

HALLIBURTON CO
Form 10-Q
October 23, 2009

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the
Securities Exchange Act of 1934
For the quarterly period ended September 30, 2009

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 001-03492

HALLIBURTON COMPANY

(a Delaware corporation)
75-2677995

3000 North Sam Houston Parkway East
Houston, Texas 77032
(Address of Principal Executive Offices)

Telephone Number – Area Code (281) 871-2699

1401 McKinney, Suite 2400, Houston, Texas 77010
(Former Address, if Changed Since Last Report)

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 No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer,” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

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Large accelerated Accelerated filer []
filer[X] Smaller reporting company[]
Non-accelerated filer
[]

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No X

As of October 16, 2009, 901,928,366 shares of Halliburton Company common stock, \$2.50 par value per share, were outstanding.

HALLIBURTON COMPANY

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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	
	2009	2008	2009	2008
Revenue:				
Services	\$ 2,645	\$ 3,608	\$ 8,137	\$ 9,864
Product sales	943	1,245	2,852	3,505
Total revenue	3,588	4,853	10,989	13,369
Operating costs and expenses:				
Cost of services	2,270	2,670	6,845	7,423
Cost of sales	796	1,055	2,431	2,940
General and administrative	49	78	149	221
Gain on sale of assets, net	(1)	(1)	(2)	(62)
Total operating costs and expenses	3,114	3,802	9,423	10,522
Operating income	474	1,051	1,566	2,847
Interest expense	(80)	(35)	(215)	(119)
Interest income	3	6	8	35
Other, net	(4)	(4)	(23)	(7)
Income from continuing operations before income taxes and noncontrolling interest	393	1,018	1,336	2,756
Provision for income taxes	(124)	(343)	(420)	(869)
Income from continuing operations	269	675	916	1,887
Loss from discontinued operations, net of tax benefit (provision) of \$2, \$(1), \$3, and \$(1)	(3)	-	(5)	(115)
Net income	\$ 266	\$ 675	\$ 911	\$ 1,772
Noncontrolling interest in net income of subsidiaries	(4)	(3)	(9)	(16)
Net income attributable to company	\$ 262	\$ 672	\$ 902	\$ 1,756
Amounts attributable to company shareholders:				
Income from continuing operations	\$ 265	\$ 672	\$ 907	\$ 1,871
Loss from discontinued operations, net	(3)	-	(5)	(115)
Net income attributable to company	\$ 262	\$ 672	\$ 902	\$ 1,756
Basic income per share attributable to company shareholders:				
Income from continuing operations	\$ 0.29	\$ 0.76	\$ 1.01	\$ 2.13
Loss from discontinued operations, net	-	-	(0.01)	(0.13)
Net income per share	\$ 0.29	\$ 0.76	\$ 1.00	\$ 2.00

Diluted income per share attributable to
company shareholders:

Income from continuing operations	\$ 0.29	\$ 0.74	\$ 1.01	\$ 2.05
Loss from discontinued operations, net	–	–	(0.01)	(0.13)
Net income per share	\$ 0.29	\$ 0.74	\$ 1.00	\$ 1.92
Cash dividends per share	\$ 0.09	\$ 0.09	\$ 0.27	\$ 0.27
Basic weighted average common shares outstanding	902	882	899	879
Diluted weighted average common shares outstanding	904	908	901	913

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, 2009	December 31, 2008
Assets		
Current assets:		
Cash and equivalents	\$ 1,675	\$ 1,124
Receivables (less allowance for bad debts of \$89 and \$60)	3,098	3,795
Inventories	1,716	1,828
Investments in marketable securities	1,515	–
Current deferred income taxes	198	246
Other current assets	497	418
Total current assets	8,699	7,411
Property, plant, and equipment, net of accumulated depreciation of \$5,067 and \$4,566	5,564	4,782
Goodwill	1,093	1,072
Other assets	981	1,120
Total assets	\$ 16,337	\$ 14,385
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable	\$ 800	\$ 898
Accrued employee compensation and benefits	487	643
Deferred revenue	194	231
Department of Justice (DOJ) and Securities and Exchange Commission (SEC) settlement and indemnity, current	190	373
Current maturities of long-term debt	–	26
Other current liabilities	513	610
Total current liabilities	2,184	2,781
Long-term debt	4,573	2,586
Employee compensation and benefits	466	539
Other liabilities	538	735
Total liabilities	7,761	6,641
Shareholders' equity:		
Common shares, par value \$2.50 per share – authorized 2,000 shares, issued 1,067 shares	2,667	2,666
Paid-in capital in excess of par value	397	484
Accumulated other comprehensive loss	(202)	(215)
Retained earnings	10,702	10,041
Treasury stock, at cost – 165 and 172 shares	(5,015)	(5,251)
Company shareholders' equity	8,549	7,725
Noncontrolling interest in consolidated subsidiaries	27	19
Total shareholders' equity	8,576	7,744
Total liabilities and shareholders' equity	\$ 16,337	\$ 14,385

See notes to condensed consolidated financial statements.

