PHELPS DODGE CORP
Form 10-K
February 27, 2006

Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-K

þ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2005

OR

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period___to ___

Commission file number 1-82
PHELPS DODGE CORPORATION
(Exact name of registrant as specified in its charter)

New York	**13-1808503**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
One North Central Avenue, Phoenix, AZ	**85004-4414**
(Address of principal executive offices)	(Zip Code)

Registrant s telephone number, including area code: (602) 366-8100

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Shares, $6.25 par value per share	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes þ No o.

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of this Act. Yes o No þ.

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 þ No o.

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. þ

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

Large Accelerated Filer þ Accelerated Filer o Non-Accelerated Filer o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No þ.

The aggregate market value of Common Shares of the issuer held by nonaffiliates at June 30, 2005, was approximately $8,962,097,728.

Number of Common Shares outstanding at February 17, 2006: 101,763,500 shares.

Documents Incorporated by Reference:

Document	Location in 10-K
Proxy Statement for 2006 Annual Meeting	Part III

PHELPS DODGE CORPORATION
Annual Report on Form 10-K
For the Year Ended December 31, 2005

Table of Contents Page

Table of Contents

PHELPS DODGE CORPORATION
2005 Annual Report on Form 10-K
PART I
Items 1. and 2. Business and Properties

Phelps Dodge Corporation (the Company, which also may be referred to as Phelps Dodge, PD, we, us or our) is one of the world s leading producers of copper and molybdenum, and is the world s largest producer of molybdenum-based chemicals and continuous-cast copper rod.

The Company consists of two major divisions: (i) Phelps Dodge Mining Company (PDMC) and (ii) Phelps Dodge Industries (PDI).

(i) PDMC includes our worldwide, vertically integrated copper operations from mining through rod production, marketing and sales; molybdenum operations from mining through conversion to chemical and metallurgical products, marketing and sales; other mining operations and investments; and worldwide mineral exploration, technology and project development programs. PDMC includes 11 reportable segments Morenci, Bagdad, Sierrita, Chino/Cobre and Tyrone (located in the United States), Candelaria/Ojos del Salado, Cerro Verde and El Abra (located in South America), Manufacturing, Sales and Primary Molybdenum and other mining activities. In 2005, the Company reassessed its reportable segments and determined that Miami/Bisbee will no longer be an individual reportable segment.

In 2005, PDMC produced 1,228,000 tons of copper on a consolidated basis (1,042,300 tons on a pro rata basis, which reflects our ownership interest) from worldwide mining operations, and an additional 60,000 tons of copper for our partner s 15 percent undivided interest in the Morenci mine. Gold, silver, molybdenum, rhenium and sulfuric acid are by-products of our copper and molybdenum operations. Production of copper for our own account (our pro rata share) from our U.S. operations constituted approximately 53 percent of the copper mined in the United States in 2005. Much of our U.S. copper cathode production, together with additional copper cathode purchased from others, is used to produce continuous-cast copper rod, the basic feed for the electrical wire and cable industry. We also are engaged in exploration efforts for metals and minerals throughout the world.

In 2005, PDMC produced 62.3 million pounds of molybdenum from mining operations. High-purity, chemical-grade molybdenum concentrate is produced at our Henderson mine in Colorado. Most of the concentrate produced at Henderson is roasted at our Fort Madison, Iowa, facility and is further processed at the facility s chemical plant into value-added molybdenum chemical products. In addition, some of the concentrate is processed into salable molysulfide for use primarily in the lubricant industry.

Molybdenum concentrate is also produced as a by-product at three of our U.S. copper operations. This concentrate generally is roasted at one of our three roasting operations to produce technical-grade molybdic oxide for sale into metallurgical markets (*i.e.*, steel industries).

We also have research and process technology facilities primarily at our Process Technology Center in Safford, Arizona, and a research and development facility for engineered materials at our Climax Technology Center in Sahuarita, Arizona.

(ii) PDI, our manufacturing division, consists of our Wire and Cable segment, which produces engineered products principally for the global energy sector.

Our Wire and Cable segment has operations in the United States, Latin America, Asia and Africa. This segment produces magnet wire, copper and aluminum energy cables, specialty conductors and other products for sale principally to original equipment manufacturers for use in electrical motors, generators, transformers, medical applications and public utilities.

On November 15, 2005, the Company entered into an agreement to sell Columbian Chemicals Company (Columbian Chemicals or Columbian), previously disclosed as our Specialty Chemicals segment, to a company owned jointly by One Equity Partners, a private equity affiliate of JPMorgan Chase & Co., and South Korean-based DC Chemical Co. Ltd. This transaction is expected to be completed in the 2006 first quarter. In addition, on November 15, 2005, the Company entered into an agreement to sell substantially all of its North American magnet

wire assets to Rea Magnet Wire Company, Inc. (Rea). This transaction was completed on February 10, 2006. (Refer to Note 3, Discontinued Operations and Assets Held for Sale, for further discussion of these transactions.)

The Company is continuing to explore strategic alternatives for Phelps Dodge High Performance Conductors, a unit of Wire and Cable.

Note 23, Business Segment Data, to our Consolidated Financial Statements contained herein includes financial data for each of the last three years relating to our business segments, including data by geographic area.

Phelps Dodge was incorporated as a business corporation under the laws of the state of New York in 1885. Our corporate headquarters is located in Phoenix, Arizona, and is a leased property. We employed approximately 15,000 people worldwide on February 15, 2006.

Throughout this document, unless otherwise stated, all references to tons are to short tons, and references to ounces are to troy ounces.

Available Information. Phelps Dodge files annual, quarterly and current reports, proxy statements and other information with the U.S. Securities and Exchange Commission (the SEC). You may read and copy any document we file at the SEC s Public Reference Room at 450 Fifth Street, NW, Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for information on the Public Reference Room. The SEC maintains a Web site that contains annual, quarterly and current reports, proxy statements and other information that issuers (including Phelps Dodge) file electronically with the SEC. The SEC s Web site is *http://www.sec.gov*.

Phelps Dodge s Web site is *http://www.phelpsdodge.com*. Phelps Dodge makes available free of charge through its internet site, via a link to the SEC s Web site at *http://www.sec.gov*, its annual reports on Form 10-K; quarterly reports on Form 10-Q; current reports on Form 8-K; Forms 3, 4 and 5 filed on behalf of directors and executive officers; and any amendments to those reports filed or furnished pursuant to the Securities Exchange Act of 1934 as soon as reasonably practicable after such material is electronically filed with, or furnished to, the SEC.

Table of Contents

Phelps Dodge also makes available free of charge on its internet site its most recent annual report on Form 10-K, its quarterly reports on Form 10-Q for the current fiscal year, its most recent proxy statement and its most recent summary annual report to shareholders, although in some cases these documents are not available on our site as soon as they are available on the SEC s site. Some of these documents are in PDF format and require Adobe Acrobat® Reader software for viewing, which is available at no cost. A link to Adobe s Internet site is provided to download the software, if needed. The information on Phelps Dodge s Web site is not incorporated by reference into this report.

PHELPS DODGE MINING COMPANY

PDMC has five reportable copper production segments in the United States (Morenci, Bagdad, Sierrita, Chino/Cobre and Tyrone) and three reportable copper production segments in South America (Candelaria/Ojos del Salado, Cerro Verde and El Abra). These segments include open-pit mining, underground mining, sulfide ore concentrating, leaching, solution extraction and electrowinning. In addition, the Candelaria/Ojos del Salado, Bagdad, Sierrita and Chino/Cobre segments also produce gold and silver, and the Bagdad, Sierrita and Chino mines also produce molybdenum and rhenium as by-products.

The Manufacturing segment consists of conversion facilities including our smelter, refinery and rod mills. The Manufacturing segment processes copper produced at our mining operations and copper purchased from others into copper anode, cathode and rod. In addition, at times it smelts and refines copper and produces copper rod for customers on a toll basis. Toll arrangements require the tolling customer to deliver appropriate copper-bearing material to our facilities, which we then process into a product that is returned to the customer. The customer pays PDMC for processing its material into the specified products.

The Sales segment functions as an agent to sell copper from our U.S. mines and Manufacturing segment. The Sales segment also purchases and sells any copper not sold by the South American mines to third parties. Copper is sold to others primarily as rod, cathode or concentrate, and as rod to PDI s Wire and Cable segment.

The Primary Molybdenum segment consists of the Henderson and Climax mines, related conversion facilities and a technology center. This segment is an integrated producer of molybdenum, with mining, roasting and processing facilities that produce high-purity, molybdenum-based chemicals, molybdenum metal powder and metallurgical products, which are sold to customers around the world. In addition, at times this segment roasts and/or processes material on a toll basis. Toll arrangements require the tolling customer to deliver appropriate molybdenum-bearing material to our facilities, which we then process into a product that is returned to the customer. The customer pays PDMC for processing its material into the specified products. This segment also includes a technology center whose primary activity is developing, marketing and selling new engineered products and applications.

Our U.S. Mining Operations and our South American Mines are discussed herein together, where appropriate, as our Worldwide Copper Mining Operations. U.S. Mining Operations comprise the following reportable segments: Morenci, Bagdad, Sierrita, Chino/Cobre, Tyrone, Manufacturing and Sales, along with other mining activities. South American Mines comprise the following reportable segments: Candelaria/Ojos del Salado, Cerro Verde and El Abra.

Properties, Facilities and Production

Following is a map indicating the approximate location of PDMC s U.S. copper and molybdenum mines:

United States Mines

U.S. Mines

We produce electrowon copper cathode at leaching and solution extraction/electrowinning (SX/EW) operations near Tyrone and Silver City (Chino), New Mexico mines, and Morenci, Bagdad and Green Valley (Sierrita), Arizona mines. We produce copper concentrate from open-pit mines and concentrators located at Bagdad and Green Valley, Arizona (Bagdad and Sierrita mines, respectively) and Silver City, New Mexico (Chino mine). Our Miami mine in Arizona, which has the capability to produce electrowon copper cathode, has been curtailed since 2002.

We are the world s leading producer of copper using the SX/EW process. In 2005, we produced a total of 532,700 tons of copper cathode at our SX/EW facilities in the United States, which includes our partner s 15 percent undivided interest in our Morenci mine. This compares with 567,100 tons in 2004 and 569,600 tons in 2003. SX/EW is a cost-effective process for extracting copper from certain types of ores and is a major factor in our continuing efforts to

maintain internationally competitive costs. The annual design plating capacity of our electrowon copper plants is 410,000 tons at Morenci, 105,000 tons at Miami, 75,000 tons at Chino, 84,000 tons at Tyrone, 25,000 tons at Sierrita and 32,500 tons at Bagdad, which includes 17,500 tons of capacity associated with its concentrate-leach facility.

Morenci

The Morenci complex in southeastern Arizona is the largest copper producing operation in North America. Morenci comprises an open-pit mine, a concentrator, four solution extraction facilities and three electrowinning tankhouses. We operate Morenci and own an 85 percent undivided interest; the remaining 15 percent interest is owned by Sumitomo Metal Mining Arizona, Inc., a jointly owned subsidiary of Sumitomo Metal Mining Co., Ltd. and Sumitomo Corporation. Each partner takes in kind its share of Morenci production.

Table of Contents

In 2001, Morenci was converted to a mine-for-leach facility, and as a result, the Morenci concentrator was placed on care-and-maintenance status. Morenci s annual electrowon cathode production is approximately 410,000 tons, and its crush-leach facility processes approximately 85,000 tons of ore daily with the remaining ore processed through stockpile leaching.

On June 1, 2005, the Company s board of directors approved expenditures of $210 million to construct a concentrate-leach, direct-electrowinning facility at Morenci, and to restart its concentrator. The concentrate-leaching facility will utilize Phelps Dodge s proprietary medium-temperature, pressure leaching and direct-electrowinning technology that has been demonstrated at our Bagdad, Arizona, copper mine. The concentrate-leach, direct-electrowinning facility is expected to be in operation by mid-2007, and copper production is projected to be approximately 150 million pounds per year. We have also made plans to accelerate the restart of the Morenci concentrator, which is expected to allow us to produce approximately 32,000 tons of concentrate in 2006. We plan to treat this concentrate at our smelter located in Miami, Arizona. Concentrate-leach technology, in conjunction with a conventional milling and flotation concentrator, allows copper in sulfide ores to be transformed into copper cathode through efficient pressure leaching and electrowinning processes instead of smelting and refining. Historically, sulfide ores have been processed into copper anodes through a smelter.

We are, at present, a party to litigation that could adversely impact the allocation of available water supplies for the Morenci operation and our other properties in Arizona. (Refer to Item 3, Legal Proceedings, for information concerning the status of these proceedings.)

Bagdad

Our wholly owned Bagdad operation in northwestern Arizona mines copper sulfide and oxide ore. The operation consists of an open-pit mine, a sulfide ore concentrator producing copper and molybdenum concentrates, and a leaching system with an SX/EW operation producing copper cathode. In January 2002, as a result of the then-current economic environment, Bagdad s mill throughput was curtailed temporarily to approximately one-half capacity. In January 2004, Bagdad began increasing production and resumed producing at full capacity in the 2004 second quarter. This decision was based upon the rapid increase in copper prices, our view of market fundamentals for copper and molybdenum over the next several years, and our internal concentrate and sulfuric acid balance.

In 2002, Bagdad constructed a high-temperature, pressure copper leaching demonstration plant for approximately $40 million designed to recover annually 35 million pounds of commercial-grade copper cathode from chalcopyrite concentrates. The plant was commissioned in the 2003 first quarter and achieved full production in the 2003 second quarter. The facility is the first of its kind in the world to use high-temperature pressure leaching to process chalcopyrite concentrates.

In early 2005, this plant was converted to operate at medium-temperature conditions (*i.e.,* 160°C) to prove an alternative technology that generates significantly less sulfuric acid and requires less oxygen than the high-temperature process. This process has potential application in operations and projects where excess by-product sulfuric acid cannot be beneficially used in stockpile or heap leaching operations, and could result in a lower-cost option for certain applications. The facility s conversion was completed in May 2005, and the plant was operated in this mode for approximately seven months. The proprietary Phelps Dodge medium-temperature process (incorporating direct electrowinning) was successfully demonstrated during the seven-month period of operation, producing LME Grade A cathode that was processed through Phelps Dodge rod mills. At the conclusion of the planned demonstration period, the facility was converted back to operate at high-temperature conditions (225°C) in December 2005 to provide the Bagdad operation with a greater amount of by-product acid necessary for low-grade stockpile leaching operations. This technology is proprietary and is covered under a Technology Development Agreement between Phelps Dodge and Placer Dome, Inc. This technology could assist in our long-term, cost-reduction strategy. Our medium-temperature technology will be utilized at the Morenci concentrate-leaching facility.

Sierrita

We own the Sierrita mine near Green Valley, Arizona. The facility consists of an open-pit mine, a sulfide ore concentrator producing copper and molybdenum concentrates, two molybdenum roasters and a rhenium processing

facility. Sierrita also uses an oxide and low-grade sulfide ore stockpile leaching system with an SX/EW operation to produce copper cathode. Late in 2004, the Company completed construction of a plant that is capable of producing approximately 40 million pounds of copper sulfate pentahydrate. This is an alternative to cathode production and production commenced in early 2005. The Sierrita operation leases property adjacent to its mine upon which its electrowinning tankhouse is located.

Sierrita s on-site roasters process molybdenum concentrates produced at Sierrita, Bagdad and Chino, as well as purchased concentrates or concentrates tolled for third parties. The resulting metallurgical-grade molybdic oxide and related products are either packaged for shipment to customers worldwide or transported to other facilities for further processing.

At year-end 2001, as a result of the then-current economic environment, mill throughput at the Sierrita mine was reduced temporarily to approximately one-half of its capacity. In January 2004, Sierrita began increasing production and resumed producing at full capacity in the 2004 fourth quarter. This decision was based upon the rapid increase in copper prices, our view of market fundamentals for copper and molybdenum over the next several years, and our internal concentrate and sulfuric acid balance.

Miami/Bisbee

Our wholly owned operations at Miami, Arizona, consist of an open-pit copper mine, an SX/EW operation producing copper cathode, a smelter, an acid plant, an electrolytic refinery (permanently closed in 2005) and a copper rod plant. The small Bisbee copper precipitation operation is located in southern Arizona. In January 2002, as a result of the then-current economic environment, the Miami mine and refinery were closed temporarily and remained closed through 2005. For 2005, 2004 and 2003, Miami s production of 12,300 tons, 9,800 tons and 17,800 tons, respectively, reflected only residual leach production.

In June 2005, with the decision to construct a concentrate-leach, direct-electrowinning facility at the Morenci copper mine, the company reassessed its operating capacity, flexibilities, efficiencies

Table of Contents

and costs, which resulted in the permanent closure of the Miami refinery. The closure of the Miami refinery resulted in an asset impairment charge of $59.1 million ($45.2 million after-tax) in the 2005 second quarter. (See the Manufacturing segment for additional discussion.)

In January 2003, as a result of reduced production at our Bagdad and Sierrita mines along with reduced toll concentrate terms, the Miami smelter was partially curtailed. In the 2004 second quarter, the Miami smelter resumed operating at full capacity. This decision was based upon the rapid increase in copper prices, our view of market fundamentals for copper over the next several years, and our internal concentrate and sulfuric acid balance.

Chino/Cobre

We operate an open-pit copper mine, concentrator, leaching and SX/EW facility near Silver City, New Mexico, and a smelter (permanently closed in 2005) in Hurley, New Mexico, that are owned by Chino Mines Company (Chino), a general partnership in which we held a two-thirds interest through December 18, 2003, and a 100 percent interest thereafter. Heisei Minerals Corporation (Heisei), a subsidiary of Mitsubishi Materials Corporation and Mitsubishi Corporation, owned the remaining one-third interest in Chino. On December 19, 2003, we purchased Heisei s interest in Chino. Prior to December 19, 2003, each partner purchased its proportionate share of Chino s monthly copper production.

