2.2. Beginning January 1, 1999 and for the remainder of the Term, Employee shall participate in the Halliburton Annual Performance Pay Plan, or any successor annual incentive plan approved by the Compensation Committee; provided, however, that all determinations relating to Employee's participation, including, without limitation, those relating to the performance goals applicable to Employee and Employee's level of participation and payout opportunity, shall be made in the sole discretion of the person or committee to whom such authority has been granted pursuant to such plan's terms.

2.3. During the Term, Employer shall pay or reimburse Employee for all actual, reasonable and customary expenses incurred by Employee in the course of his or her employment; including, but not limited to, travel, entertainment, subscriptions and dues associated with Employee's membership in professional, business and civic organizations; provided that such expenses are incurred and accounted for in accordance with Employer's applicable policies and procedures.

2.4. While employed by Employer, Employee shall be allowed to participate, on the same basis generally as other executive employees of Employer, in all general employee benefit plans and programs, including improvements or modifications of the same, which on the Effective Date or thereafter are made available by Employer or Halliburton to all or substantially all of Employer's similarly situated executive employees. Such benefits, plans, and programs may include, without limitation, medical, health, and dental care, life insurance, disability protection, and qualified and non-qualified retirement pl ans. Except as specifically provided herein, nothing in this Agreement is to be construed or interpreted to increase or alter in any way the rights, participation, coverage, or benefits under such benefit plans or programs than provided to similarly situated executive employees pursuant to the terms and conditions of such benefit plans and programs. While employed by Employer, Employee shall be eligible to receive awards under the Halliburton Company 1993 Stock and Long-Term Incentive Plan (the "1993 Plan") or any successor stock-related plan adopted by Halliburton's Board of Directors; provided, however, that the foregoing shall not be construed as a guarantee with respect to the type, amount or frequency of such awards, if any, such decisions being solely within the discretion of the Compensation Committee or its delegate, as applicable.

2.5. Neither Halliburton nor Employer shall by reason of this Article 2 be obligated to institute, maintain, or refrain from changing, amending or discontinuing, any incentive compensation, employee benefit or stock or stock option program or plan, so long as such actions are similarly applicable to covered employees generally.

2.6. Employer may withhold from any compensation, benefits, or amounts payable under this Agreement all federal, state, city, or other taxes as may be required pursuant to any law or governmental regulation or ruling.

ARTICLE 3: TERMINATION OF EMPLOYMENT AND EFFECTS OF SUCH TERMINATION:

3.1. Employee's employment with Employer shall be terminated (i) upon the death of Employee, (ii) upon Employee's Retirement (as defined below), (iii) upon Employee's Permanent Disability (as defined below), or (iv) at any time by Employer upon notice to Employee, or by Employee upon thirty (30) days' notice to Employer, for any or no reason.

3.2. If Employee's employment is terminated by reason of any of the following circumstances, Employee shall not be entitled to receive the benefits set forth in Section 3.3 hereof:

(i) Death.

(ii) Retirement. "Retirement" shall mean either (a) Employee's retirement at or after normal retirement age (either voluntarily or pursuant to Halliburton's retirement policy) or (b) the voluntary termination of Employee's employment by Employee in accordance with Employer's early retirement policy for other than Good Reason (as defined below).

(iii) Permanent Disability. "Permanent Disability" shall mean Employee's physical or mental incapacity to perform his or her usual duties with such condition likely to remain continuously and permanently as determined by the Compensation Committee.

(iv) Voluntary Termination. "Voluntary Termination" shall mean a termination of employment in the sole discretion and at the election of Employee for other than Good Reason. "Good Reason" shall mean (a) a termination of employment by Employee because of a material breach by Employer of any material provision of this Agreement which remains uncorrected for thirty (30) days following notice of such breach by Employee to Employer, provided such termination occurs within sixty (60) days after the expiration of the notice period or (b) a termination of employment by Employee within six (6) months after a material reduction in Employee's rank or responsibility with Employer.