HALLIBURTON COMPANY
Condensed Consolidated Statements of Cash Flows
(Unaudited)

Millions of dollars	Nine Months Ended September 30	
	2009	2008
Cash flows from operating activities:		
Net income	\$911	\$1,772
Adjustments to reconcile net income to net cash from operations:		
Depreciation, depletion, and amortization	677	535
Payments of DOJ and SEC settlement and indemnity	(369)	–
Provision for deferred income taxes, continuing operations	164	268
Other changes:		
Receivables	737	(628)
Inventories	114	(365)
Accounts payable	(111)	204
Other	(493)	(139)
Total cash flows from operating activities	1,630	1,647
Cash flows from investing activities:		
Sales (purchases) of investments in marketable securities	(1,518)	388
Capital expenditures	(1,390)	(1,305)
Acquisitions of assets, net of cash acquired	(37)	(408)
Other investing activities	93	96
Total cash flows from investing activities	(2,852)	(1,229)
Cash flows from financing activities:		
Proceeds from long-term borrowings, net of offering costs	1,975	1,189
Payments of dividends to shareholders	(243)	(239)
Payments on long-term borrowings	(30)	(1,896)
Payments to reacquire common stock	(12)	(504)
Other financing activities	100	165
Total cash flows from financing activities	1,790	(1,285)
Effect of exchange rate changes on cash	(17)	(7)
Increase (decrease) in cash and equivalents	551	(874)
Cash and equivalents at beginning of period	1,124	1,847
Cash and equivalents at end of period	\$1,675	\$973
Supplemental disclosure of cash flow information:		
Cash payments during the period for:		
Interest from continuing operations	\$226	\$117
Income taxes from continuing operations	\$437	\$738
See notes to condensed consolidated financial statements.		

HALLIBURTON COMPANY
Notes to Condensed Consolidated Financial Statements
(Unaudited)

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 notes required by generally accepted accounting principles for annual financial statements and should be read together with our 2008 Annual Report on Form 10-K.

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, 2009, the results of our operations for the three and nine months ended September 30, 2009 and 2008, and our cash flows for the nine months ended September 30, 2009 and 2008. Such adjustments are of a normal recurring nature. The results of operations for the three and nine months ended September 30, 2009 may not be indicative of results for the full year.

We have evaluated subsequent events through October 23, 2009, the date of issuance of the condensed consolidated financial statements.

In the first quarter of 2009, we reclassified certain services between our operating segments to re-establish a new service offering. In addition, during the first nine months of 2009, we adopted the provisions of new accounting standards. See Notes 3 and 11 for further information. All prior periods presented have been restated to reflect these changes.

Note 2. KBR Separation

During 2007, we completed the separation of KBR, Inc. (KBR) from us by exchanging KBR common stock owned by us for our common stock. In addition, we recorded a liability reflecting the estimated fair value of the indemnities and guarantees provided to KBR as described below. Since the separation, we have recorded adjustments to our liability for indemnities and guarantees to reflect changes to our estimation of our remaining obligation. All such adjustments are recorded in "Loss from discontinued operations, net of income tax."

We entered into various agreements relating to the separation of KBR, including, among others, a master separation agreement and a tax sharing agreement. The master separation agreement provides for, among other things, KBR's responsibility for liabilities related to its business and our responsibility for liabilities unrelated to KBR's business. We provide indemnification in favor of KBR under the master separation agreement for certain contingent liabilities, including our indemnification of KBR and any of its greater than 50%-owned subsidiaries as of November 20, 2006, the date of the master separation agreement, for:

- fines or other monetary penalties or direct monetary damages, including disgorgement, as a result of a claim made or assessed by a governmental authority in the United States, the United Kingdom, France, Nigeria, Switzerland, and/or Algeria, or a settlement thereof, related to alleged or actual violations occurring prior to November 20, 2006 of the United States Foreign Corrupt Practices Act (FCPA) or particular, analogous applicable foreign statutes, laws, rules, and regulations in connection with investigations pending as of that date, including with respect to the construction and subsequent expansion by a consortium of engineering firms comprised of Technip SA of France, Snamprogetti Netherlands B.V., JGC Corporation of Japan, and Kellogg Brown & Root LLC (TSKJ) of a natural gas liquefaction complex and related facilities at Bonny Island in Rivers State, Nigeria; and

-all out-of-pocket cash costs and expenses, or cash settlements or cash arbitration awards in lieu thereof, KBR may incur after the effective date of the master separation agreement as a result of the replacement of the subsea flowline bolts installed in connection with the Barracuda-Caratinga project.

Additionally, we provide indemnities, performance guarantees, surety bond guarantees, and letter of credit guarantees that are currently in place in favor of KBR's customers or lenders under project contracts, credit agreements, letters of credit, and other KBR credit instruments. These indemnities and guarantees will continue until they expire at the earlier of: (1) the termination of the underlying project contract or KBR obligations thereunder; (2) the expiration of the relevant credit support instrument in accordance with its terms or release of such instrument by the customer; or (3) the expiration of the credit agreements. Further, KBR and we have agreed that, until December 31, 2009, we will issue additional guarantees, indemnification, and reimbursement commitments for KBR's benefit in connection with: (a) letters of credit necessary to comply with KBR's Egypt Basic Industries Corporation ammonia plant contract, KBR's Allenby & Connaught project, and all other KBR project contracts that were in place as of December 15, 2005; (b) surety bonds issued to support new task orders pursuant to the Allenby & Connaught project, two job order contracts for KBR's Government and Infrastructure segment, and all other KBR project contracts that were in place as of December 15, 2005; and (c) performance guarantees in support of these contracts. KBR is compensating us for these guarantees. We have also provided a limited indemnity, with respect to FCPA and anti-trust governmental and third-party claims, to the lender parties under KBR's revolving credit agreement expiring in December 2010. KBR has agreed to indemnify us, other than for the FCPA and Barracuda-Caratinga bolts matter, if we are required to perform under any of the indemnities or guarantees related to KBR's revolving credit agreement, letters of credit, surety bonds, or performance guarantees described above.