Beginning in late 1998 and extending through the first half of 1999, production was curtailed resulting in a reduction of approximately 35,000 tons of annual copper production. In March 2001, the concentrator was temporarily shut down, and in January 2002, the Chino mine and smelter were closed temporarily. Chino s SX/EW operations continued producing copper through leaching of existing stockpiles. The production from these stockpiles declined steadily during 2002 and 2003, and limited mining for leach material was renewed in April 2003. In September 2003, Chino resumed a full mine-for-leach operation. Chino s milling operations increased to approximately 80 percent of capacity in the 2004 third quarter and remained there through 2005.

In June 2005, with the decision to construct a concentrate-leach, direct-electrowinning facility at the Morenci copper mine, the company reassessed its operating capacity, flexibilities, efficiencies and costs, which resulted in the permanent closure of the Chino smelter. The closure of the Chino smelter resulted in an asset impairment charge of $89.6 million ($68.6 million after-tax) in the 2005 second quarter. (See the Manufacturing segment for additional discussion.)

On December 19, 2003, a wholly owned subsidiary of the Company acquired Heisei s one-third general partnership interest in Chino. In connection with this transaction, Heisei paid, on behalf of Chino, approximately $64 million in cash to a trust to provide a portion of the financial assurance for mine closure/close out obligations. That amount represented a one-third share of the then-current estimate by the state of New Mexico of the amount of financial assurance Chino must provide in connection with its current permits. In addition, Heisei paid $50 million to the Company s subsidiary to cover other Heisei obligations. Due to our business expectations and plans, which resulted in significant differences in the assumed operating life of Chino compared with that assumed by Heisei, we recognized an extraordinary gain of $68.3 million upon completing the transaction.

Cobre Mining Company Inc. (Cobre) is located in southwestern New Mexico, adjacent to our Chino operations. The primary assets of Cobre include an open-pit copper mine, a concentrator and the surrounding 12,000 acres of land, including mineral rights. In 1999, production was suspended, reducing copper production by approximately 35,000 tons per year. In December 2002, after revising mine plans and assessing recoverability, the Company recognized an impairment charge to write down Cobre s assets by $115.5 million (before and after taxes). In 2004, Cobre resumed limited mining activities, including rehabilitation of haul roads, drilling and blasting to establish new access to mining areas, and cleaning of pit benches. In 2005, permitting to optimize future production with Chino s mining operations was initiated. In June 2005, with the decision to construct a concentrate-leach, direct-electrowinning facility at the Morenci copper mine, the Company reassessed the recoverability of Cobre s long-lived assets. This assessment, which was based on an analysis of cash flows associated with the related assets, indicated that the assets were not recoverable, resulting in the recognition of an asset impairment charge of $59.9 million ($45.9 million after-tax). The asset impairment charges resulted from projected higher acid, external

smelting and freight costs. As a result of the Chino smelter being permanently closed, the charges also reflected estimated higher restart and operating costs of running the Cobre mill, and increased costs for building a tailing pipeline from Cobre to the Chino mine based upon a recent detailed engineering evaluation.

Tyrone

Phelps Dodge operates its wholly owned Tyrone open-pit mine and SX/EW plant near Tyrone, New Mexico. Tyrone has been a mine-for-leach operation since 1992. Beginning in late 2003, we partially curtailed production at Tyrone to focus on stockpile reclamation. During 2005, a combination of mining and reclamation activities was conducted. These activities are expected to continue through 2006 as Tyrone focuses on site reclamation while mining its remaining ore reserves. The Tyrone SX/EW operations continue at a declining production rate.

In June 2005, with the decision to construct a concentrate-leach, direct-electrowinning facility at the Morenci copper mine, the Company reassessed the recoverability of Tyrone s long-lived assets. This reassessment, which was based on an analysis of cash flows associated with the related assets, indicated that the assets were not recoverable, and resulted in an asset impairment charge of $210.5 million ($161.2 million after-tax). The asset impairment charge resulted from fundamental changes to its life-of-mine cash flows. In addition to higher expected acid costs, Phelps Dodge decided to accelerate reclamation of portions of stockpiles around the mine perimeter. At the same time, the estimated cost associated with reclaiming the perimeter stockpiles increased. These factors increased costs and also decreased Tyrone s copper ore reserves by approximately 155 million pounds, or 14 percent.

Even though we remain optimistic about the strong copper and molybdenum markets, we will remain disciplined about our production profile. We will continue to configure our operations so that we can quickly respond both to positive and negative market demand and price swings.

Table of Contents

Following is a map indicating the approximate location of PDMC s South American mines:

South American Mines

South American Mines

We produce electrowon copper cathode at leaching and SX/EW operations near Arequipa, Peru, and near Calama, Chile. We produce copper concentrate from an open-pit and three underground mines and two concentrators located near Copiapó, Chile.

In 2005, we produced a total of 335,300 tons of copper cathode at our SX/EW facilities in South America, compared with 337,900 tons in 2004 and 346,100 tons in 2003. Our total annual design capacity of electrowon copper cathode production is 248,000 tons at El Abra and 96,000 tons at Cerro Verde.

Candelaria/Ojos del Salado

We operate the Candelaria mine located near Copiapó in the Atacama Desert of northern Chile. The operation consists of an open-pit and underground copper mines, a concentrator, port and associated facilities. We own an 80 percent partnership interest in Candelaria, a Chilean contractual mining company, through Phelps Dodge Candelaria, Inc., a wholly owned subsidiary, and the remaining 20 percent interest is jointly owned by SMMA Candelaria, Inc., Sumitomo Metal Mining Co., Ltd. and Sumitomo Corporation. In addition, we own two underground mines, a concentrator and associated infrastructure as part of our Ojos del Salado operation. These facilities are owned through our Chilean subsidiary, Compañía Contractual Minera Ojos del Salado. In 2004, due to the rapid increase in copper prices, we resumed operation of the concentrator and the two underground mines. The facilities had been curtailed since 1998. On December 22, 2005, Ojos del Salado completed a general capital increase transaction in which SMMA Candelaria, Inc. acquired a 20 percent equity interest in Ojos del Salado. As a result of the transaction, Ojos del Salado received cash of $24.8 million (net of $0.2 million of expenses) and Phelps Dodge s interest in Ojos del Salado was reduced to 80 percent from 100 percent. Phelps Dodge continues to retain a majority interest in Ojos del Salado, which we fully consolidate (and report minority interest). (Refer to Change in Interest Gains on pages 75 and 76 for additional discussion of this transaction.)

El Abra

The El Abra operation consists of a mine-for-leach, open-pit mining operation that uses three stages of crushing prior to leaching, an on/off heap leach pad, and an SX/EW operation to produce copper cathode. Other lower-grade material is placed as uncrushed, run-of-mine material and leached. Phelps Dodge owns a 51 percent partnership interest in Sociedad Contractual Minera El Abra (El Abra), a Chilean contractual mining company. The remaining 49 percent is owned by the state-owned copper enterprise Corporación Nacional del Cobre de Chile (CODELCO). El Abra holds mining concessions over more than 33,000 acres of land near Calama in the copper-rich Second Region of northern Chile.

Cerro Verde

The Cerro Verde operation, located approximately 30 kilometers southwest of Arequipa, Peru, consists of two open-pit mines, Cerro Verde and Santa Rosa, a heap-leach operation and an SX/EW operation. Cerro Verde produces copper cathode. The ore is processed through three stages of crushing and placed on a leach pad after agglomeration. Other lower-grade material is placed as uncrushed, run-of-mine material and leached.

On June 1, 2005, Cerro Verde completed a general capital increase transaction. The transaction resulted in SMM Cerro Verde Netherlands B.V., also an indirect subsidiary of Sumitomo Metal Mining Co., Ltd. and Sumitomo Corporation, acquiring an equity position in Cerro Verde totaling 21 percent. In addition, Compañía de Minas Buenaventura S.A. (Buenaventura), a publicly traded Peruvian mining concern, increased its ownership position in Cerro Verde to 18.2 percent. The remaining minority shareholders own 7.2 percent of Cerro Verde through shares publicly traded on the Lima Stock Exchange. As a result of the transaction, Cerro Verde received cash of $441.8 million (net of $1.0 million of expenses) and Phelps Dodge s interest in Cerro Verde was reduced to 53.6 percent from 82.5 percent. Phelps Dodge continues to maintain a majority interest in Cerro Verde, which we fully consolidate (and report minority interests).

In early February 2005, the Phelps Dodge board of directors approved proceeding with an approximate $850 million expansion of the Cerro Verde mine simultaneously with financing efforts. On September 30, 2005, the Company obtained debt-financing facilities in the overall amount of $450 million, subject to certain conditions, for the expansion. The above-mentioned cash invested by Sumitomo and Buenaventura to establish or increase their ownership interests in Cerro Verde is a major source of funds for the expansion. For the year ended December 31, 2005, approximately $300 million was spent on the Cerro Verde expansion.

The expansion permits the mining of a primary sulfide ore body beneath the leachable ore body currently in production. Through the expansion, approximately 1.4 billion tons of sulfide ore reserves averaging 0.49 percent copper and 0.02 percent molybdenum will be processed through a new concentrator. Processing of the sulfide ore is expected to begin in the 2006 fourth quarter, and the expanded production rate should be achieved in the first half of 2007. The current copper production at Cerro Verde is approximately 100,000 tons per year of copper cathode. After completion of the expansion, copper production is expected to approximate 300,000 tons per year (approximately 160,700 tons per year for Phelps Dodge s share).

Table of Contents

Manufacturing Segment

We own and operate a copper smelter in Miami, Arizona, and prior to 2002 we operated a smelter in Hurley, New Mexico (Chino smelter). We smelt virtually all of our share of our U.S. copper concentrate production and on occasion, depending on market circumstances and internal production requirements, concentrate production from our South American operations. In addition, we may purchase concentrate to keep our smelter operating at efficient levels. We refine our share of anode copper production from our smelter at our refinery in El Paso, Texas, and from late 1999 to early 2002 also at our refinery in Miami, Arizona. The El Paso refinery has an annual production capacity of about 450,000 tons of copper cathode, which is sufficient to refine all the anode copper we produce for our account at our operating smelter.

Our El Paso refinery also produces nickel sulfate (converted to nickel carbonate production in 2004), copper telluride, and autoclaved slimes material containing gold, silver, platinum and palladium.

In January 2002, the Chino smelter was temporarily closed. From 2001 to 2005, the El Paso refinery operated significantly below capacity due to the conversion of the Morenci operation to a mine-for-leach operation in 2001 and the curtailment of certain production facilities in early 2002. As a result of production curtailments announced in the 2001 fourth quarter, the Miami refinery was temporarily closed in 2002. In June 2005, the decision to construct a concentrate-leach, direct-electrowinning facility at the Morenci copper mine had consequences for several of Phelps Dodge s southwest operations. With future Morenci copper concentrate production being fed into the concentrate-leach facility, the Miami smelter will be sufficient to treat virtually all remaining concentrate expected to be produced by Phelps Dodge at its operations in the southwestern United States. Accordingly, the Chino smelter, which had been on care-and-maintenance status, was permanently closed and demolition initiated. With the closing of the Chino smelter, Phelps Dodge will have unnecessary refining capacity in the region. Because of its superior capacity and operating flexibility, the refinery in El Paso, Texas, will continue to operate. The El Paso refinery is more than twice the size of our refinery in Miami, Arizona, and has sufficient capacity to refine all anodes expected to be produced from Phelps Dodge s operations in the southwestern United States given the changes brought by the above-mentioned Morenci project. Accordingly, the Miami refinery, which had been on care-and-maintenance, was permanently closed. As a result of the decision to close the Chino smelter and Miami refinery, we recorded asset impairment charges during the 2005 second quarter of $89.6 million ($68.6 million after-tax) and $59.1 million ($45.2 million after-tax), respectively, to reduce the related carrying values of these properties to their respective salvage values.

We are the world s largest producer of continuous-cast copper rod, the basic feed for the electrical wire and cable industry. Most of our refined copper and additional purchased copper cathode are converted into rod at our continuous-cast copper rod facilities in El Paso, Texas; Norwich, Connecticut; Miami, Arizona; and Chicago, Illinois. Our four plants have a collective annual capacity to convert more than 1.1 million tons of refined copper into rod and other refined copper products.

Primary Molybdenum Segment

See the United States Mines map on page 2 for the location of our molybdenum mines.

Phelps Dodge owns the underground Henderson molybdenum mine near Empire, Colorado. The operation consists of an underground, block-cave mine where molybdenite ore is mined and transported to a conventional sulfide concentrator. The concentrator is capable of operating at a rate of 32,000 tons of ore per day, producing molybdenum concentrate containing up to 58 percent molybdenum. Most of the concentrate is shipped to our Fort Madison, Iowa, roasting and chemical processing facility where high-purity products are made for final sale to customers. A portion of Henderson s production is further refined and sold to customers as molysulfide.

In May 2000, as a result of an oversupply of molybdenum and continued low prices in the world market, Phelps Dodge announced a plan to curtail molybdenum production by approximately 20 percent and reduce its Henderson workforce by approximately 130 workers. This production curtailment essentially remained in place through 2003. In 2004, based on rapidly increasing molybdenum prices and our view of market fundamentals for molybdenum, we increased annual production at Henderson to approximately 28 million pounds, and in 2005, annual production at Henderson was approximately 32 million pounds. Henderson is expected to be capable of producing up to 40 million

pounds annually by mid-2006. Henderson is currently developing the new 7210-foot production level. The 7700-foot production level of the mine that has been the principal ore production level since 1991 will be depleted by mid-2007. The cost to add the increased capacity is expected to total $20 million to $24 million.

Phelps Dodge also owns the Climax molybdenum mine near Leadville, Colorado. The operation consists of an underground and open-pit mine, and a 16,000-ton-per-day concentrator. The Climax molybdenum mine was placed on care-and-maintenance in 1995 by its previous owner. We expect to bring Climax into production concurrent with the exhaustion of the Henderson molybdenum mine ore reserves for continued long-term primary molybdenum supply for the chemicals business. Nonetheless, we continue to evaluate short- and mid-term production opportunities for the Climax mine based on market conditions and projections as well as manage the facility in a manner that allows its production to commence in a timely and efficient manner. If it is brought on line, production from the Climax mine could range from 5 million to 24 million pounds a year. The property comprises more than 14,000 acres.

Phelps Dodge processes molybdenum concentrates at its conversion plants in the United States and Europe into such products as technical-grade molybdic oxide, ferromolybdenum, pure molybdic oxide, ammonium molybdates, molybdenum metal powders and molysulfide. The Company operates molybdenum roasters at Green Valley, Arizona; Fort Madison, Iowa; and Rotterdam, the Netherlands.

The Fort Madison, Iowa, facility consists of two molybdenum roasters, a sulfuric acid plant, a metallurgical (technical oxide) packaging facility, and a chemical conversion plant, which includes a wet chemicals plant and sublimation equipment. In the chemical plant, molybdic oxide is further refined into various high-purity molybdenum chemicals for a wide range of uses by chemical and

Table of Contents

catalyst manufacturers. In addition to metallurgical oxide products, the Fort Madison facility produces ammonium dimolybdate, pure molybdic oxide, ammonium heptamolybdate, ammonium octamolybdate, sodium molybdate, sublimed pure molybdic oxide and molysulfide.

The Rotterdam conversion plant consists of a molybdenum roaster, sulfuric acid plant, a metallurgical packaging facility and a chemical conversion plant. The plant produces metallurgical products primarily for third parties. Ammonium dimolybdate and pure molybdic oxide are produced in the wet chemical plant.

We also produce ferromolybdenum and molysulfide for worldwide customers at our conversion plant located in Stowmarket, United Kingdom. The plant is operated both as an internal and external customer tolling facility.

Climax has a technology center located in Sahuarita, Arizona, focused on new product development and product applications as an extension of our metals business.

Worldwide Copper Production, by Source, Other Metal Production and Sales Data, and Manufacturing and Sales Production

The following tables show our worldwide copper production by source for the years 2001 through 2005; aggregate production and sales data for copper, gold, silver, molybdenum and sulfuric acid from these sources for the same years; annual average copper and molybdenum prices; and production from our smelters and refineries. Major changes in operations during the five-year period included:

conversion of Morenci operations to mine-for-leach during 1999 and 2000, with completion in the 2001 first quarter; concentrator was placed on care-and-maintenance status in 2001;

curtailment of mill throughput at Bagdad to approximately one-half capacity in January 2002, followed by an increase in mill throughput to approximately 80 percent in January 2003, and an increase in production in January 2004, reaching full capacity in the 2004 second quarter;

curtailment of mill throughput at Sierrita to approximately one-half capacity in January 2002, followed by an increase in production in January 2004, reaching full capacity in the 2004 fourth quarter;

temporary closure of the Miami mine and refinery in January 2002; partial curtailment of Miami s smelter throughput in January 2003, followed by restart at full capacity in the 2004 second quarter; permanent closure of the Miami refinery in the 2005 second quarter;

curtailment of Chino operations beginning in the 1998 fourth quarter, followed by temporary shut-down of the concentrator in March 2001 and temporary closure of the mine and smelter in January 2002; a partial restart of mining for leach material in April 2003, with a full restart of mining for leach materials in September 2003; an increase in milling operations to 80 percent of capacity in the 2004 third quarter; permanent closure of the Chino smelter in the 2005 second quarter;

curtailment of Cobre mining and milling operations that have remained unchanged since its temporary shutdown in March 1999;

partial curtailment at Tyrone beginning in September 2003; Tyrone mining operations were temporarily curtailed in 2004 to focus on stockpile reclamation. A combination of mining and reclamation activities were conducted in 2005, and are expected to continue through 2006, as Tyrone focuses on site reclamation while mining its remaining ore reserves. Tyrone SX/EW operations continue at a declining production rate;

restart of Ojos del Salado underground mining and milling operations in the 2004 second quarter;

completion of the run-of-mine leach project at El Abra with production commencing January 2002;

partial curtailment of Henderson operations beginning in the 2000 second quarter to 18 million pounds, followed by an increase in production to approximately 28 million pounds by the end of 2004 and 32 million annual pounds in 2005.