(v) Termination for Cause. Termination of Employee's employment by Employer for Cause. "Cause" shall mean any of the following: (a) Employee's gross negligence or willful misconduct in the performance of the duties and services required of Employee pursuant to this Agreement, (b) Employee's final conviction of a felony, (c) a material violation of the Code of Business Conduct or (d) Employee's material breach of any material provision of this Agreement which remains uncorrected for thirty (30) days following notice of such breach to Employee by Employer. Determination as to whether or not Cause exists for termination of Employee's employment will be made by the Compensation Committee.

In the event Employee's employment is terminated under any of the foregoing circumstances, all future compensation to which Employee is otherwise entitled and all future benefits for which Employee is eligible shall cease and terminate as of the date of termination, except as specifically provided in this Section 3.2. Employee, or his or her estate in the case of Employee's death, shall be entitled to pro rata base salary through the date of such termination and shall be entitled to any individual bonuses or individual incentive compensation not yet paid but payable under Employer's or Halliburton's plans for years prior to the year of Employee's termination of employment, but shall not be entitled to any bonus or incentive compensation for the year in which he or she terminates employment or any other payments or benefits by or on behalf of Employer except for those which may be payable pursuant to the terms of Employer's or Halliburton's employee benefit plans (as defined in Section 3.4), stock, stock option or incentive plans, or the applicable agreements underlying such plans.

3.3 If Employee's employment is terminated by Employer or Employee for any reason other than as set forth in Section 3.2 above Employee shall be entitled to each of the following:

(i) To the extent not otherwise specifically provided in any underlying restricted stock agreements, all shares of Halliburton common stock previously granted to Employee under the 1993 Plan, and any similar plan adopted by Halliburton in the future, which at the date of termination of employment are subject to restrictions (the "Restricted Shares") will be treated in a manner consistent with Halliburton's past practices for treatment of Restricted Shares held by executives whose employment was involuntarily terminated by a Halliburton Entity for reasons other than Cause, which, in most instances, have been to forfeit the Restricted Shares and pay to such executive a lump sum cash payment equal to the value of the Restricted Shares (based on the closing price of Halliburton common stock on the New York Stock Exchange on the date of termination of employment); although in some cases, Halliburton has, in lieu of, or in combination with, the foregoing and in its discretion, caused the forfeiture restrictions with respect to all or a portion of the Restricted Shares to lapse and provided for the retention of such shares by such executive.

(ii) Subject to the provisions of Section 3.4, Employer shall pay to Employee a severance benefit consisting of a single lump sum cash payment equal to two years' of Employee's base salary as in effect at the date of Employee's termination of employment. Such severance benefit shall be paid no later than sixty (60) days following Employee's termination of employment.

(iii) Employee shall be entitled to any individual bonuses or individual incentive compensation not yet paid but payable under Employer's or Halliburton's plans for years prior to the year of Employee's termination of employment. Such amounts shall be paid to Employee in a single lump sum cash payment no later than sixty (60) days following Employee's termination of employment.

(iv) Employee shall be entitled to any individual bonuses or individual incentive compensation under Employer's or Halliburton's plans for the year of Employee's termination of employment determined as if Employee had remained employed by the Employer for the entire year. Such amounts shall be paid to Employee at the time that such amounts are paid to similarly situated employees except that no portion of such amounts shall be deferred to future years.