In February 2009, the United States Department of Justice (DOJ) and Securities and Exchange Commission (SEC) FCPA investigations were resolved. The total of fines and disgorgement was \$579 million, of which KBR consented to pay \$20 million. As of September 30, 2009, we had paid \$369 million, consisting of \$192 million as a result of the DOJ settlement and the indemnity we provided to KBR upon separation and \$177 million as a result of the SEC settlement. Our KBR indemnities and guarantees are primarily included in "Department of Justice (DOJ) and Securities and Exchange Commission (SEC) settlement and indemnity, current" and "Other liabilities" on the condensed consolidated balance sheets and totaled \$262 million at September 30, 2009 and \$631 million at December 31, 2008. Excluding the remaining amounts necessary to resolve the DOJ and SEC investigations and under the indemnity we provided to KBR, our estimation of the remaining obligation for other indemnities and guarantees provided to KBR upon separation was \$72 million at September 30, 2009. See Note 7 for further discussion of the FCPA and Barracuda-Caratinga matters.

The tax sharing agreement provides for allocations of United States and certain other jurisdiction tax liabilities between us and KBR.

Note 3. Business Segment and Geographic Information

We operate under two divisions, which form the basis for the two operating segments we report: the Completion and Production segment and the Drilling and Evaluation segment. In the first quarter of 2009, we moved a portion of our completion tools and services from the Completion and Production segment to the Drilling and Evaluation segment to re-establish our testing and subsea services offering, which resulted in a change to our operating segments. Testing and subsea services provide acquisition and analysis of dynamic reservoir information and reservoir optimization solutions to the oil and gas industry utilizing downhole test tools, data acquisition services using telemetry and electronic memory recording, fluid sampling, surface well testing, subsea safety systems, and reservoir engineering services. All periods presented reflect reclassifications related to the change in operating segments.

The following table presents information on our business segments. "Corporate and other" includes expenses related to support functions and corporate executives. Also included are certain gains and losses not attributable to a particular business segment.

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

Millions of dollars	Three Months Ended September 30		Nine Months Ended September 30	
	2009	2008	2009	2008
Revenue:				
Completion and Production	\$ 1,821	\$ 2,579	\$ 5,601	\$ 7,058
Drilling and Evaluation	1,767	2,274	5,388	6,311
Total revenue	\$ 3,588	\$ 4,853	\$ 10,989	\$ 13,369
Operating income:				
Completion and Production	\$ 240	\$ 633	\$ 846	\$ 1,674
Drilling and Evaluation	283	499	871	1,412
Total operations	523	1,132	1,717	3,086
Corporate and other	(49)	(81)	(151)	(239)
Total operating income	\$ 474	\$ 1,051	\$ 1,566	\$ 2,847
Interest expense	(80)	(35)	(215)	(119)
Interest income	3	6	8	35
Other, net	(4)	(4)	(23)	(7)
Income from continuing operations before income taxes and noncontrolling interest	\$ 393	\$ 1,018	\$ 1,336	\$ 2,756

Receivables

As of September 30, 2009, 23% of our gross trade receivables were from customers in the United States. As of December 31, 2008, 34% of our gross trade receivables were from customers in the United States.

Note 4. Inventories

Inventories are stated at the lower of cost or market. In the United States, we manufacture certain finished products and have parts inventories for drill bits, completion products, bulk materials, and other tools that are recorded using the last-in, first-out method totaling \$72 million at September 30, 2009 and \$92 million at December 31, 2008. If the average cost method was used, total inventories would have been \$33 million higher than reported at September 30, 2009 and \$31 million higher than reported at December 31, 2008. The cost of the remaining inventory was recorded on the average cost method. Inventories consisted of the following:

Millions of dollars	September 30, 2009	December 31, 2008
Finished products and parts	\$ 1,137	\$ 1,312
Raw materials and supplies	550	446
Work in process	29	70
Total	\$ 1,716	\$ 1,828

Finished products and parts are reported net of obsolescence reserves of \$100 million at September 30, 2009 and \$81 million at December 31, 2008.

Note 5. Debt

Senior unsecured indebtedness

In the first quarter of 2009, we issued \$1 billion aggregate principal amount of senior notes due September 2039 bearing interest at a fixed rate of 7.45% and \$1 billion aggregate principal amount of senior notes due September 2019

bearing interest at a fixed rate of 6.15%. We may redeem some of the notes of each series from time to time or all of the notes of each series at any time at the redemption prices, plus accrued and unpaid interest. The notes are general, senior unsecured indebtedness and rank equally with all of our existing and future senior unsecured indebtedness.

Revolving credit facility

In March 2009, we terminated the \$400 million unsecured, six-month revolving credit facility established in October 2008 to provide additional liquidity and for other general corporate purposes.

Note 6. Shareholders' Equity

The following tables summarize our shareholders' equity activity.

Millions of dollars	Total shareholders' equity	Company shareholders' equity	Noncontrolling interest in consolidated subsidiaries
Balance at December 31, 2008	\$ 7,744	\$ 7,725	\$ 19
Transactions with shareholders	151	152	(1)
Comprehensive income:			
Net income	911	902	9
Other comprehensive income	13	13	–
Total comprehensive income	924	915	9
Dividends paid on common stock	(243)	(243)	–
Balance at September 30, 2009	\$ 8,576	\$ 8,549	\$ 27

Millions of dollars	Total shareholders' equity	Company shareholders' equity	Noncontrolling interest in consolidated subsidiaries
Balance at December 31, 2007	\$ 6,966	\$ 6,873	\$ 93
Share repurchases	(481)	(481)	–
Other transactions with shareholders	(534)	(485)	(49)
Comprehensive income:			
Net income	1,772	1,756	16
Other comprehensive income	3	3	–
Total comprehensive income	1,775	1,759	16
Dividends paid on common stock	(239)	(239)	–
Balance at September 30, 2008	\$ 7,487	\$ 7,427	\$ 60

The following table summarizes comprehensive income for the quarterly periods presented.