Table of Contents

Phelps Dodge Copper Production Data, by Source
(thousand tons)

	2005	2004	2003	2002	2001
Material mined (a)					
Morenci	255,887	234,491	237,338	248,505	281,474
Bagdad	64,093	61,194	48,935	42,912	63,680
Sierrita	63,358	53,231	35,525	23,066	60,869
Chino	65,060	43,443	12,299	220	59,277
Tyrone	28,840	1,647	16,319	45,515	73,990
Miami					32,702
Candelaria	105,344	106,585	108,442	109,211	126,509
Ojos del Salado	2,800	836			
Cerro Verde	68,620	75,727	72,965	75,982	68,685
El Abra	85,140	83,705	87,682	76,831	82,737
Total material mined	739,142	660,859	619,505	622,242	849,923
Less 15% undivided interest at Morenci	38,383	35,174	35,601	37,276	42,220
Material mined on a consolidated basis	700,759	625,685	583,904	584,966	807,703
Less minority participants shares previously accounted for on a pro rata basis:					
Chino (b)			3,785	73	19,758
Candelaria (c)	21,069	21,317	21,688	21,842	25,302
Ojos del Salado (d)	15				
Cerro Verde (e)	23,810	13,252	12,769	13,297	12,020
El Abra (f)	41,719	41,015	42,964	37,647	40,541
Material mined on a pro rata basis	614,146	550,101	502,698	512,107	710,082
Mill ore processed					
Morenci					4,301
Bagdad	26,592	27,157	26,103	19,783	31,667
Sierrita	39,199	34,885	26,654	21,439	38,133
Chino	12,604	4,895			3,109
Candelaria (g)	25,064	27,318	26,407	28,507	27,365
Ojos del Salado	2,586	742			
Total mill ore processed	106,045	94,997	79,164	69,729	104,575
Less 15% undivided interest at Morenci					645

Mill ore processed on a consolidated basis	106,045	94,997	79,164	69,729	103,930
Less minority participants shares previously accounted for on a pro rata basis:					
Chino (b)					1,036
Candelaria (c)	5,013	5,464	5,281	5,701	5,473
Ojos del Salado (d)	12				
Mill ore processed on a pro rata basis	101,020	89,533	73,883	64,028	97,421
Leach ore placed in stockpiles					
Morenci	239,052	224,918	228,940	241,955	258,202
Bagdad (h)	23,857	23,627		328	696
Sierrita	1,888	1,330	375	170	14,347
Chino (h)	28,103	30,799	11,066	198	31,009
Tyrone (h)	20,328	18,185	10,722	34,835	27,513
Miami					10,208
Cerro Verde	22,839	22,628	21,014	24,096	23,436
El Abra (h)	83,620	71,361	80,604	71,224	75,875
Total leach ore placed in stockpiles	419,687	392,848	352,721	372,806	441,286
Less 15% undivided interest at Morenci	35,858	33,738	34,341	36,293	38,729
Leach ore placed in stockpiles on a consolidated basis	383,829	359,110	318,380	336,513	402,557
Less minority participants shares previously accounted for on a pro rata basis:					
Chino (b)			3,376	66	10,336
Cerro Verde (e)	8,025	3,959	3,677	4,217	4,101
El Abra (f)	40,974	34,967	39,496	34,900	37,179
Leach ore placed in stockpiles on a pro rata basis	334,830	320,184	271,831	297,330	350,941

See footnote explanations on page 11.

Table of Contents

Phelps Dodge Copper Production Data, by Source
(thousand tons)

	2005	2004	2003	2002	2001
Grade of ore mined percent copper					
Morenci mill					0.78
Morenci leach	0.28	0.29	0.28	0.28	0.30
Bagdad mill	0.40	0.41	0.43	0.43	0.43
Bagdad leach	0.10	0.09		0.29	0.28
Sierrita mill	0.22	0.25	0.29	0.32	0.29
Sierrita leach	0.20	0.23	0.26	0.21	0.22
Miami leach					0.41
Chino mill	0.51	0.81			0.79
Chino leach	0.26	0.35	0.80	0.29	0.48
Tyrone leach	0.26	0.17	0.34	0.35	0.29
Candelaria mill	0.79	0.89	0.97	0.84	0.96
Ojos del Salado mill	1.35	1.57			
Cerro Verde mill					
Cerro Verde leach	0.59	0.66	0.60	0.55	0.53
El Abra leach	0.43	0.47	0.49	0.50	0.60
Average copper grade mill	0.46	0.52	0.56	0.56	0.54
Average copper grade leach	0.31	0.33	0.37	0.35	0.38
Copper production					
Morenci:					
Concentrate					23.5
Electrowon	400.0	420.3	421.2	412.7	368.1
Bagdad:					
Concentrate	84.8	82.1	82.5	68.4	118.1
Electrowon	15.8	28.0	24.5	15.6	10.5
Sierrita:					
Concentrate	71.8	73.5	66.3	60.0	94.6
Electrowon	7.5	4.0	9.3	16.2	26.3
Chino:					
Concentrate	50.7	29.8			18.3
Electrowon	54.1	61.9	39.9	53.8	59.9
Tyrone:					
Electrowon	40.5	43.1	56.9	69.9	76.4
Miami:					
Electrowon	12.3	9.8	17.8	10.5	44.1
Bisbee:					
Precipitate				0.1	0.2
Tohono:					
Electrowon	2.5				
Candelaria:					

Concentrate	179.3	220.5	234.5	219.5	243.2
Ojos del Salado:					
Concentrate	31.1	10.4			
Cerro Verde:					
Electrowon	103.1	97.6	96.3	95.3	84.9
El Abra:					
Electrowon	232.2	240.3	249.8	248.2	239.8
Manufacturing (i)	2.3	2.3	6.6	5.4	3.0
Total copper production	1,288.0	1,323.6	1,305.6	1,275.6	1,410.9
Less 15% undivided interest at Morenci	60.0	63.0	63.3	61.9	58.8
Copper production on a consolidated basis	1,228.0	1,260.6	1,242.3	1,213.7	1,352.1
Less minority participants shares previously accounted for on a pro rata basis:					
Chino (b)			12.5	17.9	26.1
Candelaria (c)	35.9	44.1	46.9	43.9	48.6
Ojos del Salado (d)	0.1				
Cerro Verde (e)	35.9	17.1	16.8	16.7	14.9
El Abra (f)	113.8	117.7	122.4	121.7	117.5
Manufacturing (i)			1.2	1.4	(0.2)
Copper production on a pro rata basis	1,042.3	1,081.7	1,042.5	1,012.1	1,145.2

See footnote explanations on page 11.

Table of Contents

10

Phelps Dodge Copper Sales Data, by Source
(thousand tons)

	2005	2004	2003	2002	2001
Copper sales:					
From own mines (j):					
Morenci	400.0	420.3	421.2	412.7	391.8
Bagdad	104.4	111.9	111.0	92.3	132.9
Sierrita	82.8	79.2	79.3	83.8	125.1
Chino	104.8	91.7	40.7	53.7	78.2
Tyrone	40.5	43.1	56.9	69.9	76.4
Miami	14.5	10.9	20.0	15.2	46.6
Bisbee				0.1	0.3
Tohono	2.5				
Candelaria	179.7	223.2	234.3	218.3	237.6
Ojos del Salado	30.9	10.3			
Cerro Verde	102.7	98.2	95.6	94.9	84.7
El Abra	233.3	240.8	251.8	254.1	248.4
Manufacturing (i)	2.3	2.3	6.6	5.9	4.2
Total copper sales from own mines	1,298.4	1,331.9	1,317.4	1,300.9	1,426.2
Less 15% undivided interest at Morenci	60.0	63.0	63.3	61.9	58.8
Copper sales from own mines on a consolidated basis	1,238.4	1,268.9	1,254.1	1,239.0	1,367.4
Less minority participants shares previously accounted for on a pro rata basis:					
Chino (b)			13.3	17.9	26.1
Candelaria (c)	36.0	44.6	46.9	43.7	47.5
Ojos del Salado (d)	0.1				
Cerro Verde (e)	36.4	17.2	16.7	16.6	14.8
El Abra (f)	114.3	118.0	123.4	124.5	121.7
Manufacturing (i)			1.2	1.8	1.3
Copper sales from own mines on a pro rata basis	1,051.6	1,089.1	1,052.6	1,034.5	1,156.0
Purchased copper:					
Candelaria (c)	23.1	37.1	22.1	35.8	37.0
El Abra (f)			7.3	56.5	5.8
Manufacturing (i)	369.5	394.0	274.6	267.7	342.6
Sales	18.1	1.9	70.5	83.0	75.8
Total purchased copper	410.7	433.0	374.5	443.0	461.2

Total copper sales on a consolidated basis (k)	1,649.1	1,701.9	N/A	N/A	N/A
Total copper sales on a pro rata basis (k)	N/A	N/A	1,427.1	1,477.5	1,617.2

Phelps Dodge Other Metal Production and Sales

	2005	2004	2003	2002	2001
Gold (thousand ounces)					
Total production	134	134	129	132	140
Less minority participants shares previously accounted for on a pro rata basis:	20	23	26	24	31
Net Phelps Dodge share	114	111	103	108	109
Sales (j)	114	112	108	136	77
Silver (thousand ounces)					
Total production	3,090	3,018	2,754	2,582	3,773
Less minority participants shares previously accounted for on a pro rata basis:	250	284	265	225	490
Net Phelps Dodge share	2,840	2,734	2,489	2,357	3,283
Sales (j)	2,866	3,249	2,292	3,317	2,504
Molybdenum (thousand pounds)					
Primary Molybdenum Henderson	32,201	27,520	22,247	20,517	18,603
By-product	30,105	29,969	29,747	24,448	36,912
Total production	62,306	57,489	51,994	44,965	55,515
Less minority participants shares previously accounted for on a pro rata basis:					
Chino (b)					50
Net Phelps Dodge share	62,306	57,489	51,994	44,965	55,465
Sales Net Phelps Dodge share					
from own mines (j)	59,947	63,108	54,158	46,665	55,105
Purchased molybdenum	12,830	12,844	8,199	7,393	1,609
Total sales	72,777	75,952	62,357	54,058	56,714

Sulfuric acid (thousand tons)					
Copper smelters (l)	726.1	722.0	647.6	748.6	1,236.7
Molybdenum (l)	130.5	122.5	116.5	114.3	97.8
Total production	856.6	844.5	764.1	862.9	1,334.5
Copper smelters (l)	98.6	99.0	45.5	14.5	15.9
Molybdenum (l)	144.8	121.4	117.9	115.4	102.3
Total sales	243.4	220.4	163.4	129.9	118.2

See footnote explanations on page 11.

Table of Contents

Prices
(per pound)

	2005	2004	2003	2002	2001
COMEX copper price (m)	$ 1.68	1.29	0.81	0.72	0.73
LME copper price (n)	$ 1.67	1.30	0.81	0.71	0.72
Metals Week molybdenum Dealer Oxide mean price (o)	$ 31.73	16.41	5.32	3.77	2.36

Phelps Dodge Manufacturing and Sales Production

	2005	2004	2003	2002	2001
Smelters (p)					
Total copper (thousand tons)	218.9	214.4	200.8	243.8	463.5
Less minority participants shares previously accounted for on a pro rata basis				0.5	36.7
Net Phelps Dodge share	218.9	214.4	200.8	243.3	426.8
Refineries (q)					
Copper (thousand tons)	295.0	308.4	284.6	319.6	502.6
Gold (thousand ounces) (r)				79.0	86.6
Silver (thousand ounces) (r)				1,786.0	3,719.1
Rod (s)					
Total copper (thousand tons)	1,008.1	1,014.6	825.8	850.6	879.8

Footnotes to tables on pages 8 through 11:

(a) Included material mined for leaching operations, excluded material mined from stockpiles.

(b) Reflected a one-third partnership interest in Chino Mines Company from January 1, 2001 to December 18, 2003 (minority interest acquired by PDMC on December 19, 2003).

(c) Reflected a 20 percent partnership interest in Candelaria.

(d) Reflected a 20 percent equity interest in Ojos del Salado beginning December 23, 2005.

(e) Reflected a 17.5 percent equity interest in Cerro Verde through May 31, 2005, and a 46.4 percent equity interest beginning June 1, 2005.

(f) Reflected a 49 percent partnership interest in El Abra.

(g) Included mill ore from stockpiles.

(h) Leach ore placed in the stockpiles included previously considered waste material that is now being leached.

(i) Included smelter production from custom receipts and flux as well as tolling gains or losses.

(j) Excluded sales of purchased copper, molybdenum, silver and gold.

(k) 2005 and 2004 reflected full consolidation of El Abra and Candelaria, 2003 and prior reflected El Abra and Candelaria on a pro rata basis (51 percent and 80 percent, respectively).

(l) Sulfuric acid production resulted from smelter and molybdenum air quality control operations; sales do not include internal usage.

(m) New York Commodity Exchange annual average spot price per pound cathodes.

(n) London Metal Exchange annual average spot price per pound cathodes.

(o) Annual *Metals Week* molybdenum Dealer Oxide mean price per pound as quoted in Platts *Metals Week*.

(p) Included production from purchased concentrates and copper smelted for others on a toll basis.

(q) Included production from purchased material and copper refined for others on a toll basis.

(r) El Paso closed its precious metals processing facility in the 2002 fourth quarter.

(s) Included rod, wire, oxygen-free billets/cakes, scrap and other shapes.

Table of Contents

Other Mining

Other mining comprises our worldwide mineral exploration and development programs, a process technology center that directs its activities at improving existing processes and developing new cost-competitive technologies, other ancillary operations and mining investments.

Exploration

Our exploration group s primary objectives are to increase PDMC s ore reserve base through discoveries and joint ventures and, where appropriate, to diversify into other metals, minerals and geographic areas. Exploration is focused on finding large-scale copper and copper/gold deposits in the four principal copper-producing regions of the world: southwest U.S./Mexico, South American Cordillera, Central Africa and Australasia, as well as in other highly prospective areas. This group operates in more than 12 countries and maintains offices in Australia, Brazil, Bulgaria, Canada, Chile, Mexico, Peru, the Philippines and the United States.

In 2005, Phelps Dodge expended $81.0 million on worldwide exploration, compared with $35.6 million in 2004 and $25.8 million in 2003. The increase in exploration for 2005 primarily was due to increased exploration in Central Africa, mostly associated with Tenke Fungurume, and at our U.S. mines. Approximately 36 percent of the 2005 expenditures occurred in the United States, with approximately 31 percent being spent at our U.S. mine sites, and the remainder for support of U.S. and international exploration activities. This compares with 40 percent in 2004 (31 percent at U.S. mine sites) and 32 percent in 2003 (25 percent at U.S. mine sites). In addition, approximately 34 percent was spent in Central Africa and approximately 7 percent was spent at our South American mine sites. The balance of exploration expenditures was spent principally in Chile, Europe, Australasia, Peru, Mexico, Canada and Brazil.

During 2005, exploration programs continued at some of our existing copper operations. A high-grade, underground mineable reserve was added at our Candelaria operation. At our Morenci mine, significant progress was made on definition drilling of the Garfield and Shannon deposits. In the Safford district, we commenced exploration drilling of two deposits situated within four miles of the Dos Pobres ore body.

In August 2002, Phelps Dodge announced it had replaced BHP Billiton as option holder under an existing agreement among BHP Billiton, Tenke Mining Corp. and others to acquire a controlling interest and operatorship in the Tenke Fungurume Mining (TFM) copper/cobalt project in the Democratic Republic of the Congo (DRC). On January 16, 2004, Phelps Dodge Exploration Corporation entered into a joint venture agreement with Tenke Holdings Limited with respect to the exploration, development and, if warranted, commercial production associated with the TFM copper/cobalt mineral deposit. On November 2, 2005, Phelps Dodge exercised its option to acquire a controlling interest of the TFM copper/cobalt mining concessions in the DRC. The action came after the government of the DRC and La Generale des Carrieres et des Mines (Gecamines), a state-owned mining company, executed amended agreements governing development of the concessions and after approval by DRC presidential decree. Phelps Dodge now holds an effective 57.75 percent interest in the project, along with Tenke Mining Corp. at 24.75 percent and Gecamines at 17.5 percent (non-dilutable). A Phelps Dodge subsidiary will be the operator of the project as it is developed and put into production. As part of the transaction, Gecamines will receive asset transfer payments totaling $50 million, including a $15 million asset transfer payment that was paid by Phelps Dodge on November 16, 2005, over a period of approximately five years as specified project milestones are reached. Phelps Dodge is responsible for funding all pre-development costs and an additional $10 million of asset transfer payments; thereafter, the Company and Tenke Mining Corp. are responsible for funding 70 percent and 30 percent, respectively, of any advances. Phelps Dodge has the right to withdraw from the project any time prior to approval of the bankable feasibility study by paying a $750,000 withdrawal fee. If Phelps Dodge withdraws, Tenke Mining Corp. then will be responsible for funding the remaining project costs, asset transfer payments, and any other advances, if required.

The Tenke Fungurume feasibility study is expected to be completed in mid-2006, with construction of basic infrastructure in early 2007. Production could commence as early as late 2008 or early 2009.

In 2004, an updated feasibility study was completed on our Safford project in eastern Arizona. On September 16, 2005, the federal Bureau of Land Management (BLM) completed a land exchange with the Company. This action allows us to advance development of the proposed copper mining operation near Safford, Arizona, which will include

development of the Dos Pobres and San Juan copper ore bodies, about eight miles north of Safford in southeastern Arizona.

On February 1, 2006, the Phelps Dodge board of directors conditionally approved development of the new copper mine near Safford, Arizona. Final approval is contingent upon receiving certain state permits needed for the mine. The Safford mine will require a capital investment of approximately $550 million and will be the first major new copper mine to be opened in the United States in more than 30 years.