3.4. The severance benefit paid to Employee pursuant to Section 3.3 shall be in consideration of Employee's continuing obligations hereunder after such termination, including, without limitation, Employee's obligations under Article 4. Further, as a condition to the receipt of such severance benefit, Employer, in its sole discretion, may require Employee to first execute a release, in the form established by Employer, releasing Employer and all other Halliburton Entities, and their officers, directors, employe es, and agents, from any and all claims and from any and all causes of action of any kind or character, including, but not limited to, all claims and causes of action arising out of Employee's employment with Employer and any other Halliburton Entities or the termination of such employment. The performance of Employer's obligations under Section 3.3 and the receipt of the severance benefit provided thereunder by Employee shall constitute full settlement of all such claims and causes of action. Employee shall not be under any duty or obligation to seek or accept other employment following a termination of employment pursuant to which a severance benefit payment under Section 3.3 is owing and the amounts due Employee pursuant to Section 3.3 shall not be reduced or suspended if Employee accepts subsequent employment or earns any amounts as a self-employed individual. Employee's rights under Section 3.3 are Employee's sole and exclusive rights against the Employer or its affiliates and the Employer's sole and exclusive liability to Employee under this Agreement, in contract, tort or otherwise, for the termination of his or her employment relationship with Employer. Employee agrees that all disputes relating to Employee’s termination of employment, including, without limitation, any dispute as to “Cause” or “Voluntary Termination” and any claims or demands against Employer or Halliburton based upon Employee’s employment for any monies other than those specified in Section 3.3, shall be resolved through the Halliburton Dispute Resolution Plan as provided in Section 5.6 hereof; provided, however, that decisions as to whether "Cause" exists for termination of the employment relationship with Employee and whether and as of what date Employee has become permanently disabled are delegated to the Compensation Commi ttee for determination and any dispute of Employee with any such decision shall be limited to whether the Compensation Committee reached such decision in good faith. Nothing contained in this Article 3 shall be construed to be a waiver by Employee of any benefits accrued for or due Employee under any employee benefit plan (as such term is defined in the Employees' Retirement Income Security Act of 1974, as amended) maintained by Employer or Halliburton except that Employee shall not be entitled to any severance benefits pursuant to any severance plan or program of the Employer or Halliburton.

3.5. Termination of the employment relationship does not terminate those obligations imposed by this Agreement which are continuing obligations, including, without limitation, Employee's obligations under Article 4.

ARTICLE 4: OWNERSHIP AND PROTECTION OF INTELLECTUAL PROPERTY AND CONFIDENTIAL INFORMATION:

4.1. All information, ideas, concepts, improvements, discoveries, and inventions, whether patentable or not, which are conceived, made, developed or acquired by Employee, individually or in conjunction with others, during Employee's employment by Employer or any of its affiliates (whether during business hours or otherwise and whether on Employer's premises or otherwise) which relate to the business, products or services of Employer or its affiliates (including, without limitation, all such information relating to corporate opportunities, research, financial and sales data, pricing and trading terms , evaluations, opinions, interpretations, acquisition prospects, the identity of customers or their requirements, the identity of key contacts within the customer's organizations or within the organization of acquisition prospects, or marketing and merchandising techniques, prospective names, and marks), and all writings or materials of any type embodying any of such items, shall be the sole and exclusive property of Employer or its affiliates, as the case may be.

4.2. Employee acknowledges that the businesses of Employer and its affiliates are highly competitive and that their strategies, methods, books, records, and documents, their technical information concerning their products, equipment, services, and processes, procurement procedures and pricing techniques, the names of and other information (such as credit and financial data) concerning their customers and business affiliates, all comprise confidential business information and trade secrets which are valuable, special, and unique assets which Employer or its affiliates use in their business to obtain a competitive advantage over their competitors. Employee further acknowledges that protection of such confidential business information and trade secrets against unauthorized disclosure and use is of critical importance to Employer and its affiliates in maintaining their competitive position. Employee hereby agrees that Employee will not, at any time during or after his or her employment by Employer, make any unauthorized disclosure of any confidential business information or trade secrets of Employer or its affiliates, or make any use thereof, except in the carrying out of his or her employment responsibilities hereunder. Confidential business information shall not include information in the public domain (but only if the same becomes part of the public domain through a means other than a disclosure prohibited hereunder). The above notwithstanding, a disclosure shall not be unauthorized if (i) it is required by law or by a court of competent jurisdiction or (ii) it is in connection with any judicial, arbitr ation, dispute resolution or other legal proceeding in which Employee's legal rights and obligations as an employee or under this Agreement are at issue; provided, however, that Employee shall, to the extent practicable and lawful in any such events, give prior notice to Employer of his or her intent to disclose any such confidential business information in such context so as to allow Employer or its affiliates an opportunity (which Employee will not oppose) to obtain such protective orders or similar relief with respect thereto as may be deemed appropriate.