Millions of dollars	Three Months Ended	
	September 30	
	2009	2008
Net income	\$ 266	\$ 675
Other comprehensive loss	(4)	(1)
Total comprehensive income	262	674
Comprehensive income attributable to noncontrolling interest	4	3
Comprehensive income attributable to company	\$ 258	\$ 671

Accumulated other comprehensive loss consisted of the following:

September 30,	December 31,
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Millions of dollars	2009	2008
Defined benefit and other postretirement liability adjustments	\$ (138)	\$ (151)
Cumulative translation adjustments	(64)	(60)
Unrealized losses on investments	–	(4)
Total accumulated other comprehensive loss	\$ (202)	\$ (215)

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Note 7. Commitments and Contingencies

Foreign Corrupt Practices Act investigations

Background. As a result of an ongoing FCPA investigation at the time of the KBR separation, we provided indemnification in favor of KBR under the master separation agreement for certain contingent liabilities, including our indemnification of KBR and any of its greater than 50%-owned subsidiaries as of November 20, 2006, the date of the master separation agreement, for fines or other monetary penalties or direct monetary damages, including disgorgement, as a result of a claim made or assessed by a governmental authority in the United States, the United Kingdom, France, Nigeria, Switzerland, and/or Algeria, or a settlement thereof, related to alleged or actual violations occurring prior to November 20, 2006 of the FCPA or particular, analogous applicable foreign statutes, laws, rules, and regulations in connection with investigations pending as of that date, including with respect to 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.

TSKJ is a private limited liability company registered in Madeira, Portugal whose members are Technip SA of France, Snamprogetti Netherlands B.V. (a subsidiary of Saipem SpA of Italy), JGC Corporation of Japan, and Kellogg Brown & Root LLC (a subsidiary of KBR), each of which had an approximate 25% beneficial interest in the venture. Part of KBR's ownership in TSKJ was held through M.W. Kellogg Limited (MWKL), a United Kingdom joint venture and subcontractor on the Bonny Island project, in which KBR beneficially owns a 55% interest. 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. (an affiliate of ENI SpA of Italy).

DOJ and SEC investigations resolved. In February 2009, the FCPA investigations by the DOJ and the SEC were resolved with respect to KBR and us. The DOJ and SEC investigations resulted from allegations of improper payments to government officials in Nigeria in connection with the construction and subsequent expansion by TSKJ of the Bonny Island project.

The DOJ investigation was resolved with respect to us with a non-prosecution agreement in which the DOJ agreed not to bring FCPA or bid coordination-related charges against us with respect to the matters under investigation, and in which we agreed to continue to cooperate with the DOJ's ongoing investigation and to refrain from and self-report certain FCPA violations. The DOJ agreement did not provide a monitor for us.

As part of the resolution of the SEC investigation, we retained an independent consultant to conduct a 60-day review and evaluation of our internal controls and record-keeping policies as they relate to the FCPA, and we agreed to adopt any necessary anti-bribery and foreign agent internal controls and record-keeping procedures recommended by the independent consultant. The review and evaluation were completed during the second quarter of 2009, and we have implemented the consultant's immediate recommendations and will implement the remaining long-term recommendations over the next year. As a result of the substantial enhancement of our anti-bribery and foreign agent internal controls and record-keeping procedures prior to the review of the independent consultant, we do not expect the implementation of the consultant's recommendations to materially impact our long-term strategy to grow our international operations. In 2010, the independent consultant will perform a 30-day, follow-up review to confirm that we have implemented the recommendations and continued the application of our current policies and procedures and to recommend any additional improvements.

KBR has agreed that our indemnification obligations with respect to the DOJ and SEC FCPA investigations have been fully satisfied.

Other matters. In addition to the DOJ and the SEC investigations, we are aware of other investigations in France, Nigeria, the United Kingdom, and Switzerland regarding the Bonny Island project. In the United Kingdom, the Serious Fraud Office (SFO) is considering civil claims or criminal prosecution under various United Kingdom laws and appears to be focused on the actions of MWKL, among others. Violations of these laws could result in fines, restitution and confiscation of revenues, among other penalties, some of which could be subject to our indemnification obligations under the master separation agreement. Our indemnity for penalties under the master separation agreement with respect to MWKL is limited to 55% of such penalties, which is KBR's beneficial ownership interest in MWKL. Whether the SFO pursues civil or criminal claims, and the amount of any fines, restitution, confiscation of

revenues or other penalties that could be assessed would depend on, among other factors, the SFO's findings regarding the amount, timing, nature and scope of any improper payments or other activities, whether any such payments or other activities were authorized by or made with knowledge of MWKL, the amount of revenue involved, and the level of cooperation provided to the SFO during the investigations.

The settlements and the other ongoing investigations could result in third-party claims against us, which may include claims for special, indirect, derivative or consequential damages, damage to our business or reputation, loss of, or adverse effect on, cash flow, assets, goodwill, results of operations, business prospects, profits or business value or claims by directors, officers, employees, affiliates, advisors, attorneys, agents, debt holders, or other interest holders or constituents of us or our current or former subsidiaries.