The two deposits, Dos Pobres and San Juan, contain an estimated total of 538 million tons of leachable reserves with an ore grade of 0.37 percent copper. We anticipate that the Safford mine will be in full production during the second half of 2008, with full copper production expected to be approximately 240 million pounds per year. Life of the operation is expected to be at least 18 years.

In December 2004, Phelps Dodge Mining (Zambia) Ltd., a subsidiary of Phelps Dodge Corporation, sold the remaining portion (49 percent) of the Lumwana exploration property to Equinox Minerals Ltd. for $5.0 million in cash and a 1 percent future production royalty. Lumwana is a copper deposit in the Zambian copper belt located in northwestern Zambia.

In October 2003, Phelps Dodge Australasia, Inc., a subsidiary of Phelps Dodge Corporation, sold its Australian exploration property portfolio to Red Metal Limited, a newly formed junior mining exploration company that listed on the Australian Stock Exchange. As consideration, Phelps Dodge Australasia acquired a 15 percent shareholding in Red Metal Limited and rights to acquire interests in properties explored.

In mid-2004, Phelps Dodge transferred a 53 percent interest in the Ambatovy nickel/cobalt deposit in central Madagascar to Dynatec as Dynatec had completed its portion of a joint venture agreement. In February 2005, the Company sold its remaining 47 percent interest in

Table of Contents

the project to Dynatec in exchange for 20.9 million Dynatec common shares, subject to certain holding restrictions, resulting in a 9.9 percent interest in Dynatec Corporation. We also received 100 preferred shares of Dynatec Corporation (BVI) Inc., a wholly owned subsidiary of Dynatec Corporation. The preferred shares are subject to a put/call arrangement that upon certain triggering events, including the commencement of commercial production, would entitle the Company to receive in the form of cash and stock the difference between $70 million and the then-current value of the 20.9 million Dynatec shares.

In October 2001, Phelps Dodge sold its 50 percent interest in Mineração Serra do Sossego to Companhia Vale do Rio Doce (CVRD) for $42.5 million in cash. Sossego is a copper-gold mine in the Carajas region of Brazil.

Process Technology

The objective of PDMC s process technology center (PTC) based in Safford, Arizona, is to enhance and strengthen Phelps Dodge s competitive position in the world copper market. The PTC provides metallurgical process development capabilities, process optimization services, metallurgical testing and advanced material characterization services to meet the needs of PDMC and its operations. The PTC is ISO-9001-2000 certified. The activities at PTC are directed at the development of new cost-competitive, step change technologies and the continuous improvement of existing processes. A strong focus is maintained on the effective implementation, transfer and sharing of technology within PDMC operations and projects. The PTC employs approximately 119 engineers, scientists and technical support staff. The facilities include:

- a large-diameter, column-leach facility for testing run-of-mine material, which is capable of processing up to approximately 600 tons of ore annually;
- a continuous SX/EW test facility capable of producing approximately 1.5 tons of copper cathode per day;
- a small-diameter, column-leach facility with a capacity of about 250 individual tests per year for crushed material;
- a metallurgical laboratory for the development of biological leaching processes and enhancements, and other biological applications;
- a demonstration facility for production of new copper products; and
- a state-of-the-art material characterization laboratory with advanced mineralogy, analytical chemistry and metallography capabilities.

The principal areas of activity include hydrometallurgy (leaching, solution extraction and electrowinning), mineral processing (crushing, grinding and flotation), material characterization, environmental technology, new copper products and technical information services. Some of the most important projects and milestones in 2005 were as follows:

- The high-temperature, concentrate pressure-leaching demonstration plant at the Bagdad mine was converted in early 2005 to operate at medium-temperature conditions (*i.e.,* 160ºC) to prove an alternative technology that generates significantly less sulfuric acid and requires less oxygen than the high-temperature process. This process has potential application in operations and projects where excess by-product sulfuric acid cannot be beneficially used in stockpile or heap-leaching operations, and consequently could result in a lower-cost option for certain applications. The facility s conversion at Bagdad was completed in May 2005, and the plant was operated in this mode for approximately seven months. The proprietary Phelps Dodge medium-temperature process (incorporating direct electrowinning) was successfully demonstrated during the seven-month period of operation, producing LME Grade A cathode that was processed through Phelps Dodge rod mills.

At the conclusion of the planned demonstration period, the facility was converted back to operate at high temperature (*i.e.,* 225ºC) in December 2005 to provide the Bagdad operation with a greater amount of by-product acid necessary for low-grade stockpile leaching operations. This technology is proprietary and is covered under a Technology Development Agreement between Phelps Dodge and Placer Dome, Inc.

The decision was made to install concentrate leaching at Morenci in conjunction with a re-start of the Morenci concentrator to process chalcopyrite-containing ores from Western Copper, Garfield and other areas of the mine. The concentrate-leaching facility will utilize Phelps Dodge s proprietary medium-temperature pressure-leaching and direct-electrowinning technology that has been demonstrated at Bagdad, Arizona. The facility is expected to be in operation by mid-2007 and copper production is projected to be approximately 150 million pounds per year. The capital cost of the facility is estimated to be $106 million, with approximately $8 million spent in 2005.

Construction of a Central Analytical Service Center (CASC) to provide routine analytical services for PDMC s operations in Arizona and New Mexico was essentially completed and commissioning started prior to the end of 2005. The facility, located in Safford, Arizona, will replace most analytical functions and capabilities at Phelps Dodge mining operations in Arizona and New Mexico, and will ensure that high-quality, timely and cost-effective analytical capability is provided to PDMC s operations on a consistent basis.

Proprietary technology for heap and stockpile leaching of low-grade chalcopyrite ores was advanced, including the continued operation of a large-scale (27 million ton) demonstration plant at Bagdad.

The investigation of cost-effective, heap-leaching options for primary sulfide material at El Abra was advanced during the year. Biological heap leaching is expected to provide an alternative technology to conventional milling, flotation and smelting of bornite-rich primary sulfide ore at El Abra in the future.

Investigation and commercial demonstration of alternative technologies to reduce the cost of copper electrowinning continued during 2005.

Investigation and commercial demonstration of alternative sulfuric acid production techniques were advanced during 2005.

The commercial demonstration of proprietary alternative copper products and production techniques was in progress during the second half of 2005.

We continued the operation and ramp-up of a facility at Bisbee, Arizona, using technology owned by BioteQ (Vancouver, Canada)

Table of Contents

to recover copper as a sulfide precipitate from low-grade, copper-bearing solution.

Total expenditures for PTC in 2005 were approximately $45 million, compared with $26 million in 2004 and $18 million in 2003. PDMC intends to advance all of the aforementioned research and development projects aggressively in 2006; however, there is no assurance that any of these technologies will be commercialized.

Other Ancillary Operations

Our Tohono copper operation in south central Arizona includes an SX/EW facility capable of producing copper cathode. It is located on land leased from the Tohono O odham Nation. Ore mining at Tohono ceased in July 1997, but copper cathode production continued from existing leach stockpiles until early 1999 at which time the site was placed on care-and-maintenance status. As a result of higher copper prices, the facility restarted operations in the 2004 fourth quarter to recover copper from existing leach stockpiles. Cathode production commenced in January 2005.

Mining Investments

Through June 15, 2005, we owned a 14.0 percent interest in Southern Peru Copper Corporation (SPCC), which operates two open-pit copper mines, two concentrators, an SX/EW operation, a smelter and a refinery in Peru.

On June 9, 2005, the Company entered into an Underwriting Agreement with Citigroup Global Markets, Inc., UBS Securities LLC, SPCC, Cerro Trading Company, Inc. and SPC Investors, LLC. On June 15, 2005, pursuant to the Underwriting Agreement, the Company sold all of its SPCC common shares to the underwriters for a net price of $40.635 per share (based on a market price of $42.00 per share less underwriting fees). This transaction resulted in a special, pre-tax gain of $438.4 million ($388.0 million after-tax).

SPCC s results are not included in our earnings because we accounted for our investment in SPCC on a cost basis. During 2005, we received dividend payments of $40.5 million from SPCC, compared with $26.7 million and $6.3 million in 2004 and 2003, respectively.

Ore Reserves

Ore reserves are those estimated quantities of proven and probable material that may be economically mined and processed for extraction of their constituent values. Estimates of our ore reserves are based upon engineering evaluations of assay values derived from samplings of drill holes and other openings. In our opinion, the sites for such samplings are spaced sufficiently closely and the geologic characteristics of the deposits are sufficiently well defined to render the estimates reliable. The ore reserve estimates include assessments of the resource, mining and metallurgy as well as consideration of economic, marketing, legal, environmental, social and governmental factors.

Phelps Dodge s calculations of its ore reserves are based on our mine designs for each property. In addition to the evaluations and assessments referred to above, Phelps Dodge uses several additional factors to determine our mine designs that can limit the amount of material classified as reserves, but which we believe maximizes the value of future cash flows for each mine by eliminating the mining of material that does not add to the net present value of the property. Time-valued concepts recognize, for example, the elapsed time between mining of overburden and the mining of ore. Our mine design concepts also recognize the amount of capital and other expenditures required to extract the ore reserves over the life of the mine. Finally, cutoff-grade strategies are implemented to maximize time-valued cash flows. Phelps Dodge believes its ore reserve estimation methodology is prudent and consistent with appropriate industry standards.

Proven and probable ore reserves at December 31, 2005, and 2004, for each of our operating, curtailed and development properties are summarized on the following page.

Table of Contents

Total Ore Reserves Estimated at December 31, 2005 (1)

	Millable Reserves			Leachable Reserves				Phelps Dodge Interest (%)
				Crushed Leach		Run-of-Mine (ROM)		
	Million Tons	% Copper	% Moly	Million Tons	% Copper	Million Tons	% Copper	
Operating and Curtailed Operations								
Morenci (2)	247.6	0.49		587.5	0.54	2,490.7	0.19	85.0
Bagdad (3)	618.9	0.35	0.02			16.3	0.31	100.0
Sierrita (3)	1,061.6	0.26	0.03			26.1	0.18	100.0
Chino (3)	72.6	0.70	0.02			156.0	0.40	100.0
Cobre (3), (4) & (8)						110.3	0.35	100.0
Tyrone (3)						49.3	0.29	100.0
Miami (4)						112.1	0.37	100.0
Candelaria (3), (5) & (6)	339.0	0.73						80.0
Ojos del Salado (5) & (9)	15.1	1.33						80.0
Cerro Verde (7) & (9)	1,392.0	0.49	0.02	268.1	0.50	97.1	0.29	53.6
El Abra				227.7	0.47	226.4	0.32	51.0
Primary Molybdenum:								
Climax (4)	156.4		0.19					100.0
Henderson	150.7		0.21					100.0
Undeveloped Copper Ore Reserves require substantial capital investments to bring into production								
Safford (8)				455.3	0.40	82.7	0.21	100.0

Total Ore Reserves Estimated at December 31, 2004 (1)

	Millable Reserves			Leachable Reserves				Phelps Dodge Interest (%)
				Crushed Leach		Run-of-Mine (ROM)		
	Million Tons	% Copper	% Moly	Million Tons	% Copper	Million Tons	% Copper	
Operating and Curtailed								

Operations								
Morenci	224.0	0.46		585.7	0.55	2,434.1	0.19	85.0
Bagdad	676.3	0.34	0.02			14.4	0.29	100.0
Sierrita	1,075.1	0.26	0.03			27.1	0.18	100.0
Chino	111.4	0.71	0.02			282.6	0.39	100.0
Cobre	57.6	0.55				77.8	0.26	100.0
Tyrone						274.7	0.31	100.0
Miami						126.4	0.37	100.0
Candelaria	422.0	0.72						80.0
Ojos del Salado	17.9	1.31						100.0
Cerro Verde	1,428.1	0.49	0.02	228.0	0.57	159.2	0.27	82.5
El Abra				243.4	0.49	239.5	0.29	51.0
Primary Molybdenum:								
Climax	156.4		0.19					100.0
Henderson	158.7		0.21					100.0
Undeveloped Copper Ore Reserves require substantial capital investments to bring into production Safford				455.3	0.40	82.7	0.21	100.0

(1) Total ore reserves estimated (i) are presented on a 100% basis (i.e., included 100 percent of Morenci, Candelaria, Ojos del Salado, Cerro Verde and El Abra), (ii) included only in-situ tonnages, and (iii) excluded stockpiled ores.

(2) Morenci ore reserves increased with the inclusion of additional ore reserves in the Shannon, American Mountain and Garfield areas.

(3) Bagdad, Sierrita, Chino, Cobre, Tyrone and Candelaria ore reserves reflected new pit designs based on updated slope and economic parameters. At Cobre, most of the material previously classified as millable reserves has been reclassified as leachable reserves consistent with the current development plan, which does not include operation of the Cobre mill.

(4) Miami and Climax properties have been on care-and-maintenance status with no mining taking place; Cobre had limited activity in 2004 and 2005 to improve and establish access to mining areas.

(5) The Candelaria and Ojos del Salado deposits also contained 0.004 ounces and 0.012 ounces of gold per ton, respectively.

(6) The Candelaria ore reserves included 4.6 million tons of underground ore reserves from the Candelaria Norte area.

(7) Cerro Verde millable ore reserves reflect the approved development of the mill project.

(8) The Safford and Hanover (Cobre) leach deposits were at various stages of the permitting process. On February 1, 2006, the Company s board of directors conditionally approved development of the Safford mine subject to receiving certain state permits.

(9) Reflects change in ownership interest in Cerro Verde and Ojos del Salado.

Table of Contents

Average Drill-Hole Spacing at Ore Reserve Properties

The following table sets forth the average drill-hole spacing for proven and probable ore reserves by process types:

	As of December 31, 2005			
	Proven (average spacing-feet)		Probable (average spacing-feet)	
Property	Mill	Leach	Mill	Leach
Morenci	283	283	400	400
Bagdad	190	81	441	323
Sierrita	224	143	348	243
Chino	141	200	200	283
Cobre	150	200	200	300
Tyrone	N/A	283	N/A	283
Miami	N/A	200	N/A	300
Candelaria	115	N/A	230	N/A
Ojos del Salado	82	N/A	164	N/A
Cerro Verde	164	164	328	328
El Abra	N/A	233	N/A	328
Climax	200	N/A	200	N/A
Henderson	65	N/A	290	N/A
Safford	N/A	200	N/A	400

Metallurgical Recovery

The following table sets forth the average expected metallurgical recovery by process type:

	As of December 31, 2005		
	Copper		Molybdenum
Property	Mill % (a)	Leach % (b)	Mill % (c)
Morenci	79.3	56.4	N/A
Bagdad	84.0	43.3	72.7
Sierrita	82.9	54.0	78.3
Chino	78.1	64.2	25.9
Cobre	N/A	62.1	N/A
Tyrone	N/A	73.5	N/A
Miami	N/A	64.0	N/A
Candelaria	91.2	N/A	N/A
Ojos del Salado	90.2	N/A	N/A
Cerro Verde	85.0	73.4	54.5
El Abra (d)	N/A	59.0	N/A
Safford	N/A	70.2	N/A
Climax	N/A	N/A	85.1
Henderson	N/A	N/A	86.2

(a)

Mill recoveries include expected mill and smelter recoveries and an allowance for concentrate transportation losses.

(b) Leach recoveries are the expected total recoveries over multiple leach cycles.

(c) Molybdenum recoveries include mill recoveries and roaster deductions.

(d) El Abra average leach recoveries for both oxides and sulfide ores.

Mill and Leach Stockpiles

Stockpiled copper-bearing material that has been removed from the mine, and for which we have reasonable certainty of processing, is summarized below. We begin capitalization of costs for mill and leach stockpiles when we have reasonable certainty that the material will be processed. The capitalized costs are evaluated periodically to ensure carrying amounts are stated at the lower of cost or market. (Refer to Note 1, Summary of Significant Accounting Policies, and Note 8, Mill and Leach Stockpiles, Inventories and Supplies, for additional financial information regarding mill and leach stockpiles.) Effective January 1, 2004, for accounting purposes, El Abra (51 percent) and Candelaria (80 percent) are fully consolidated. The Phelps Dodge pro rata basis in the tables below reflects our ownership interests in El Abra (51 percent), Candelaria (80 percent), Ojos del Salado (80 percent), Cerro Verde (53.6 percent) and Morenci (85 percent). In 2004, Cerro Verde is included at 100 percent for all categories presented.

(in million tons)	As of December 31, 2005			
	Stockpile Material	Contained Copper (%)*	Recovery (%)	Recoverable Copper
Mill stockpiles:				
100% basis	101	0.47	83.0	0.4
Consolidated basis				0.4
Phelps Dodge pro rata basis				0.3
Leach stockpiles:				
100% basis	8,737	0.27	5.8	1.4
Consolidated basis				1.3
Phelps Dodge pro rata basis				1.2

* Copper grade of ore when placed.

(in million tons)	As of December 31, 2004			
	Stockpile Material	Contained Copper (%)*	Recovery (%)	Recoverable Copper
Mill stockpiles:				
100% basis	96	0.48	83.1	0.4
Consolidated basis				0.4
Phelps Dodge pro rata basis				0.3
Leach stockpiles:				
100% basis	8,331	0.27	6.4	1.4
Consolidated basis				1.4
Phelps Dodge pro rata basis				1.3

* Copper grade of ore when placed.

We employ reasonable estimation methods to determine copper contained in mill and leach stockpiles.

Mill Stockpiles

Mill stockpiles contain low-grade ore that has been extracted from the mine and is available for processing to recover the contained copper by milling, concentrating, smelting and refining, or alternatively, by concentrate leaching. The quantity of material delivered to the stockpiles is based on surveyed volumes of mined material and daily production records. Sampling and assaying of blast-hole cuttings determine the estimated copper grades of the material delivered to the mill stockpiles.

Expected copper recovery rates are determined by metallurgical testing. The recoverable copper in mill stockpiles can be extracted into copper concentrate almost immediately upon processing. Estimates of copper contained in mill stockpiles are adjusted as material is added or removed.