4.3. All written materials, records, and other documents made by, or coming into the possession of, Employee during the period of Employee's employment by Employer which contain or disclose confidential business information or trade secrets of Employer or its affiliates shall be and remain the property of Employer, or its affiliates, as the case may be. Upon termination of Employee's employment by Employer, for any reason, Employee promptly shall deliver the same, and all copies thereof, to Employer.

4.4 For purposes of this Article 4, "affiliates" shall mean entities in which Employer or Halliburton has a 20% or more direct or indirect equity interest.

ARTICLE 5: MISCELLANEOUS:

5.1. Except as otherwise provided in Section 4.4 hereof, for purposes of this Agreement, the terms "affiliate" or "affiliated" means an entity who directly, or indirectly through one or more intermediaries, controls, is controlled by, or is under common control with Halliburton or in which Halliburton has a 50% or more equity interest.

5.2. For purposes of this Agreement, notices and all other communications provided for herein shall be in writing and shall be deemed to have been duly given when received by or tendered to Employee, Halliburton or Employer, as applicable, by pre-paid courier or by United States registered or certified mail, return receipt requested, postage prepaid, addressed as follows:

If to Employer or Halliburton, to Halliburton Company at 3600 Lincoln Plaza, 500 North Akard Street, Dallas, Texas 75201-3391, to the attention of the General Counsel.

If to Employee, to his or her last known personal residence.

5.3. This Agreement shall be governed by and construed and enforced, in all respects in accordance with the law of the State of Texas, without regard to principles of conflicts of law, unless preempted by federal law, in which case federal law shall govern; provided, however, that the Halliburton Dispute Resolution Plan and the Federal Arbitration Act shall govern in all respects with regard to the resolution of disputes hereunder.

5.4. No failure by either party hereto at any time to give notice of any breach by the other party of, or to require compliance with, any condition or provision of this Agreement shall be deemed a waiver of similar or dissimilar provisions or conditions at the same or at any prior or subsequent time.

5.5. It is a desire and intent of the parties that the terms, provisions, covenants, and remedies contained in this Agreement shall be enforceable to the fullest extent permitted by law. If any such term, provision, covenant, or remedy of this Agreement or the application thereof to any person, association, or entity or circumstances shall, to any extent, be construed to be invalid or unenforceable in whole or in part, then such term, provision, covenant, or remedy shall be construed in a manner so as to permit its enforceability under the applicable law to the fullest extent permitted by law. In an y case, the remaining provisions of this Agreement or the application thereof to any person, association, or entity or circumstances other than those to which they have been held invalid or unenforceable, shall remain in full force and effect.

5.6. It is the mutual intention of the parties to have any dispute concerning this Agreement resolved out of court. Accordingly, the parties agree that any such dispute shall, as the sole and exclusive remedy, be submitted for resolution through the Halliburton Dispute Resolution Plan; provided, however, that the Employer, on its own behalf and on behalf of any of the Halliburton Entities, shall be entitled to seek a restraining order or injunction in any court of competent jurisdiction to prevent any breach or the continuation of any breach of the provisions of Article 4 and Employee hereby consent s that such restraining order or injunction may be granted without the necessity of the Employer posting any bond. The parties agree that the resolution of any such dispute through such Plan shall be final and binding.

5.7. This Agreement shall be binding upon and inure to the benefit of Employer, to the extent herein provided, Halliburton and any other person, association, or entity which may hereafter acquire or succeed to all or substantially all of the business or assets of Employer or Halliburton by any means whether direct or indirect, by purchase, merger, consolidation, or otherwise. Employee's rights and obligations under this Agreement are personal and such rights, benefits, and obligations of Employee shall not be voluntarily or involuntarily assigned, alienated, or transferred, whether by operation of l aw or otherwise, without the prior written consent of Employer, other than in the case of death or incompetence of Employee.