Our indemnity of KBR and its majority-owned subsidiaries continues with respect to other investigations within the scope of our indemnity. Our indemnification obligation to KBR does not include losses resulting from third-party claims against KBR, including claims for special, indirect, derivative or consequential damages, nor does our indemnification apply to damage to KBR's business or reputation, loss of, or adverse effect on, cash flow, assets, goodwill, results of operations, business prospects, profits or business value or claims by directors, officers, employees, affiliates, advisors, attorneys, agents, debt holders, or other interest holders or constituents of KBR or KBR's current or former subsidiaries.

At this time, other than the claims being considered by the SFO, no claims by governmental authorities in foreign jurisdictions have been asserted against the indemnified parties. Therefore, we are unable to estimate the maximum potential amount of future payments that could be required to be made under our indemnity to KBR and its majority-owned subsidiaries related to these matters. See Note 2 for additional information.

Barracuda-Caratinga arbitration

We also provided indemnification in favor of KBR under the master separation agreement for all out-of-pocket cash costs and expenses (except for legal fees and other expenses of the arbitration so long as KBR controls and directs it), or cash settlements or cash arbitration awards, KBR may incur after November 20, 2006 as a result of the replacement of certain subsea flowline bolts installed in connection with the Barracuda-Caratinga project. Under the master separation agreement, KBR currently controls the defense, counterclaim, and settlement of the subsea flowline bolts matter. As a condition of our indemnity, for any settlement to be binding upon us, KBR must secure our prior written consent to such settlement's terms. We have the right to terminate the indemnity in the event KBR enters into any settlement without our prior written consent.

At Petrobras' direction, KBR replaced certain bolts located on the subsea flowlines that failed through mid-November 2005, and KBR has informed us that additional bolts have failed thereafter, which were replaced by Petrobras. These failed bolts were identified by Petrobras when it conducted inspections of the bolts. We understand KBR believes several possible solutions may exist, including replacement of the bolts. Initial estimates by KBR indicated that costs of these various solutions ranged up to \$148 million. In March 2006, Petrobras commenced arbitration against KBR claiming \$220 million plus interest for the cost of monitoring and replacing the defective bolts and all related costs and expenses of the arbitration, including the cost of attorneys' fees. We understand KBR is vigorously defending this matter and has submitted a counterclaim in the arbitration seeking the recovery of \$22 million. The arbitration panel held an evidentiary hearing in March 2008 to determine which party is responsible for the designation of the material used for the bolts. On May 13, 2009, the arbitration panel held that KBR and not Petrobras selected the material to be used for the bolts. Accordingly, the arbitration panel held that there is no implied warranty by Petrobras to KBR as to the suitability of the bolt material and that the parties' rights are to be governed by the express terms of their contract. The parties and the arbitration panel are now in discussion regarding the future course of the arbitration proceedings with respect to the issues of liability and damages. Our estimation of the indemnity obligation regarding the Barracuda-Caratinga arbitration is recorded as a liability in our condensed consolidated financial statements as of September 30, 2009 and December 31, 2008. See Note 2 for additional information regarding the KBR indemnification.

Securities and related litigation

In June 2002, a class action lawsuit was filed against us in federal court alleging violations of the federal securities laws after the SEC initiated an investigation in connection with our change in accounting for revenue on long-term construction projects and related disclosures. In the weeks that followed, approximately twenty similar class actions were filed against us. Several of those lawsuits also named as defendants 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 in April 2003. As a result of a

substitution of lead plaintiffs, the case is now styled Archdiocese of Milwaukee Supporting Fund (AMSF) v. Halliburton Company, et al. We settled with the SEC in the second quarter of 2004.

In June 2003, the lead plaintiffs 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 claims, the second amended consolidated complaint included 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.

In April 2005, the court appointed new co-lead counsel and named AMSF the new lead plaintiff, directing that it file a third consolidated amended complaint and that we file our motion to dismiss. The court held oral arguments on that motion in August 2005, at which time the court took the motion under advisement. In March 2006, the court entered an order in which it granted the motion to dismiss with respect to claims arising prior to June 1999 and granted the motion with respect to certain other claims while permitting AMSF to re-plead some of those claims to correct deficiencies in its earlier complaint. In April 2006, AMSF filed its fourth amended consolidated complaint. We filed a motion to dismiss those portions of the complaint that had been re-pled. A hearing was held on that motion in July 2006, and in March 2007 the court ordered dismissal of the claims against all individual defendants other than our Chief Executive Officer (CEO). The court ordered that the case proceed against our CEO and Halliburton.

In September 2007, AMSF filed a motion for class certification, and our response was filed in November 2007. The court held a hearing in March 2008, and issued an order November 3, 2008 denying AMSF's motion for class certification. AMSF then filed a motion with the Fifth Circuit Court of Appeals requesting permission to appeal the district court's order denying class certification. The Fifth Circuit granted AMSF's motion and the order denying class certification is currently on appeal. The case will remain stayed in the district court pending the outcome of the appeal. As of September 30, 2009, we had not accrued any amounts related to this matter because we do not believe that a loss is probable. Further, an estimate of possible loss or range of loss related to this matter cannot be made.