Leach Stockpiles

Leach stockpiles contain low-grade ore that has been extracted from the mine and is available for processing to recover the contained copper through a leaching process. Leach stockpiles are exposed to acidic solutions that dissolve contained copper and deliver the copper in solution to the extraction processing facilities. The quantity of material is based on surveyed volumes of mined material and daily production records. Sampling and assaying of

Table of Contents

blast-hole cuttings determine the estimated copper grade of the material delivered to the leach stockpiles.

Expected copper recovery rates are determined using small-scale laboratory tests, medium-and large-scale column testing (which simulates the production-scale process), historical trends and other factors, including mineralogy of the ore and rock type.

Ultimate recovery of copper contained in leach stockpiles can vary from a very low percentage to more than 90 percent depending on several variables, including type of processing, mineralogy and particle size of the rock. Although as much as 70 percent of the copper ultimately recoverable may be extracted during the first year of processing, recovery of the remaining copper may take many years.

The estimated recoverable copper contained in stockpiles at each mine was as follows:

(in million tons)

	December 31,	
	2005	2004
Mill stockpiles:		
Candelaria	0.3	0.3
Cerro Verde	0.1	0.1
	0.4	0.4
Leach stockpiles:		
Morenci	0.2	0.3
Bagdad	0.1	0.1
Sierrita	0.2	0.1
Chino	0.6	0.5
Tyrone	0.1	0.1
Miami	0.0	0.1
Cerro Verde	0.1	0.1
El Abra	0.1	0.1
	1.4	1.4
Total (100% basis)	1.8	1.8
Consolidated basis	1.7	1.8
Phelps Dodge pro rata basis	1.5	1.6

Note: The Candelaria mill stockpiles are expected to be processed late in the mine s life as milling capacity is available. Some of the Cerro Verde mill stockpiles will be processed during initial mill start-up operations in 2007. The leach stockpiles are expected to be processed over the lives of the respective mines.

Our estimated share of aggregate copper and molybdenum ore reserves as of December 31 was as follows:

	2005	2004	2003	2002	2001
Milling reserves on a pro rata basis (billion tons) (a)	3.3	4.2	3.5	3.4	3.6
Leaching reserves on a pro rata basis (billion tons) (a)	4.1	4.5	4.0	4.3	5.2

Commercially recoverable copper (million tons):					
Ore reserves	17.7	23.2	19.5	19.6	22.1
Stockpiles and in-process inventories	1.5	1.6	1.6	1.4	0.9
Total Phelps Dodge pro rata basis	19.2	24.8	21.1	21.0	23.0
Total consolidated basis (b)	23.7	26.1	N/A	N/A	N/A
Commercially recoverable molybdenum (billion pounds)					
Phelps Dodge pro rata basis	1.9	2.1	2.0	2.1	2.1
Total consolidated basis	2.0	2.1	2.0	2.1	2.1

(a) Milling and leaching reserves on a 100% basis would have been 4.1 and 4.9 billion tons, respectively, as of December 31, 2005, if El Abra, Candelaria, Cerro Verde, Morenci and Ojos del Salado were reflected on a 100% basis.

(b) Commercially recoverable copper on a 100% basis would have been 24.5 million tons of copper as of December 31, 2005, if El Abra, Candelaria, Cerro Verde, Morenci and Ojos del Salado were reflected on a 100% basis.

The decrease in commercially recoverable copper at December 31, 2005, was primarily due to the reduction of the Company s interest in Cerro Verde to 53.6 percent from 82.5 percent, new pit designs at Bagdad, Cerro Verde, Chino, Cobre, Tyrone and Candelaria, as well as 2005 production.

Copper and Molybdenum Prices

The volatility of copper and molybdenum prices is reflected in the following table, which gives the high, low and average COMEX price of high-grade copper and the Platts *Metals Week* mean price of molybdenum oxide for each of the last 15 years:

	Cents per pound of Copper COMEX			Dollars per pound of Molybdenum Dealer Oxide Platts *Metals Week*		
Year	High	Low	Average	High	Low	Mean
1991	120	96	105	2.78	2.08	2.38
1992	116	93	103	2.44	1.82	2.21
1993	107	72	85	2.80	1.82	2.32
1994	140	78	107	17.00	2.68	4.51
1995	146	121	135	17.50	3.90	8.08
1996	131	86	106	5.50	2.90	3.79
1997	123	76	104	4.90	3.52	4.31
1998	86	64	75	4.60	2.00	3.41
1999	85	61	72	2.90	2.48	2.65
2000	93	74	84	2.98	2.15	2.56
2001	87	60	73	2.65	2.15	2.36
2002	78	65	72	8.30	2.40	3.77
2003	104	71	81	7.80	3.15	5.32
2004	154	106	129	33.25	7.20	16.41
2005	228	140	168	40.00	26.00	31.73

Phelps Dodge s reported ore reserves are economic at the most-recent three-year historical average COMEX copper price of $1.26 per pound and the most-recent three-year historical average molybdenum price of $17.82 per pound (*Metals Week* Dealer Oxide mean price).

Phelps Dodge develops its business plans using a time horizon that is reflective of the historical moving average for the full price cycle. Through 2005, we used a long-term average COMEX price of 90 cents per pound of copper and an average molybdenum price of $5.00 per pound (*Metals Week* Dealer Oxide mean price), along with near-term price forecasts reflective of the current price environment,

Table of Contents

to develop mine plans and production schedules (effective for 2006, we have begun to use a long-term average COMEX price of 95 cents per pound of copper for these purposes).

The per pound COMEX copper price during the past 10 years, 15 years and 20 years averaged 96 cents, $1.00 and $1.00, respectively. The per pound *Metals Week* Dealer Oxide molybdenum mean price over the same periods averaged $7.63, $6.39 and $5.57, respectively.

Mineralized Material

We hold various properties containing mineralized material that we believe could be brought into production should market conditions warrant. Permitting and significant capital expenditures would likely be required before operations could commence at these properties. The deposits are estimated to contain the following mineralized material as of December 31, 2005:

		Milling Material		Leaching Material				Phelps Dodge
Property/Deposit	Location	Millions of Tons	% Copper	Millions of Tons	% Copper	% Molybdenum	% Cobalt	Interest (%)
Ajo	Arizona	205	0.50					100.0
Candelaria Norte & Sur (1)	Chile	10	2.00					80.0
Climax	Colorado	87				0.25		100.0
Cochise/Bisbee	Arizona			276	0.47			100.0
El Abra (2)	Chile	300	0.50	500	0.50			51.0
Lone Star	Arizona			1,600	0.38			100.0
Safford	Arizona	330	0.65					100.0
Sanchez	Arizona			230	0.29			100.0
Tenke Fungurume (3)	Dem. Rep. Congo			103	3.44		0.34	57.8
Tohono	Arizona	276	0.70	404	0.63			100.0
Tyrone	New Mexico			123	0.34			100.0

(1) Candelaria Norte and Sur are potential underground mines that would utilize the existing process facilities and infrastructure. The stated tonnage also contains 0.015 oz. gold per ton. Approximately 4 million tons of underground ores were transferred into the stated Candelaria reserves at year-end 2005, and development of these ores commenced in late 2005.

(2) Phelps Dodge moved the leachable portion of the sulfide mill material to leachable material at the end of 2005. The remaining millable material is mostly primary sulfides that have very low leach recoveries.

(3) Phelps Dodge exercised its option with Tenke Mining, resulting in the acquisition of 57.75% of the Tenke Fungurume copper/cobalt project in the Democratic Republic of the Congo.

Note: Mineralized material is a mineralized body that has been delineated by appropriately spaced drilling and/or underground sampling to support the reported tonnage and average grade of metal(s). Such a deposit does not qualify

as a reserve until legal and economic feasibility are concluded based upon a comprehensive evaluation of unit costs, grade, recoveries and other material factors.

Table of Contents

Sales and Competition

U.S. Mining Operations

The majority of our copper produced or purchased at our U.S. Mining Operations is cast into rod. Rod sales to outside wire and cable manufacturers constituted approximately 75 percent of PDMC s U.S. sales in 2005, 70 percent in 2004 and 65 percent in 2003. The remainder of our U.S. copper sales is primarily in the form of copper cathode or copper concentrate. Sales of rod and cathode are made directly to wire and cable fabricators and brass mills under contracts principally of a one-year duration. Cathode contract prices are generally based on the prevailing COMEX copper monthly average spot price for shipments in that period. Our rod also is used by our Wire and Cable segment. We generally sell our copper rod and cathode produced at our U.S. Mining Operations at a premium over COMEX prices.

South American Mines

The production from our South American mines is sold as copper concentrate or as copper cathode. Our Candelaria mine sells its production in the form of copper concentrate primarily to copper smelters located in Japan and elsewhere in Asia under long-term contracts. Production not committed under long-term contracts is either shipped to North America for smelting at our Miami smelter (under certain circumstances) or sold on a spot basis to other smelters or merchants. The majority of our Ojos del Salado concentrate production is sold to local Chilean smelters. Copper concentrate sold by our South American operations primarily is based on LME prices.

Most of Candelaria s concentrate contracts allow for an annual pricing election that must be declared prior to the beginning of the contract year. The options allowed under this pricing election are the monthly average price of either (i) the month of shipment or (ii) the third calendar month following the month of arrival of concentrates at destination. During 2005 and 2004, approximately 90 percent of Candelaria s concentrate sales were priced on the basis of the third calendar month following arrival. During 2003, over 95 percent of its sales were priced on the basis of the month of shipment.

El Abra produces copper cathodes that are sold primarily under annual or multi-year contracts to Asian or European rod or brass mill customers or to merchants. Cerro Verde produces copper cathode, with the majority shipped to our U.S. rod mills for processing. The remainder of Cerro Verde s production is sold under annual contracts to South American customers or to merchants on a spot basis. Cathode contract prices are generally based on the prevailing LME copper monthly average spot price in the month of arrival. The copper cathode sold by our international operations generally is sold at a premium over LME prices.

Worldwide Copper Mining Operations

Most of the refined copper we sell is incorporated into electrical wire and cable products worldwide for use in the construction, electric utility, communications and transportation industries. It also is used in industrial machinery and equipment, consumer products and a variety of other electrical and electronic applications.

When we sell copper as rod, cathode and concentrate, we compete, directly or indirectly, with many other sellers, including at least two other U.S. primary producers, as well as numerous foreign producers, metal merchants, custom refiners and scrap dealers. Some major producers outside the United States have cost advantages resulting from richer ore grades, lower labor costs and, in some cases, a lack of strict regulatory requirements. We believe our ongoing programs to contain costs, improve productivity and employ new technologies will significantly narrow these cost advantages and place us in a more competitive position with respect to a number of our international competitors.

Other materials that compete with copper include aluminum, plastics, stainless steel and fiber optics. Our principal methods of competing include pricing, product properties, product quality, customer service and dependability of supply.

From time to time, we engage in hedging programs designed to enable us to realize current average prices for metal delivered or committed to be delivered. We also have entered into price protection arrangements from time to time, depending on market circumstances, to ensure a minimum price for a portion of expected future sales.

Primary Molybdenum Segment

Molybdic oxide is used primarily in the steel industry for corrosion resistance, strengthening and heat resistance. Molybdenum chemicals are used in a number of diverse applications such as lubricants, additives for water treatment, feedstock for the production of pure molybdenum metal and catalysts used for petroleum refining. Pure molybdenum metal powder products are used in a number of diverse applications, such as lighting, electronics and specialty steel alloys. Approximately 60 percent of Phelps Dodge s expected 2006 molybdenum production is committed for sale throughout the world pursuant to annual or quarterly agreements based primarily on prevailing market prices one month prior to the time of sale.

The metallurgical market for molybdenum is characterized by cyclical and volatile prices, little product differentiation and strong competition. The chemical market is more diverse and contains more specialty products and segments. In both markets, prices are influenced by production costs of domestic and foreign competitors, worldwide economic conditions, world and regional supply/demand balances, inventory levels, governmental regulatory actions, currency exchange rates and other factors. Molybdenum prices also are affected by the demand for end-use products in, for example, the construction, transportation and durable goods markets. A substantial portion of world molybdenum is produced as a by-product of copper mining, which is relatively insensitive to molybdenum price levels. By-product production is estimated to account for approximately 65 percent of global molybdenum production in 2005.

Prices, Supply and Consumption

Worldwide Copper Mining Operations

Copper is an internationally traded commodity, and its prices are effectively determined by the three major metals exchanges COMEX, LME and Shanghai Futures Exchange (SHFE). The prices on these exchanges generally reflect the worldwide balance of copper demand and supply, but are also influenced significantly from time to time by speculative actions and by currency exchange rates.

Table of Contents

Copper is a critical component of the world s infrastructure. The demand for copper ultimately reflects the rate of underlying world economic growth, particularly the growth in industrial production, construction and durable goods. Copper s end-use markets reflect its fundamental role in the world economy. Estimated percentages of copper consumption by end-use markets comprise (i) construction 37 percent, (ii) electrical applications 26 percent, (iii) industrial machinery 15 percent, (iv) transportation 11 percent, and (v) consumer products 11 percent. Since 1990, refined copper consumption grew by an estimated annual compound rate of 3.1 percent to 17.1 million tons, according to published data by the World Bureau of Metals Statistics (WBMS) and Phelps Dodge s estimate for 2005. This rate of increase was slightly higher than the growth of world industrial production, which grew at an estimated compound annual rate of 2.7 percent over the same period. Asian copper consumption, led by China, was particularly strong, increasing by almost 6.5 percent per year from 1990 through 2005. Asia now represents approximately half of the world s refined copper consumption, compared with 22 percent for Western Europe and 21 percent for the Americas. The strong demand for copper in Asia has been driven by the increasing standard of living in this region as well as production of value-added products for export to the developed world.

From 1990 through 2005, refined copper production has grown at an average annual rate of 3.0 percent, according to WBMS (based on published data through 2004) and Phelps Dodge s estimates for 2005. This growth was influenced by a number of factors. First, limited investment in new mine production in the latter half of the 1980s coupled with growing demand for copper during that period resulted in market deficits and declining copper inventories that in turn encouraged new investment. Second, an improved investment climate in Latin America, particularly Chile, encouraged investment in that region. In 2005, Latin America represented 47 percent of world mine production, a significant increase from 25 percent in 1990. Third, SX/EW technology made some previously uneconomic resources viable investments.

Copper demand and price tend to follow economic cycles and, therefore, copper price has historically experienced significant fluctuations. Considering the period 1991 through 2005, the LME price of copper averaged 99 cents per pound and ranged from a high annual average price of $1.67 per pound in 2005 to a low annual average price of 71 cents per pound in 2002. The COMEX price of copper averaged $1.00 per pound from 1991 through 2005, but has ranged from a high annual average price of $1.68 per pound in 2005 to a low annual average price of 72 cents per pound in 2002.

In 2005, the average COMEX price of $1.68 per pound was almost 40 cents above the prior year s average. Critically low global inventory levels combined with production shortfalls more than offset the effects of lower than anticipated consumption levels. Refined production was estimated to increase approximately 5.7 percent year-on-year while consumption was estimated to increase by a modest 1 to 2 percent year-on-year. Consumption was again led by Asia, specifically China, which grew at approximately 9.0 percent year-on-year. U.S. demand for copper cathode was down 2.0 percent for the year due to de-stocking of inventory build in 2004. Exchange inventories were up slightly, 32,000 metric tons over the prior year, to approximately 156,000 metric tons.

In 2004, the average COMEX price of $1.29 per pound was almost 50 cents above the previous year average. The large increase in price was led by year-on-year consumption growth of approximately 7.5 percent. This was only partially offset by a more modest growth in refined production of 5.1 percent. Consumption was driven by Asia, which we estimate grew approximately 9.7 percent year-on-year led by China, which experienced an estimated 15 percent growth year-on-year. Demand also benefited from a recovery in the U.S. manufacturing sector. We estimate that U.S. copper consumption grew by approximately 9.0 percent year-on-year in 2004. Production increases were drawn from re-started idled capacity and brownfield expansions. Only one significant greenfield project began production in 2004. The imbalance between supply and demand drove exchange inventories down more than 80 percent, or 675,000 metric tons.

In 2003, the average COMEX price of 81 cents per pound was almost 9 cents higher than the 2002 average price. The higher price levels were driven by moderate consumption rates combined with flat production growth and a depreciating U.S. dollar. U.S. economic recovery in the second half of the year combined with continued strong growth rates in Asia, led by China, boosted consumption levels in 2003.

Global demand for copper in 2003 grew by 3.5 percent led by Asia, specifically China, which grew at 18 percent. China s double digit consumption rate continues to be based on domestic economic growth and a burgeoning export market. Speculative activity, in anticipation of a U.S. recovery, reached record levels in October 2003, and led to a large price increase in the 2003 fourth quarter.

On the production side, a number of disruptions due to accidents and strikes offset restarts from some major producers. Global refined production is estimated to have declined slightly (0.3 percent) in 2003. The rise in consumption combined with production disruptions led to an approximate 495,000 metric ton reduction in global exchange inventories, which were just over 800,000 metric tons at year-end 2003. This also led to an estimated deficit for the global copper market of approximately 360,000 metric tons for the year.

Primary Molybdenum Segment

Molybdenum demand is heavily dependent on the worldwide steel industry, which uses the metal as a hardening and corrosion inhibiting agent. Approximately 80 percent of molybdenum is used for this application. The balance is used in specialty chemical applications such as refinery catalysts, water treatment and lubricants.

Molybdenum continued to experience price improvement during 2005 for the fourth straight year, with molybdenum prices in 2005 reaching historical highs. Production increases were primarily experienced in by-product copper production, although North American primary production also experienced an increase resulting principally from an increase in production from the Henderson mine as metal prices improved throughout the year. Production in China remains difficult to estimate; however, based on published reports, production was negatively impacted in several molybdenum producing regions due to new government tax, regulatory and restructuring directives related to safety and environmental concerns and operational issues. Tight supply of western, high-quality materials continued throughout the first half of the year and eased in the second half as demand slowed in the metallurgical segment.