5.8. This Agreement replaces and merges any previous agreements and discussions pertaining to the subject matter covered herein. This Agreement constitutes the entire agreement of the parties with regard to the terms of Employee's employment, termination of employment and severance benefits, and contains all of the covenants, promises, representations, warranties, and agreements between the parties with respect to such matters. Each party to this Agreement acknowledges that no representation, inducement, promise, or agreement, oral or written, has been made by either party with respect to the forego ing matters which is not embodied herein, and that no agreement, statement, or promise relating to the employment of Employee by Employer that is not contained in this Agreement shall be valid or binding. Any modification of this Agreement will be effective only if it is in writing and signed by each party whose rights hereunder are affected thereby, provided that any such modification must be authorized or approved by the Compensation Committee or its delegate, as appropriate.

IN WITNESS WHEREOF, Employer and Employee have duly executed this Agreement in multiple originals to be effective on the Effective Date.

HALLIBURTON ENERGY SERVICES, A DIVISION OF HALLIBURTON ENERGY SERVICES, INC.

By: /s/ Edgar Ortiz
Name: Edgar Ortiz
Title: President

EMPLOYEE

/s/ Andrew R. Lane
Andrew R. Lane

Exhibit 12

HALLIBURTON COMPANY
Computation of Ratio of Earnings to Fixed Charges
(Millions of dollars, except for ratios)
(Unaudited)

	For the nine months ended September 30, 2004	Years Ended December 31				
		2003	2002	2001	2000	1999
Earnings available for fixed charges:						
Income (loss) from continuing operations before income taxes, minority interests, and cumulative effects of accounting changes, net	$ 354	$ 612	$ (228)	$ 954	$ 335	$ 307
Add:						
Distributed earnings from equity in unconsolidated affiliates	33	113	33	38	34	63
Fixed charges	208	203	168	209	203	194
Subtotal	$ 595	$ 928	$ (27)	$ 1,201	$ 572	$ 564
Less:						
Undistributed equity in earnings and losses of unconsolidated affiliates	17	25	74	107	88	99
Total	$ 578	$ 903	$ (101)	$ 1,094	$ 484	$ 465
Fixed charges:						
Interest expense	$ 160	$ 139	$ 113	$ 147	$ 146	$ 141
Rental expense representative of interest	48	64	55	62	57	53
Total	$ 208	$ 203	$ 168	$ 209	$ 203	$ 194
Ratio of earnings to fixed charges	2.8	4.4	(a)	5.2	2.4	2.4

(a) For the year ended December 31, 2002 earnings were inadequate to cover fixed charges by $269 million.

SECTION 302 CERTIFICATION

I, David J. Lesar, certify that:

1. I have reviewed this quarterly report on Form 10-Q for the quarter ending September 30, 2004 of Halliburton Company;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 5, 2004

/s/ David J. Lesar
David J. Lesar
Chief Executive Officer

SECTION 302 CERTIFICATION

I, C. Christopher Gaut, certify that:

1. I have reviewed this quarterly report on Form 10-Q for the quarter ending September 30, 2004 of Halliburton Company;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

    (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

    (b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

    (c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 5, 2004

/s/ C. Christopher Gaut
C. Christopher Gaut
Chief Financial Officer

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Halliburton Company (the “Company”) on Form 10-Q for the period ending September 30, 2004 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, David J. Lesar, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ David J. Lesar
David J. Lesar
Chief Executive Officer
Date: November 5, 2004

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Halliburton Company (the “Company”) on Form 10-Q for the period ending September 30, 2004 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, C. Christopher Gaut, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ C. Christopher Gaut
C. Christopher Gaut
Chief Financial Officer
Date: November 5, 2004