Shareholder derivative cases

In May 2009, two shareholder derivative lawsuits involving us and KBR were filed in Harris County, Texas naming as defendants various current and retired Halliburton directors and officers and current KBR directors. These cases allege that the individual Halliburton defendants violated their fiduciary duties of good faith and loyalty to the detriment of Halliburton and its shareholders by failing to properly exercise oversight responsibilities and establish adequate internal controls. The petitions contain various allegations of resulting wrongdoing, including violations of the FCPA and claimed KBR offenses under United States government contracts. As of September 30, 2009, we had not accrued any amounts related to this matter because we do not believe that a loss is probable. Further, an estimate of possible loss or range of loss related to this matter cannot be made.

Asbestos insurance settlements

At December 31, 2004, we resolved all open and future asbestos- and silica-related claims in the prepackaged Chapter 11 proceedings of DII Industries LLC, Kellogg Brown & Root LLC, and our other affected subsidiaries that had previously been named as defendants in a large number of asbestos- and silica-related lawsuits. During 2004, we settled insurance disputes with substantially all the insurance companies for asbestos- and silica-related claims and all other claims under the applicable insurance policies and terminated all the applicable insurance policies.

Under the insurance settlements entered into as part of the resolution of our Chapter 11 proceedings, we have agreed to indemnify our insurers under certain historic general liability insurance policies in certain situations. We have concluded that the likelihood of any claims triggering the indemnity obligations is remote, and we believe any potential liability for these indemnifications will be immaterial. Further, an estimate of possible loss or range of loss related to this matter cannot be made. At September 30, 2009, we had not recorded any liability associated with these indemnifications.

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 Resource 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 often 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 \$54 million as of September 30, 2009 and \$64 million as of December 31, 2008. Our total liability related to environmental matters covers numerous properties.

We have subsidiaries that have been named as potentially responsible parties along with other third parties for 10 federal and state superfund sites for which we have established a liability. As of September 30, 2009, those 10 sites accounted for approximately \$14 million of our total \$54 million liability. For any particular federal or state superfund site, since our estimated liability is typically within a range and our accrued liability may be the amount on the low end of that range, our actual liability could eventually be well in excess of the amount accrued. Despite attempts to resolve these superfund matters, the relevant regulatory agency may at any time bring suit against us for amounts in excess of the amount accrued. With respect to some superfund sites, we have been named a potentially responsible party by a regulatory agency; however, in each of those cases, we do not believe we have any material liability. We also could be subject to third-party claims with respect to environmental matters for which we have been named as a potentially responsible party.

Letters of credit

In the normal course of business, we have agreements with financial institutions under which approximately \$2 billion of letters of credit, bank guarantees, or surety bonds were outstanding as of September 30, 2009, including \$394 million of surety bonds related to Venezuela. In addition, \$554 million of the total \$2 billion relates to KBR letters of credit, bank guarantees, or surety bonds that are being guaranteed by us in favor of KBR's customers and lenders. KBR has agreed to compensate us for these guarantees and indemnify us if we are required to perform under any of these guarantees. Some of the outstanding letters of credit have triggering events that would entitle a bank to require cash collateralization.

Note 8. Income per Share

Basic income per share is based on the weighted average number of common shares outstanding during the period. Diluted income per share includes additional common shares that would have been outstanding if potential common shares with a dilutive effect had been issued.

A reconciliation of the number of shares used for the basic and diluted income per share calculations is as follows:

Millions of shares	Three Months Ended		Nine Months Ended	
	September 30		September 30	
	2009	2008	2009	2008
Basic weighted average common shares outstanding	902	882	899	879
Dilutive effect of:				
Convertible senior notes premium	–	22	–	30
Stock options	2	4	2	4
Diluted weighted average common shares outstanding	904	908	901	913

Excluded from the computation of diluted income per share are options to purchase six million and eight million shares of common stock that were outstanding during the three and nine months ended September 30, 2009 and two

million shares during both the three and nine months ended September 30, 2008. These options were outstanding during these periods but were excluded because they were antidilutive, as the option exercise price was greater than the average market price of the common shares.

Note 9. Fair Value of Financial Instruments

During the second quarter of 2009, we purchased \$1.5 billion in United States Treasury securities with maturities that extend through September 2010. These securities are accounted for as available-for-sale and recorded at fair value in "Investments in marketable securities" on the condensed consolidated balance sheet at September 30, 2009.

The fair value of \$426 million and \$412 million of our long-term debt at September 30, 2009 and December 31, 2008 was calculated based on the fair value of other actively-traded, Halliburton debt. The carrying amount of cash and equivalents, receivables, short-term notes payable, and accounts payable, as reflected in the condensed consolidated balance sheets, approximates fair market value due to the short maturities of these instruments. The following table presents the fair values of our other financial assets and liabilities and the basis for determining their fair values:

Millions of dollars	Carrying Value	Fair value	Quoted prices in active markets for identical assets or liabilities	Significant observable inputs for similar assets or liabilities
September 30, 2009				
Marketable securities	\$ 1,515	\$ 1,515	\$ 1,515	\$ –
Long-term debt	4,573	5,304	4,878	426
December 31, 2008				
Long-term debt	\$ 2,612	\$ 2,826	\$ 2,414	\$ 412

Note 10. Retirement Plans

The components of net periodic benefit cost related to pension benefits for the three and nine months ended September 30, 2009 and September 30, 2008 were as follows:

Millions of dollars	Three Months Ended September 30			
	2009		2008	
	United States	International	United States	International
Service cost	\$ –	\$ 6	\$ –	\$ 7
Interest cost	1	10	2	13
Expected return on plan assets	(1)	(8)	(2)	(11)
Settlements/curtailments	–	–	–	(6)
Recognized actuarial loss	–	1	1	1
Net periodic benefit cost	\$ –	\$ 9	\$ 1	\$ 4