Table of Contents

Supply was also restricted by limited western roaster capacity for much of the year. Some additional roasting capacity became available late in the year. The overall market fundamentals shifted from a supply deficit in the first half of 2005 to a slight supply surplus late in the year.

Annual *Metals Week* Dealer Oxide mean prices averaged $31.73 per pound in 2005, compared with $16.41 per pound in 2004 and $5.32 per pound in 2003. Continued strong demand, which has outpaced supply over the past several years (deficit market conditions), has reduced inventory levels throughout the industry; however, in 2005 concentrate inventory increased due to limited Western roasting capacity. The majority of our molybdenum sales are based on published pricing (*i.e.*, Platts *Metals Week*, *Ryan s Notes* or *Metal Bulletin*), plus a premium. The remaining sales are priced on a fixed basis (capped), or on a variable basis within certain ranges, for periods of varying duration. Given this mix of pricing, Phelps Dodge received an average realized price of $25.88 per pound in 2005, compared with $12.65 per pound in 2004 and $5.79 per pound in 2003, reflecting a broad mix of upgraded molybdenum products as well as technical grade molybdic oxide.

Costs

Worldwide Copper Mining Operations

Energy, including electricity, diesel fuel and natural gas, represents a significant portion of production costs for our operations. The principal sources of energy for our mining operations are electricity, purchased petroleum products and natural gas.

In response to volatile energy markets in 2000 and 2001, we implemented a power cost stabilization plan that moderated electricity-related costs at our U.S. mining operations. Under the plan, we use a combination of multi-year energy contracts that we put in place at favorable points in the price cycle as well as self-generation and natural gas hedging. Additionally, we enter into price protection programs for our diesel fuel and natural gas purchases to protect us against significant short-term upward movements in energy prices while maintaining the flexibility to participate in any favorable price movements. However, because energy is a significant portion of our production costs, we could be negatively impacted by future energy availability issues or increases in energy prices. For example, as our diesel fuel and natural gas price protection programs were extended at gradually increasing price levels, our energy cost per pound of copper increased in 2005. In 2006, we may continue to experience higher energy costs if the current energy commodity prices remain at the levels experienced in 2005 or higher.

We continue to explore alternatives to moderate or offset the impact to increasing energy costs. To address volatility associated with a shortfall of power generation capacity experienced during the 2000 energy crisis in the western United States, in late 2004 we purchased a one-third interest in a partially constructed power plant in New Mexico owned by Duke Energy Luna, LLC. The plant is expected to be operating by the 2006 second quarter. One-third of its electricity (approximately 190 megawatts) is expected to be consumed by PDMC operations in New Mexico and Arizona. This investment in an efficient, low-cost plant, which utilizes natural gas, is expected to continue to stabilize our southwest U.S. operations energy costs and increase the reliability of our energy supply.

To mitigate the Company s exposure to increases in diesel fuel and natural gas prices, we utilize several price protection programs designed to protect the Company against a significant short-term upward movement in prices. The Company s diesel fuel price protection program consists of a combination of purchased, out-of-the-money (OTM) diesel fuel call options and fixed-price diesel fuel swaps for our North American and Chilean operations. The OTM call options give the holder the right, but not the obligation, to purchase a specific commodity at a pre-determined dollar cost, or strike price. OTM call options are options with a strike price above the prevailing market price for that commodity when purchased.

OTM diesel fuel call options mitigate a portion of our exposure to volatile markets by capping the cost of the commodity if prices rise above the strike price. If the price of diesel fuel is less than the strike price, the Company has the flexibility to purchase diesel fuel at prices lower than the strike price and the options expire with no value. The swaps allow us to establish a fixed price for a specific commodity product for delivery during a specific future period.

Our natural gas price protection program consists of purchasing OTM call options for our North American operations. OTM call options cap the commodity purchase cost at the strike price while allowing the Company the

ability to purchase natural gas at a lower cost when market prices are lower than the strike price.

As a result of the above-mentioned programs, in 2005, 2004 and 2003, Phelps Dodge was able to reduce and partially mitigate the impacts of volatile electricity markets and rising diesel fuel and natural gas prices. Nevertheless, we pay more for our energy needs during these times of progressively higher energy prices. For PDMC, energy accounted for 19.5 cents per pound of copper produced in 2005, compared with 14.6 cents in 2004 and 13.5 cents in 2003.

In addition, we realized cost increases in 2005 that were the result of the overall improved business climate. Some of these cost increases were anticipated. For example, we realized additional compensation costs resulting from certain employee bonus and variable compensation programs that are contingent on copper price and/or company performance. Additionally, our decision to bring back into production certain higher-cost properties, in response to very strong demand for copper, has increased our average cost of copper production. Other costs that have increased due to business conditions include taxes, freight and transportation, smelting and refining rates, and materials and supplies that are manufactured from metal or fossil fuels. We would anticipate that at least a portion of these cost increases may reverse in periods of lower metal and commodity prices.

Environmental and Other Regulatory Matters

U.S. Mining Operations

Significant Federal Environmental Programs

Our operations in the United States are subject to stringent federal, state and local laws and regulations related to improving or maintaining environmental quality. Our global operations also are subject to many environmental protection laws in the jurisdictions where we operate. We pursue environmental performance at all of our operations with the same diligence that we pursue financial, health and safety performance. We are committed to pollution prevention and responsible environmental stewardship worldwide.

Table of Contents

Environmental regulatory programs create potential liability for our domestic operations, which may result in requirements to perform environmental investigations or corrective actions under federal and state laws and to federal and state Superfund requirements. (Refer to the discussion of Superfund requirements in Other Environmental Matters on pages 31 through 33.) Major environmental programs and developments of particular interest are summarized in the paragraphs that follow.

Most air emissions from our domestic operations are subject to regulation under the federal Clean Air Act (CAA) and related state laws. These laws impose permitting, performance standards, emission limits, and monitoring and reporting requirements on sources of regulated air pollutants.

Several of our domestic operations have obtained major source operating permits under Title V of the CAA and related state laws. Facilities with a smelter, rod mill, molybdenum roaster or power plants are the primary examples of our operations that are subject to this program. These permits typically do not impose new substantive requirements, but rather incorporate all existing requirements into one permit. However, they can increase compliance costs by imposing new monitoring requirements, such as more frequent emission testing, to demonstrate compliance with existing requirements. The process of developing and renewing these comprehensive permits also can bring to light new or previously unknown agency interpretations of existing regulations, which also may increase compliance costs.

Our smelter is subject to one or more Maximum Achievable Control Technology (MACT) standards under the CAA. These standards do not have immediate compliance dates; instead they allow two or three years after promulgation to provide the opportunity to come into compliance or to reduce emissions to avoid regulation before the compliance date. For example, the copper smelter MACT standard was issued in 2002, and the compliance date for that standard was June 2005. We continue to monitor the development and implementation of other MACT standards.

Most discarded materials from our domestic operations are subject to regulation as solid waste under the federal Resource Conservation and Recovery Act (RCRA) and related state laws. These laws impose design, operating, closure and post-closure care requirements on facilities used to store, treat or dispose of solid waste.

Mineral extraction (mining) and beneficiation (the concentration of economic minerals) occur at our mining operations. The solid wastes uniquely associated with these activities are exempt from hazardous waste regulation. Mineral processing (the segregation of minerals or the alteration of a mineral from one mineralogic state to another) occurs at our smelter, refinery and molybdenum roasting operations. Except for a list of 20 exempt processing wastes (three of which include wastes from copper mineral processing operations), all mineral processing wastes generated at our U.S. Mining Operations are subject to hazardous waste regulation if they exhibit a hazardous waste characteristic or if the U.S. Environmental Protection Agency (EPA) specifically designates them as a listed hazardous waste. In 1998, EPA finalized its supplemental Land Disposal Restriction Phase IV (LDR) rules that imposed regulation on certain hazardous mineral processing wastes. This final LDR rule also subjects certain mineral processing wastes that exhibit a hazardous waste characteristic to stringent treatment standards if the materials are disposed on land. A portion of the LDR rule was judicially vacated on appeal in 2000. While EPA s final LDR rule likely will require us to continue to make expenditures to manage hazardous mineral processing wastes, it is not possible to determine the full impact on us of the new LDR requirements until the requirements are fully adopted and implemented.

The federal Emergency Planning and Community Right-to-Know Act (EPCRA) was expanded in 1997 to cover mining operations. This law requires companies to report to EPA the amount of certain materials managed in or released from their operations each year. Annually, we report a significant volume of naturally occurring minerals and other substances that we managed during the previous year. While these materials are very high in volume, how they are safely managed is governed by existing regulations and permit requirements outside of EPCRA.

The federal National Pollutant Discharge Elimination System (NPDES) program requires a permit for the point source discharge of pollutants to surface waters that qualify as waters of the United States. Although most states, including Arizona and Colorado, have received authorization to implement this program in lieu of EPA, New Mexico has not received such authorization and therefore the NPDES permit program in New Mexico continues to be implemented primarily by EPA. The NPDES permit program also regulates the discharge of stormwater runoff from active and inactive mines and construction activities. EPA and authorized states have issued general permits that cover

stormwater discharges from active and inactive mines. We likely will continue to have to make expenditures to comply with the NPDES permit program, especially as the program continues to expand as applied to stormwater discharges.

The Clean Water Act requires states to periodically evaluate surface waters to determine whether they meet levels of water quality adequate to support the designated uses of the waters as determined by the state. Surface waters that do not meet water quality standards may be identified as impaired waters. Waters listed as impaired must be further evaluated by the state. Unless further study shows that the water is not impaired, the state must establish a total maximum daily load (TMDL) for the water. A TMDL must establish the allowable pollutant load and allocate the allowable load among the sources of the pollutant. Following the establishment of a TMDL, sources of the pollutant may be required to take measures to reduce the pollutant load to acceptable levels. Some of the Company s operations are located in the vicinity of waters that are listed as impaired and for which TMDLs have been or may be established. Operations in the vicinity of such waters may be required to take measures to reduce pollutant loading to the listed waters.

Significant Arizona Environmental and Reclamation Programs

Arizona Department of Environmental Quality (ADEQ) has adopted regulations for its aquifer protection permit (APP) program that replaced the previous Arizona groundwater quality protection permit regulations. Several of our properties continue to operate pursuant to the transition provisions for existing facilities under the APP regulations. The APP regulations require permits for certain facilities, activities and structures for mining, concentrating and

Table of Contents

smelting. The APP requires compliance with aquifer water quality standards at an applicable point of compliance well or location. The APP also may require mitigation and discharge reduction or elimination of some discharges. Existing facilities operating under the APP transition provisions are not required to modify operations until requested by the state of Arizona, or unless a major modification at the facility alters the existing discharge characteristics.

An application for an APP requires a description of a closure strategy to meet applicable groundwater protection requirements following cessation of operations and a cost estimate to implement the closure strategy. An APP may specify closure requirements, which may include post-closure monitoring and maintenance requirements. A more detailed closure plan must be submitted within 90 days after a permittee notifies ADEQ of its intent to cease operations. A permit applicant must demonstrate its financial capability to meet the closure costs required under the APP. In 2005, ADEQ amended the financial assurance requirements under the APP regulations. As a result of the amendments, facilities covered by APPs may have to provide additional financial assurance demonstrations or mechanisms for closure and post-closure costs.

We have received an APP for our Morenci operations, for portions of our Bagdad and Miami mines, for the sewage treatment facility at Ajo, and for a closed tailing impoundment in Clarkdale, Arizona. We have conducted groundwater studies and submitted APP applications for several of our other properties and facilities, including the Bagdad, Sierrita and Miami mines, our Safford development property and Copper Queen and United Verde branches. Permits for most of these other properties and facilities likely will be issued by ADEQ during 2006. We will continue to submit all required APP applications for our remaining properties and facilities, as well as for any new properties or facilities. We do not know what the APP requirements are going to be for all existing and new facilities, and, therefore, it is not possible for us to estimate costs associated with those requirements. For instance, at our Sierrita and Copper Queen properties, ADEQ has proposed detailed requirements to protect public drinking water sources with respect to non-hazardous substances, such as sulfate. We are likely to continue to have to make expenditures to comply with the APP program.

Portions of the Company s Arizona mining operations that operated after January 1, 1986, also are subject to the Arizona Mined Land Reclamation Act (AMLRA). AMLRA requires reclamation to achieve stability and safety consistent with post-mining land use objectives specified in a reclamation plan. Reclamation plans require approval by the State Mine Inspector and must include a cost estimate to perform the reclamation measures specified in the plan. Financial assurance must be provided under AMLRA covering the estimated cost of performing the reclamation plan.

Both under APP regulations and AMLRA, a publicly traded company may satisfy the financial assurance requirements by showing that its unsecured debt rating is investment grade and that it meets certain requirements regarding assets in relation to estimated closure and post-closure cost and reclamation cost estimates. Phelps Dodge s senior unsecured debt currently carries an investment-grade rating. Additionally, the Company currently meets another financial strength test under Arizona law that is not ratings dependent. Under the amended APP regulations, Phelps Dodge may provide guarantees for the financial assurance obligations of its subsidiaries.

At December 31, 2005 and 2004, we had accrued closure costs of approximately $68 million and $48 million, respectively, for our Arizona operations. The amount of financial assurance currently demonstrated for closure and reclamation activities is approximately $104 million.

Cyprus Tohono Corporation (Cyprus Tohono) leases lands on the Tohono O odham Nation (the Nation). The leased lands include the site of a mining operation comprising an open pit, underground mine workings, leach and non-leach rock stockpiles, tailing and evaporation ponds, SX/EW operations and ancillary facilities. Ore mining at Tohono ceased in July 1997, but copper cathode production continued from existing leach stockpiles until early 1999 at which time the site was placed on care-and-maintenance status. As a result of higher copper prices, the facility restarted operations to recover copper from existing leach stockpiles in the 2004 fourth quarter, which allowed initial cathode production in January 2005. Many of these facilities are covered by Mine Plans of Operations (MPOs) that were issued by the federal Bureau of Land Management (BLM). The leases and MPOs impose certain environmental compliance, closure and reclamation requirements upon Cyprus Tohono. The closure and reclamation requirements under the leases require action to be taken upon termination of the leases, which currently expire between 2012 and

2017, unless terminated earlier in accordance with the terms of the leases. Previous studies indicate that closure and reclamation requirements, excluding any potential Superfund environmental response costs, are estimated to cost approximately $5 million; updated studies will be completed in 2006.

The Nation, along with several federal agencies, has notified Cyprus Tohono of groundwater quality concerns and concerns with other environmental impacts of historical mining operations. In 2003, Cyprus Tohono expanded its groundwater-monitoring well network, and samples from a few of the new wells show contaminant values above primary and secondary drinking water standards. Tests of a neighboring Native American village s water supply well indicate elevated concentrations of sulfate. Cyprus Tohono has installed new water wells and provided an alternative water supply to the village.

EPA has completed a Preliminary Assessment and Site Investigation (PA/SI) of the Tohono mine under the federal Superfund program and has concluded that the site is eligible for listing on the National Priorities List. Cyprus Tohono initiated an Engineering Evaluation/Cost Analysis (EE/CA) study of potential remedial alternatives to address the former tailing impoundment and evaporation pond areas; this study has been conducted through the EPA Superfund program s Removal Branch. Based on information in the October 2005 EE/CA, the Company increased its reserve for this Superfund matter from approximately $15 million to approximately $20 million. Cyprus Tohono is subject to financial assurance for mine reclamation. It has provided interim financial assurance in the amount of $5.1 million, of which $5.0 million is in the form of a Company performance guarantee. Cyprus Tohono is evaluating its closure obligations in order to update its closure plans in 2006.

The Company s historical United Verde mine has obtained an APP for closure of a tailing impoundment located near Clarkdale, Arizona, and is awaiting approval of an APP for existing mine water

Table of Contents

discharge containment facilities at the mine near Jerome, Arizona. The tailing impoundment has not received tailing discharges since the early 1950s, but has received discharges of municipal sewage effluent from the town of Clarkdale since the late 1970s. Closure work under the APP for the tailing impoundment has been partially completed, and the Company is seeking an amendment to alter the cap design for final closure. The Company plans on initiating cap construction on the tailing impoundment during 2006. Implementation of the plan under the proposed United Verde mine APP is required under the terms of a Consent Decree settling alleged Clean Water Act violations and entered by the U.S. District Court for the District of Arizona on November 23, 2003. A voluntary remediation project also has commenced under supervision of ADEQ at the nearby historic Iron King mine to manage potential discharges of acidic water from an adit. Additional work may be required at historical mine workings in the district that are owned by the Company to satisfy requirements under stormwater discharge permits. At the United Verde mine, APP and remedial costs are estimated to be approximately $14 million; at the Clarkdale tailing, APP costs are estimated to be approximately $12 million; and at the Iron King mine, voluntary remediation costs are estimated to be approximately $2 million. These amounts, totaling approximately $28 million, were included in environmental reserves at December 31, 2005.

Significant New Mexico Environmental and Reclamation Programs

The Company s New Mexico operations, Chino Mines Company (Chino), Phelps Dodge Tyrone, Inc. (Tyrone), Cobre Mining Company (Cobre) and Phelps Dodge Hidalgo, Inc. (Hidalgo), each are subject to regulation under the New Mexico Water Quality Act and the Water Quality Control Commission (WQCC) regulations adopted under that Act. The New Mexico Environmental Department (NMED) has required each of these operations to submit closure plans for NMED s approval. The closure plans must describe the measures to be taken to prevent groundwater quality standards from being exceeded following closure of the discharging facilities and to abate any groundwater or surface water contamination.

Chino, Tyrone and Cobre also are subject to regulation under the New Mexico Mining Act (the Mining Act), which was enacted in 1993, and the Mining Act Rules, which are administered by the Mining and Minerals Division (MMD) of the New Mexico Energy, Minerals and Natural Resources Department. Under the Mining Act, Chino, Tyrone and Cobre are required to submit and obtain approval of closeout plans describing the reclamation to be performed following closure of the mines or portions of the mines.