Millions of dollars	Nine Months Ended September 30			
	2009		2008	
	United States	International	United States	International
Service cost	\$–	\$ 19	\$–	\$ 20
Interest cost	4	31	5	39
Expected return on plan assets	(5)	(25)	(6)	(34)
Settlements/curtailments	1	1	–	(6)
Recognized actuarial loss	1	3	3	4
Net periodic benefit cost	\$ 1	\$ 29	\$ 2	\$ 23

During the nine months ended September 30, 2009, we contributed \$77 million to our international pension plans, including a discretionary contribution of \$66 million to our United Kingdom pension plans in the third quarter of 2009. We currently expect to contribute an additional \$14 million to our international pension plans in 2009. We made discretionary contributions of approximately \$13 million to our United States pension plans during the first nine months ended 2009 and do not expect to make further contributions to these plans in 2009.

Effective June 30, 2009, we amended our United Kingdom pension plan to cease benefit accruals related to service thereafter, resulting in a \$32 million decrease in the projected benefit obligation and a \$24 million decrease, net of tax, in accumulated other comprehensive loss.

Note 11. New Accounting Standards

Accounting standards recently adopted

On June 30, 2009, in our condensed consolidated financial statements, we adopted the provisions of a new accounting standard relating to subsequent events, which establishes general standards of accounting for and disclosures of events that occur after the balance sheet date but before the financial statements are issued or are available to be issued. It requires the disclosure of the date through which an entity has evaluated subsequent events.

On June 30, 2009, we adopted an update to accounting standards for disclosures about the fair value of financial instruments, which requires publicly-traded companies to provide disclosures on the fair value of financial instruments in interim financial statements.

On January 1, 2009, we adopted the provisions of a new accounting standard, which establishes new accounting, reporting, and disclosure standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. This standard requires the recognition of a noncontrolling interest as equity in the condensed consolidated financial statements and separate from the parent's equity. Noncontrolling interest has been presented as a separate component of shareholders' equity for the current reporting period and prior comparative period in our condensed consolidated financial statements.

On January 1, 2009, we adopted an update to existing accounting standards for business combinations. The update, which retains the underlying concepts of the original standard in that all business combinations are still required to be accounted for at fair value under the acquisition method of accounting, changes the method of applying the acquisition method in a number of ways. Acquisition costs are no longer considered part of the fair value of an acquisition and will generally be expensed as incurred, noncontrolling interests are valued at fair value at the acquisition date, in-process research and development is recorded at fair value as an indefinite-lived intangible asset at the acquisition date, restructuring costs associated with a business combination are generally expensed subsequent to the acquisition date, and changes in deferred tax asset valuation allowances and income tax uncertainties after the acquisition date generally will affect income tax expense. In April 2009, the Financial Accounting Standards Board (FASB) issued a further update in relation to accounting for assets acquired and liabilities assumed in a business combination that arise from contingencies, which amends the previous guidance to require contingent assets acquired and liabilities assumed in a business combination to be recognized at fair value on the acquisition date if fair value can be reasonably estimated during the measurement period. If fair value cannot be reasonably estimated during the measurement period, the contingent asset or liability would be recognized in accordance with standards and guidance on accounting for contingencies and reasonable estimation of the amount of a loss. Further, this update eliminated the specific subsequent accounting guidance for contingent assets and liabilities, without significantly revising the original guidance. However, contingent consideration arrangements of an acquiree assumed by the acquirer in a business combination would still be initially and subsequently measured at fair value. These updates are effective for all business acquisitions occurring on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. We adopted the provisions of these updates for business combinations with an acquisition date on or after January 1, 2009.

On January 1, 2009, we adopted an update to accounting standards related to convertible debt instruments that may be settled in cash upon conversion (including partial cash settlement). The update clarifies that convertible debt instruments that may be settled in cash upon conversion, including partial cash settlement, should separately account for the liability and equity components in a manner that will reflect the entity's nonconvertible debt borrowing rate when interest cost is recognized in subsequent periods. Upon adopting the update, we retroactively applied its provisions and restated our condensed consolidated financial statements for prior periods.

In applying this update, \$63 million of the carrying value of our 3.125% convertible senior notes due July 2023 was reclassified to equity as of the July 2003 issuance date. This amount represents the equity component of the proceeds from the notes, calculated assuming a 4.3% non-convertible borrowing rate. The discount was accreted to interest expense over the five-year term of the notes. Accordingly, \$14 million of additional non-cash interest expense, or \$0.01 per diluted share, was recorded in 2006 and 2007 and \$7 million of additional non-cash interest expense was recorded in 2008, all during the first six months of the year. Furthermore, under the provisions of this update, the \$693 million loss to settle our convertible debt recorded in the third quarter of 2008 was reversed and recorded to additional paid-in capital. This resulted in an increase of \$686 million to income from continuing operations and net income attributable to company in the first nine months of 2008 and full year 2008 and a net increase of \$630 million to beginning retained earnings as of January 1, 2009. Diluted income per share for the first nine months of 2008 and full year 2008 increased by \$0.76 as a result of the adoption. These notes were converted and settled during the third quarter of 2008.

On January 1, 2009, we adopted an update to accounting standards related to accounting for instruments granted in share-based payment transactions as participating securities. This update provides that unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents, whether paid or unpaid, are participating securities and shall be included in the computation of both basic and diluted earnings per share. According to the provisions of this update, we restated prior periods' basic and diluted earnings per share to include such outstanding unvested restricted shares of our common stock in the basic weighted average shares outstanding calculation. Upon adoption, both basic and diluted income per share for the first nine months of 2008 and full year 2008 decreased by \$0.01 for continuing operations and net income attributable to company shareholders. In September 2006, the FASB issued a new accounting standard for fair value measurements, which is intended to increase consistency and comparability in fair value measurements by defining fair value, establishing a framework for measuring fair value, and expanding disclosures about fair value measurements. The standard applies to other accounting standards that require or permit fair value measurements and is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. In February 2008, the FASB issued an update to the new standard for fair value measurements that provides guidance on the application of the new standard to other standards that address fair value measurements for purposes of lease classification or measurement. This update removes certain leasing transactions from the scope of the new accounting standard for fair value measurements. Further, an additional update was issued which deferred the effective date of the new standard for one year for certain nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis. In October 2008, the FASB also issued an update to the original standard related to determining the fair value of a financial asset when the market for that asset is not active, which clarifies the application of the fair value measurement standard in an inactive market and illustrates how an entity would determine fair value when the market for a financial asset is not active. On January 1, 2008, we adopted without material impact on our condensed consolidated financial statements the provisions of the fair value measurement standard related to financial assets and liabilities and to nonfinancial assets and liabilities measured at fair value on a recurring basis. On January 1, 2009, we adopted without material impact on our condensed consolidated financial statements the provisions of the fair value measurement standard related to nonfinancial assets and nonfinancial liabilities that are not required or permitted to be measured at fair value on a recurring basis, which include those measured at fair value in goodwill impairment testing, indefinite-lived intangible assets measured at fair value for impairment assessment, nonfinancial long-lived assets measured at fair value for impairment assessment, asset retirement obligations initially measured at fair value, and those initially measured at fair value in a business combination.

In April 2009, the FASB further updated the fair value measurement standard to provide additional guidance for estimating fair value when the volume and level of activity for the asset or liability have significantly decreased. This update re-emphasizes that regardless of market conditions the fair value measurement is an exit price concept as defined in the original standard. It clarifies and includes additional factors to consider in determining whether there has been a significant decrease in market activity for an asset or liability and provides additional clarification on estimating fair value when the market activity for an asset or liability has declined significantly. The scope of this

update does not include assets and liabilities measured under level 1 inputs. We adopted this update on June 30, 2009 prospectively to all fair value measurements as appropriate without material impact on our condensed consolidated financial statements.

Accounting standards not yet adopted

In October 2009, the FASB issued an update to existing guidance on revenue recognition for arrangements with multiple deliverables. This update will allow companies to allocate consideration received for qualified separate deliverables using estimated selling price for both delivered and undelivered items when vendor-specific objective evidence or third-party evidence is unavailable. Additional disclosures discussing the nature of multiple element arrangements, the types of deliverables under the arrangements, the general timing of their delivery, and significant factors and estimates used to determine estimated selling prices are required. We will adopt this update for new revenue arrangements entered into or materially modified beginning January 1, 2011. We have not yet determined the impact on our condensed consolidated financial statements.

In August 2009, the FASB further updated the fair value measurement guidance to clarify how an entity should measure liabilities at fair value. The update reaffirms fair value is based on an orderly transaction between market participants, even though liabilities are infrequently transferred due to contractual or other legal restrictions. However, identical liabilities traded in the active market should be used when available. When quoted prices are not available, the quoted price of the identical liability traded as an asset, quoted prices for similar liabilities or similar liabilities traded as an asset, or another valuation approach should be used. This update also clarifies that restrictions preventing the transfer of a liability should not be considered as a separate input or adjustment in the measurement of fair value. We will adopt the provisions of this update for fair value measurements of liabilities effective October 1, 2009, which we do not expect to have a material impact on our condensed consolidated financial statements.

In June 2009, the FASB issued a new accounting standard which provides amendments to previous guidance on the consolidation of variable interest entities. This standard clarifies the characteristics that identify a variable interest entity (VIE) and changes how a reporting entity identifies a primary beneficiary that would consolidate the VIE from a quantitative risk and rewards calculation to a qualitative approach based on which variable interest holder has controlling financial interest and the ability to direct the most significant activities that impact the VIE's economic performance. This statement requires the primary beneficiary assessment to be performed on a continuous basis. It also requires additional disclosures about an entity's involvement with a VIE, restrictions on the VIE's assets and liabilities that are included in the reporting entity's consolidated balance sheet, significant risk exposures due to the entity's involvement with the VIE, and how its involvement with a VIE impacts the reporting entity's consolidated financial statements. The standard is effective for fiscal years beginning after November 15, 2009. We will adopt the standard on January 1, 2010 and have not yet determined the impact on our condensed consolidated financial statements.

In December 2008, the FASB issued an update to accounting standards related to an employer's disclosures about postretirement benefit plan assets. This update amends the disclosure requirements for employer's disclosure of plan assets for defined benefit pensions and other postretirement plans. The objective of this update is to provide users of financial statements with an understanding of how investment allocation decisions are made, the major categories of plan assets held by the plans, the inputs and valuation techniques used to measure the fair value of plan assets, significant concentration of risk within the company's plan assets, and for fair value measurements determined using significant unobservable inputs a reconciliation of changes between the beginning and ending balances. The update is effective for fiscal years ending after December 15, 2009. We will adopt the new disclosure requirements in the 2009 annual reporting period.