Financial assurance is required to ensure that funding will be available to perform both the closure and the closeout plans if the operator is not able to perform the work required by the plans. The amount of the financial assurance is based upon the estimated cost for a third party to complete the work specified in the plans, including any long-term operation and maintenance, such as operation of water treatment systems. NMED and MMD calculate the required amount of financial assurance using a net present value (NPV) method, based upon approved discount and escalation rates, when the closure plan and/or closeout plan require performance over a long period of time.

In April 2005, the governor of New Mexico signed Senate Bill 986, effective June 17, 2005, that removes the requirement to provide financial assurance for the gross receipts tax levied on closure work. Eliminating this requirement is expected to reduce our New Mexico financial assurance by approximately $27 million (NPV basis).

The Company s cost estimates to perform the work itself (internal cost basis) generally are lower than the cost estimates used for financial assurance due to the Company s historical cost advantages, savings from the use of the Company s own personnel and equipment as opposed to third-party contractor costs, and opportunities to prepare the site for more efficient reclamation as mining progresses.

Chino, Tyrone and Cobre each have NMED-issued closure permits and MMD-approved closeout plans. Chino s closure permit was appealed to the WQCC by a third party. The appeal originally was dismissed by the WQCC on procedural grounds, but that decision was overturned by the New Mexico Court of Appeals. Consequently, there may be a hearing on that permit before the WQCC during 2006. Tyrone appealed certain conditions in its closure permit to the WQCC, which upheld the permit conditions. The WQCC s decision is on appeal to the New Mexico Court of Appeals, which held oral argument on the appeal on January 19, 2006. Hidalgo has applied for renewal of its discharge permit, which includes a requirement for an updated closure plan. Hidalgo expects NMED to issue a new

permit, including permit conditions regarding closure and financial assurance, within the next few months.

The terms of the NMED closure permits and MMD-approved closeout plans for Chino, Tyrone and Cobre require the facilities to conduct supplemental studies concerning closure and closeout, including feasibility studies to evaluate additional closure and reclamation alternatives. The feasibility study is due, along with amended closure plans, before the end of the five-year permit terms, which end in 2008 for Chino and Tyrone and in 2009 for Cobre. The terms of the NMED closure permits also require the facilities to prepare and submit abatement plans to address groundwater that exceeds New Mexico groundwater quality standards as well as potential sources of future groundwater contamination. Changes to the existing closure plans and additional requirements arising from the abatement plans could increase or decrease the cost of closure and closeout. Cobre also has submitted an application to MMD and NMED for a standby permit to defer implementation of closure and reclamation requirements while Cobre continues on care-and-maintenance status.

The terms of the permits also require Chino, Tyrone, Cobre and Hidalgo to provide and maintain financial assurance based upon the estimated cost to the state of New Mexico to implement the closure and closeout plans in the event of a default by the operators. The third-party cost estimates for financial assurance under the existing permits are $395 million for Chino, $439 million for Tyrone and $45 million for Cobre on an undiscounted and unescalated basis over the 100-year period of the closure and closeout plans. Hidalgo is updating its cost estimate as part of its pending closure permit renewal. These cost estimates are converted to a NPV basis to determine the amount of financial assurance required for each facility. The current financial assurance amounts are $196 million for Chino, $275 million for Tyrone and $30 million for Cobre. In addition,

Table of Contents

Hidalgo has provided financial assurance for approximately $11 million under the terms of its existing discharge permit.

Up to 70 percent of the financial assurance for Chino, Tyrone and Cobre is in the form of third-party guarantees provided by Phelps Dodge. The terms of the guarantees require Phelps Dodge to meet certain financial tests that, in part, require Phelps Dodge to maintain an investment-grade rating on its senior unsecured debt. Phelps Dodge s senior unsecured debt currently carries an investment-grade rating. In the event of a ratings downgrade below investment-grade, some additional portion of the financial assurance would have to be provided in a different form. The balance of the financial assurance (approximately 30 percent) is provided in the form of trust funds, real estate collateral, surety bonds and letters of credit.

The Company estimates its cost, on an internal cost basis, to perform the requirements of the approved closure and closeout permits to be approximately $287 million for Chino, $354 million for Tyrone and $41 million for Cobre (undiscounted and unescalated) over the 100-year period of the closure and closeout plans. That estimate is lower than the estimated costs used as the basis for financial assurance amounts due to the factors discussed above, and reflects our internal cost estimate. Our cost estimates, on a third-party cost basis used to determine the fair value of our closure and closeout accrual for SFAS No. 143, were approximately $395 million for Chino, $460 million for Tyrone and $47 million for Cobre (undiscounted and unescalated). Tyrone s cost estimate includes approximately $21 million of net costs in addition to the financial assurance cost estimate that primarily relates to an increased scope of work for the tailing, stockpiles and other projects, and updated estimates for actual closure expenditures incurred. Cobre s cost estimate includes approximately $2 million of costs in addition to the financial assurance cost estimate primarily for increased scope of work for stockpiles and characterization studies. At December 31, 2005, we had accrued approximately $65 million for Chino, $186 million for Tyrone, $8 million for Cobre and $4 million for Hidalgo. For comparison, at December 31, 2004, we had accrued approximately $52 million for Chino, $99 million for Tyrone, $7 million for Cobre and $4 million for Hidalgo.

During 2005, Tyrone continued certain closure activities, including completion of a project to remove a portion of the 1C stockpile and initiating reclamation of the area, accelerated reclamation of tailing impoundments located in the Mangas Valley, including completion of reclamation of one tailing impoundment, and commencement of reclamation of a portion of the leach and waste stockpiles. Through December 31, 2005, approximately $39 million has been spent on these actions, including approximately $20 million on the 1C stockpile. In 2005, Tyrone submitted an application to reduce the required amount of financial assurance by $32 million to reflect the completion of the 1C stockpile removal project and 2005 legislation that eliminated a requirement to include New Mexico gross receipts tax in the cost estimates used for financial assurance. On December 12, 2005, the state concurred with the reduction.

In December 1994, Chino entered into an Administrative Order on Consent (AOC) with NMED. The AOC requires Chino to perform a Comprehensive Environmental Response, Compensation and Liability Act (CERCLA) quality investigation of environmental impacts and potential risks to human health and the environment associated with portions of the Chino property affected by historical mining operations. The remedial investigations began in 1995 and are still under way, although substantial portions of the remedial investigations are near completion. The Company expects that some remediation will be required and is considering interim remediation proposals, although no feasibility studies have yet been completed. Chino has begun remediating residential yards in the town of Hurley after agreement was reached with NMED on cleanup levels. NMED has not yet issued a record of decision regarding any additional remediation that may be required under the AOC. The Company s estimated cost for all aspects of the AOC, as of December 31, 2005, is approximately $21 million. In addition to work under the AOC, Chino is continuing ongoing projects to control blowing dust from tailing impoundments at an estimated cost of approximately $5 million. Chino initiated work on excavating and removing copper-bearing material from an area known as Lake One for copper recovery in existing leach stockpiles at the mine. The Company s estimated cost, as of December 31, 2005, for the remaining work at Lake One is approximately $2 million. The Company s aggregate environmental reserve for liability under the Chino AOC, the interim work on the tailing impoundments and Lake One, as described above, is approximately $28 million at December 31, 2005.

Significant Colorado Reclamation Programs

Our Climax and Henderson mines in Colorado are subject to permitting requirements under the Colorado Mined Land Reclamation Act, which requires approval of reclamation plans and provisions for financial assurance. These mines have had approved mined-land reclamation plans for several years and have provided the required financial assurance to the state of Colorado in the amount of $52.4 million and $28.5 million, respectively, for Climax and Henderson. The Climax financial assurance comprises a single surety bond in the amount of $52.4 million. The Henderson financial assurance comprises $18.2 million in collateralized Climax Molybdenum water rights, a $10.1 million surety bond and a letter of credit in the amount of $0.2 million. As a result of adjustments to the approved cost estimates for various reasons, the amount of financial assurance requirements can increase or decrease over time. In 2005, PD finalized Henderson s reclamation plan and related financial assurance with the Colorado Division of Minerals and Geology, which resulted in a revision to our asset retirement obligations (ARO) estimates. At December 31, 2005 and 2004, we had accrued closure costs of approximately $24 million and $20 million, respectively, for our Colorado operations.

Avian Mortalities and Natural Resources Damage Claims

Since the fall of 2000, we have been sharing information and discussing various approaches with the U.S. Fish and Wildlife Service (FWS) in conjunction with the FWS investigations of avian mortalities at some of the Company s mining operations, including Cyprus Tohono, Tyrone, Chino and Morenci. As a result of the FWS investigations, federal authorities have raised issues related to the avian mortalities under two federal laws, the Migratory Bird Treaty Act (MBTA) and the natural resource damages provision of CERCLA. As part of the discussions regarding the MBTA, the FWS has requested that the mining operations undertake various measures to reduce the potential for future avian mortalities, including measures to eliminate or reduce avian access to ponds that contain acidic

Table of Contents

water. The FWS interprets the MBTA as strictly prohibiting the unauthorized taking of any migratory bird, and there are no licensing or permitting provisions under the MBTA that would authorize the taking of migratory birds as a result of industrial operations such as mining.

On August 9, 2004, a plea agreement was entered in the U.S. District Court for the District of Arizona to resolve MBTA charges at Morenci, under which Morenci pled guilty to one misdemeanor count. The plea agreement requires Morenci to implement a corrective action plan to address the avian concerns at that mine during a five-year probation period. The plea agreement also required payment of a $15,000 fine and expenditures totaling $90,000 toward identifying options to conduct mitigation projects and bird rehabilitation.

On August 30, 2005, the United States Court for the District of New Mexico entered a plea agreement to resolve MBTA charges at Tyrone, under which Tyrone also pled guilty to one misdemeanor count. The Tyrone plea agreement is similar to the Morenci plea agreement and requires Tyrone to implement a corrective action plan to address the avian concerns at Tyrone during a five-year probation period. The corrective action plan includes implementation of the tailing closure project required under Tyrone s approved closure and closeout permits. The plea agreement also requires payment of a $15,000 fine and a $15,000 contribution for avian habitat restoration and/or migratory bird studies, and acknowledged a previous $5,000 contribution by Tyrone toward bird rehabilitation.

The Company received a letter, dated August 21, 2003, from the U.S. Department of Interior as trustee for certain natural resources, and on behalf of trustees from the states of New Mexico and Arizona, asserting claims for natural resource damages relating to the avian mortalities and other matters. The notice cited CERCLA and the Clean Water Act and identified alleged releases of hazardous substances at the Chino, Tyrone and Continental (Cobre Mining Company) mines in New Mexico and the Morenci mine in Arizona. In addition to allegations of natural resource damages relating to avian mortalities, the letter alleges injuries to other natural resources, including other wildlife, surface water and groundwater. The letter was accompanied by a Preassessment Screen report. On July 13, 2004, the Company entered into a Memorandum of Agreement (MOA) to conduct a cooperative assessment of the alleged injury. The Company has entered into tolling agreements with the trustees to toll the statute of limitations while the Company and the trustees engage in the cooperative assessment process.

The Bureau of Indian Affairs (BIA) and the Tohono O odham Nation have notified Cyprus Tohono of potential claims for natural resource damages resulting from groundwater contamination and avian mortalities. The Company has entered into a cooperative assessment process with federal and tribal trustees.

On February 6, 2004, the Company received a Notice of Intent to Initiate Litigation for Natural Resource Damages from the New Jersey Department of Environmental Protection for the Company s Port Carteret facility. The Company offered to settle New Jersey s claim through restoration work. The state has not responded to the Company s settlement offer.

The Kansas Trustee Council has notified Cyprus Amax of the Council s intent to perform a natural resource damage assessment in the Cherokee County Superfund site in Cherokee County, Kansas. The Council has initiated the assessment. Cyprus Amax is in settlement discussions with the Council to resolve its potential natural resource damage liabilities at the site.

Significant Changes in International Closure and Reclamation Programs

Sociedad Minera Cerro Verde S.A.A.

On August 15, 2005, the Peruvian Ministry of Energy and Mines published the final regulation associated with the Mine Closure Law. The regulation requires companies to submit closure plans for existing projects within one year after August 15, 2005, and for new projects within one year after approval of the Environment Impact Statement. Additionally, the regulation sets forth the financial assurance requirements, including guidance for calculating the estimated cost and the types of financial assurance instruments that can be utilized.

In accordance with the new regulation, Cerro Verde is required to submit a closure plan before August 15, 2006. Cerro Verde is currently in the process of reviewing the technical requirements and revising its cost estimates both for its existing operations and the sulfide expansion project to comply with the regulation. It is also in the process of determining its financial assurance obligations associated with the new regulation. At both December 31, 2005 and

2004, Cerro Verde had accrued closure costs of approximately $5 million, which were based on the requirements set forth in the environmental permits. Upon completion of its review, Cerro Verde s ARO estimates will be updated.

Other

On February 7, 2004, the Chilean Ministry of Mining published and passed a modification to its mining safety regulations. The current published regulation requires a company to submit a reclamation plan within five years of the published regulation. In the 2005 fourth quarter, El Abra and Candelaria completed their comprehensive review of the revised cost estimates based on existing regulations, which resulted in a revision to the ARO estimates. (Refer to Note 21, Contingencies, for further discussion.) ARO estimates may require further revision if new interpretations or additional technical guidance are published to further clarify the regulation. Final closure plans and related financial assurance requirements will be filed with the Ministry before February 2009. At December 31, 2005 and 2004, we had accrued closure costs of approximately $20 million and $14 million, respectively, for our Chilean operations.

Other

Some portions of our mining operations located on public lands are subject to mine plans of operation approved by the federal BLM. BLM s regulations include financial assurance requirements for reclamation plans required as part of the approved plans of operation. As a result of recent changes to BLM s regulations, including more stringent financial assurance requirements, increases in existing financial assurance amounts held by BLM could be required. Currently, financial assurance for the Company s operations held by BLM totals $3.6 million.

The Company is investigating available options to provide additional financial assurance and, in some instances, to replace existing financial assurance. The cost of surety bonds, the traditional source of financial assurance, has increased significantly during the past few

Table of Contents

years, and many surety companies now are requiring an increased level of collateral supporting the bonds such that they no longer are economically prudent. Some surety companies that issued surety bonds to the Company are seeking to exit the market for reclamation bonds. The terms and conditions presently available from one of our principal surety bond providers for reclamation and other types of long-lived surety bonds have made this type of financial assurance economically impracticable in certain instances. We are working with the impacted state and federal agencies to put in place acceptable alternative forms of financial assurance in a timely fashion.

Portions of Title 30, Chapter 2, of the United States Code govern access to federal lands for exploration and mining purposes (the General Mining Law). In 2003, and again in late 2005, legislation was introduced in the U.S. House of Representatives to amend the General Mining Law. Similar legislation was introduced in Congress during the 1990s. None of these bills has been enacted into law. Concepts in the legislation over the years have included the payment of royalties on minerals extracted from federal lands, payment of fair market value for patenting federal lands and reversion of patented lands used for non-mining purposes to the federal government. Several of these same concepts and others likely will continue to be pursued legislatively in the future.

The federal Endangered Species Act protects species listed by the FWS as endangered or threatened, as well as designated critical habitat for those species. Some listed species and critical habitat may be found in the vicinity of our mining operations. When a federal permit is required for a mining operation, the agency issuing the permit must determine whether the activity to be permitted may affect a listed species or critical habitat. If the agency concludes that the activity may affect a listed species or critical habitat, the agency is required to consult with the FWS concerning the permit. The consultation process can result in delays in the permit process and the imposition of requirements with respect to the permitted activities as are deemed necessary to protect the listed species or critical habitat. The mine operators also may be required to take or avoid certain actions when necessary to avoid affecting a listed species.

We also are subject to federal and state laws and regulations pertaining to plant and mine safety and health conditions. These laws include the Occupational Safety and Health Act of 1970 and the Mine Safety and Health Act of 1977. Present and proposed regulations govern worker exposure to a number of substances and conditions present in work environments. These include dust, mist, fumes, heat and noise. We are making, and will continue to make, expenditures to comply with health and safety laws and regulations.

We estimate that our share of capital expenditures for programs to comply with applicable environmental laws and regulations that affect our mining operations will total approximately $80 million in 2006 and approximately $30 million in 2007; approximately $42 million was spent on such programs in 2005. The increase in environmental capital expenditures for 2006 is primarily due to higher spending associated with accelerated reclamation projects in Arizona and New Mexico, as well as for air and water quality projects. We also anticipate making significant capital and other expenditures beyond 2007 for continued compliance with such laws and regulations. In light of the frequent changes in the laws and regulations and the uncertainty inherent in this area, we are unable to reasonably estimate the total amount of such expenditures over the longer term, but it may be material. (Refer to the discussion of Other Environmental Matters on pages 31 through 33.)

We do not expect that additional capital and operating costs associated with achieving compliance with the many environmental, health and safety laws and regulations will have a material adverse affect on our competitive position relative to other U.S. copper producers. These domestic copper producers are subject to comparable requirements. However, because copper is an internationally traded commodity, these costs could significantly affect us in our efforts to compete globally with those foreign producers not subject to such stringent requirements.

Ownership of Property

U.S. Mining Operations

In the United States, most of the land occupied by our copper and molybdenum mines, concentrators, SX/EW facilities, smelter, refinery, rod mills, and molybdenum roasters, processing facilities and the Climax technology center generally is owned by, or is located on unpatented mining claims owned by, the Company. Certain portions of our Henderson, Miami, Bagdad, Sierrita, Tyrone, Chino and Cobre operations are located on government-owned land

and are operated under a Mine Plan of Operations, or other use permit. The Sierrita operation leases property adjacent to its mine upon which its electrowinning tankhouse is located. Cyprus Tohono Corporation holds leases for land, water and business purposes on land owned by the Tohono O odham Nation. Various federal and state permits or leases on government land are held for purposes incidental to mine operations.

South American Mining

At the Candelaria, Ojos del Salado, El Abra and Cerro Verde operations in South America, mine properties and facilities are controlled through mining concessions under the general mining laws of the relevant country. The concessions are owned or controlled by the operating companies in which the Company or its subsidiaries have an ownership interest.

Primary Molybdenum Operations

Climax s Rotterdam processing operation is located on leased property. The Company has leased the land through a series of three 25-year lease periods that commenced on December 1, 1964. The lease agreement will expire on November 30, 2039, unless the Company chooses not to use its renewal option for the third extension of 25 years, in which case the lease will end on November 30, 2014.

PHELPS DODGE INDUSTRIES

PDI, our manufacturing division, consists of our Wire and Cable segment which produces engineered products principally for the global energy sector. Its operations are characterized by products with significant market share, internationally competitive cost and quality, and specialized engineering capabilities.

In prior years, PDI consisted of two segments Specialty Chemicals and Wire and Cable. On November 15, 2005, the Company entered into an agreement to sell Columbian Chemicals to a company owned jointly by One Equity Partners, a private equity affiliate of JPMorgan Chase & Co., and South Korean-based DC Chemical Co. Ltd. This transaction is expected to be completed in

Table of Contents

the 2006 first quarter. In addition, on November 15, 2005, the Company entered into an agreement to sell substantially all of its North American magnet wire assets to Rea Magnet Wire Company, Inc. (Rea). This transaction was completed on February 10, 2006. In the 2005 Form 10-K, Specialty Chemicals is reflected as a discontinued operation.

The Company is continuing to explore strategic alternatives for Phelps Dodge High Performance Conductors, a unit of the Wire and Cable segment.

Wire and Cable Segment

The Wire and Cable segment, headquartered in Phoenix, Arizona, consists of three worldwide product line businesses comprising magnet wire, energy cables and specialty conductors.

Magnet wire, the insulated conductor used in most electrical motors, was manufactured in 2005 in the United States at our plant in Fort Wayne, Indiana. We also manufactured magnet wire at our wholly owned subsidiary at Monterrey, Mexico during 2005. In 2003, we began construction of a new magnet wire production facility in China. The facility, which is in Suzhou, began production during 2004, and is serving the fast-growing demand for magnet wire in China.

Under the November 15, 2005, agreement, Rea agreed to purchase the North American magnet wire assets, including certain copper inventory, for approximately $125 million in cash, subject to a working capital adjustment at the time of closing. This transaction was completed on February 10, 2006, at which time the working capital adjustment was estimated at approximately $14 million, increasing the estimated sales proceeds to approximately $139 million.

In January 2004, Phelps Dodge Magnet Wire announced plans to consolidate its North American manufacturing operations to reduce costs and strengthen its competitiveness in the global marketplace. This action resulted in special, pre-tax charges of $7.2 million associated with the closure of the manufacturing plant in El Paso, Texas, which ceased operations during the 2004 fourth quarter. During 2005, additional pre-tax asset impairment charges of $2.1 million were recorded at our El Paso, Texas, facility, which were determined through an assessment of fair market value based on projected cash flows.

In the 2004 third quarter, Phelps Dodge Magnet Wire entered into a strategic partnership with Schwering und Hasse Elektrodaht Ltd. in Germany to produce its product at its Lugde, Germany, facility. This action resulted in special, pre-tax charges of $3.3 million associated with the closure of our PD Austria facility, which included severance-related, plant removal and dismantling expenses, and take-or-pay contracts.

In the 2003 fourth quarter, based upon the continuing reduced market conditions in North America for magnet wire, we determined that our Laurinburg, North Carolina, plant would not re-open and its value was written down by $0.5 million to reflect appraised value. At the end of 2002, this facility was temporarily closed with production being shifted to the El Paso, Texas, and Fort Wayne, Indiana, facilities, and its value was written down by $15.3 million.

In addition, as part of annual assessment of goodwill, in the 2003 fourth quarter we recognized an impairment charge of $0.9 million to write off the remaining goodwill balance of Phelps Dodge Magnet Wire, which was based on a comparison of the carrying value to the respective fair value, using an estimate of discounted cash flows.

Phelps Dodge International Corporation manufactures energy cables for international markets in factories located in 10 countries. We provide management, marketing assistance, technical support, and engineering and purchasing services to these companies. Three of our international wire and cable companies have continuous-cast copper rod facilities, and three of our international wire and cable companies have continuous-cast aluminum rod facilities. We have majority interests in companies with production facilities in seven countries Brazil, Chile, Costa Rica, Honduras, Thailand, Venezuela and Zambia. We also have minority interests in companies located in Hong Kong and the Philippines, accounted for on the equity basis, and in a company located in India, accounted for on the cost basis. We operate distribution centers in eight countries in addition to the United States Guatemala, El Salvador, Honduras, Panama, Puerto Rico, Colombia, Ecuador and South Africa.

We manufacture and market highly engineered conductors of copper and copper alloy wire electroplated with silver, tin or nickel for sophisticated, specialty product niches in the aerospace, automotive, biomedical, computer and

consumer electronics markets. Those products are manufactured in plants located in Inman, South Carolina, and Trenton, Georgia. As part of the manufacturing rationalization program originally initiated in 1999, the West Caldwell, New Jersey, plant was temporarily closed in 2002 and its value was written down by $1.6 million. In the 2003 fourth quarter, based upon the continuing reduced market conditions in North America for high performance conductors, we determined that our West Caldwell plant would not re-open and its value was written down by $0.8 million to reflect appraised value. Its productive capacities were transferred to the remaining facilities.

In the 2002 third quarter, actions were taken to improve efficiencies and consolidate certain wire and cable operations. In addition to the above-mentioned closures of our Laurinburg and West Caldwell facilities, we streamlined operational and production support at other high performance conductor facilities in order to reduce costs and increase operating efficiencies, and restructured and consolidated certain administrative functions. The restructuring plan included the reduction of approximately 300 positions and charges associated with employee severance and relocation ($3.9 million) and pension and other postretirement obligations ($2.8 million).

Competition and Markets

Until the sale of our North American magnet wire assets on February 10, 2006, Phelps Dodge was one of the world s largest manufacturers of magnet wire. Our plants draw, roll and insulate copper and aluminum wire that is sold as magnet wire and bare conductors to original equipment manufacturers for use in electric motors, generators, transformers, televisions, automobiles and a variety of small electrical appliances. Magnet wire also was sold to electrical equipment repair shops and smaller original equipment manufacturers through a network of distributors. We principally competed with two international and two U.S. magnet wire producers.

Our international energy cable companies primarily sell products to contractors, distributors, and public and private utilities. Our

Table of Contents

products are used in lighting, power distribution, and other electrical applications. Our competitors range from worldwide wire and cable manufacturers to small local producers.

Our specialty conductors are sold primarily to intermediaries (insulators, assemblers, subcontractors and distributors). Approximately 40 percent of these products ultimately are sold to commercial and military aerospace companies for use in airframes, avionics, space electronics, radar systems and ground control electronics. Specialty conductors also are used in appliances, instrumentation, computers, telecommunications, military electronics, medical equipment and other products. We have two primary U.S. competitors and compete with three importers in the specialty conductor market; however, in those few markets where we compete for high volume products, we face competition from several U.S. fabricators.

Raw Materials and Energy Supplies

The principal raw materials used by our magnet wire manufacturing operations are copper, aluminum and various chemicals and resins used in the manufacture of electrical insulating materials. Most of the copper purchased for our magnet wire operations is from our PDMC division.

The principal raw materials used by our international energy cable companies are copper, copper alloy, aluminum, aluminum alloy, copper-clad steel and various electrical insulating materials.

The specialty conductor product line usually is plated with silver, nickel or tin. With the exception of copper needed in specialty conductors, the majority of the materials used by these companies are purchased from others. We do not believe that the loss of any one supplier would have a material adverse effect on our financial condition or on the results of our operations.

Most of our wire and cable operations generally use purchased electricity and natural gas as their principal sources of energy. Our magnet wire company s principal manufacturing equipment uses natural gas; however, it is also equipped to use alternative fuels.

Ownership of Property

We owned most of the plants and land on which our wire and cable operations are located. The exceptions are the leased land of our Suzhou, China, magnet wire facility and our closed specialty conductor facility in Montville, New Jersey. This land is not material to our overall operations.

On February 10, 2006, we completed the sale of substantially all of our North American magnet wire assets.

Phelps Dodge estimates special, net after-tax charges of approximately $16 million associated with this transaction, mostly resulting from employee-related costs and asset impairment charges. Of this amount, approximately $11 million after-tax was recognized in the 2005 fourth quarter.

Discontinued Operations Columbian Chemicals

Columbian Chemicals and its subsidiaries, previously disclosed as our Specialty Chemicals segment headquartered in Marietta, Georgia, is an international producer and marketer of carbon black. Columbian Chemicals produces a full range of rubber and industrial carbon black in 12 plants worldwide, with approximately 38 percent of its production in North America and the remaining 62 percent at facilities in Europe, Asia and South America. Its El Dorado, Arkansas, plant is idled.

Rubber carbon black improves the tread wear and durability of tires, and extends the service lives of many rubber products, such as belts and hoses. Industrial carbon black is used in such diverse applications as pigmentation of coatings, inks and plastics; ultraviolet stabilization of plastics; and as conductive insulation for wire and cable. Columbian also maintains sales offices worldwide and uses a network of distributors where appropriate.

Extensive research and development is performed at technology centers located at Marietta, Georgia, and Avonmouth, United Kingdom. These technology centers are responsible for studies specific both to industrial and rubber applications of carbon black. Carbon black product and process development at these technology centers is supported by development work at Columbian s plants worldwide.

Beginning in December 2001, Columbian curtailed 54,000 metric tons of annual North American carbon black production at its El Dorado, Arkansas, plant due to significant over-capacity in the U.S. market caused by economic recession. Columbian recognized a full impairment of the plant s fixed assets in the amount of $5.9 million in 2004. The Company will continue to maintain the plant in an idled status, to allow for a restart of operations, until such time

as it is determined there is no possibility of bringing the facility back on line.

Competition and Markets

The principal competitive factors in the various markets in which Columbian Chemicals competes are product quality, customer service, price, dependability of supply, delivery lead time, breadth of product line, and technical service and innovation.

Columbian is among the world s largest producers of carbon black. Approximately 90 percent of the carbon black it produces is used in rubber applications, a substantial portion of which is used in the tire industry. Major tire manufacturers worldwide account for a significant portion of Columbian s carbon black sales. In addition, it has maintained a strong competitive position in both the mechanical rubber goods market and the industrial carbon black market based on a commitment to quality, service and technical innovation. Despite ongoing attempts to substitute carbon black with silica, reclaimed rubber or other materials, none has been able to match the cost and performance of carbon black in its principal applications. The closest successful substitute is a silane-treated silica that has made some in-roads in the tire market due to its increased wet traction characteristics for specific applications.

Including Columbian, there are a total of five major carbon black producers in the United States, three in Canada, three in Western Europe and three in South America. There also are many producers in Asia and Eastern Europe (Russia and the Ukraine). The carbon black industry is highly competitive, particularly in the rubber black market.

Raw Materials and Energy Supplies

Carbon black is produced primarily from heavy residual oil, a by-product of the crude oil refining process. Columbian purchases substantially all of its feedstock at market prices that fluctuate with world oil prices. Residual oil feedstock and other raw materials for the specialty chemicals business are purchased from various

Table of Contents

suppliers. The cost of this feedstock is a significant factor in the cost of carbon black. To achieve satisfactory financial results during periods of high and/or increasing oil prices, Columbian must be able to pass through these high and/or increasing costs to its customers. Hence, Columbian has put in place a number of formula-based contracts that allow selling prices to increase/decrease with feedstock costs. We do not believe that the loss of any one supplier would have a material adverse effect on Columbian s financial condition or results of operations.

Columbian s specialty chemical operations generally use purchased or internally generated electricity and natural gas as their principal sources of energy.

Ownership of Property

Columbian owns all property other than the leased land at its U.K., German and Korean facilities. This leased land is not material to Columbian s overall operations.

Environmental Matters

Columbian s domestic carbon black operations have obtained major source operating permits under Title V of the CAA and related state laws. These permits do not impose new substantive requirements, but rather incorporate in one permit all existing requirements.

Domestic carbon black plants are subject to the carbon black MACT standard issued in 2002. The compliance deadline of July 2005 was met at all facilities, except in the case of the Marshall, West Virginia, plant, which has an extended deadline until April 17, 2006. The Fort Wayne magnet wire plant is subject to the Miscellaneous Metal Parts and Products (MMPP) MACT standard under the federal CAA. The MMPP MACT standard for magnet wire plants was issued in 2003 with a compliance date of 2007. We continue to monitor the development and implementation of other MACT standards.

The European Union (EU) is working on finalizing the Best Available Technology (BAT) for the carbon black industry. The current BAT Reference Document (BREF Note) proposes to control sulfur dioxide emissions by limiting the annual sulfur content in feedstocks to between 0.5 percent to 1.5 percent, depending upon local ambient conditions. The lower part of this range, if adopted, could negatively impact the carbon black industry, including Columbian. Columbian, through the carbon black industry trade association, is actively involved in reviewing with the EU the proposed limits. The BREF Note is expected to be finalized by October 31, 2006, so that BAT can be reflected in EU environmental operating (IPPC) permits that must be issued by the end of October 2007.

The EU, certain other countries and certain states of the United States are beginning to implement greenhouse gas (GHG) reduction plans for various industry segments to meet targets under the Kyoto Treaty. Carbon black production is not currently listed as an activity subject to the European Directive, but will likely be included by certain member states or specifically included in later lists. The initial step is to be identified as a potential GHG generating facility so that a GHG inventory can be developed, with GHG reduction targets ultimately being established by industry sector. Columbian continues to monitor this process.

Because of the frequent changes in environmental laws and regulations and the uncertainty these changes create for us, we are unable to estimate reasonably the total amount of such expenditures over the longer term, but it may be material to Columbian s results of operations. (Refer to the discussion of Other Environmental Matters on pages 31 through 33.)

LABOR MATTERS

The Company employs approximately 15,000 people to sustain its global operations. Approximately 10,500 employees work for PDMC, and most of these employees are not represented by unions. Those PDMC employees represented by unions are listed below, with the approximate number of employees represented and the expiration date of the applicable union agreements. Negotiations for Rotterdam on new agreements began in January 2006 and the union-represented employees continue to work. We expect to reach final agreement during the 2006 first quarter.

Phelps Dodge Mining Company

	Number of Union

Location	Number of Unions	Employees	Expiration Date
El Abra Chile	2	484	Oct-08
Candelaria Chile	2	505	Oct-09
Cerro Verde Peru	1	429	Dec-08
Chino New Mexico	1	289	Nov-09
Rotterdam, The Netherlands	2	41	Dec-05
Stowmarket, United Kingdom	1	44	May-06

In addition, we currently have labor agreements covering most of our U.S. and international manufacturing division plants. Columbian Chemicals (reflected in this Form 10-K as discontinued operations) employs approximately 1,300 individuals. Below is a list of those operations within this segment that have employees who are represented by unions. Also included are the approximate number of employees represented and the expiration date of the applicable union agreements. Negotiations are expected to begin in the first quarter of 2006 in regard to the Trecate, Italy; Yosu, South Korea; Santander, Spain; and North Bend, Louisiana; agreements. Trecate is governed by a national contract that will be announced after the Consumer Price Index (CPI) is determined. Typically the contract is settled mid-year and is retroactive. Wage negotiations for Yosu generally start in the second quarter of the year and are retroactive. Santander negotiations, like Trecate, do not start until after the CPI is established. Negotiations will start mid-year and will be retroactive. North Bend negotiations are currently ongoing. The represented employees at these locations continue to work.

Table of Contents

Columbian Chemicals

Location	Number of Unions	Number of Union Employees	Expiration Date
Trecate, Italy	2	85	Dec-05
Trecate, Italy	1	9	Dec-08
Hamilton, Ontario	1	60	Nov-06
Cubatao, Brazil	1	216	Oct-06
Sao Paulo, Brazil	1	27	Oct-06
Bristol, United Kingdom	2	51	Apr-06
Hannover, Germany	1	50	Mar-07
Yosu, South Korea	1	40	Feb-06
Santander, Spain	1	44	Dec-05
Marshall, West Virginia	2	59	Jun-08
North Bend, Louisiana	1	109	Feb-06

Wire and Cable employs approximately 3,400 people (including employees of the North American magnet wire plants). Employees at Wire and Cable s operations in Bentonville, Arkansas; Inman, South Carolina; Trenton, Georgia; China, Costa Rica, Honduras and Thailand are not represented by any unions. Below is a list of those operations within this segment that have employees who are represented by unions, along with the approximate number of employees represented and the expiration date of the applicable union agreements.

Phelps Dodge Wire and Cable Operations

Location	Number of Unions	Number of Union Employees	Expiration Date
Elizabeth, New Jersey	1	47	Apr-07
Luanshya, Zambia	1	75	Jul-06
Monterrey, Mexico	1	314	Mar-06
Fort Wayne, Indiana	1	172	May-08
Pocos de Caldas, Brazil	1	408	Sep-06
Sao Paulo, Brazil	1	37	Nov-06
Valencia, Venezuela	1	138	Oct-06
Valencia, Venezuela	1	113	Dec-06
Santiago, Chile	1	184	May-07

On November 15, 2005, the Company announced that it had agreed to sell its Columbian Chemicals group and substantially all of Phelps Dodge s North American magnet wire assets. The closing of these transactions will have an impact on the labor matters reported above. With respect to Columbian Chemicals, all of the union-represented employees will remain with that group and will be the responsibility of the new owner. With respect to Wire and Cable, the Monterrey, Mexico, union-represented employees will remain in the employ of Rea and will no longer be the responsibility of Phelps Dodge, while the union-represented employees at the Fort Wayne plant will be separated from service consistent with the sale of the Fort Wayne assets.

In November 2005, the Company exercised its option to acquire a controlling interest in the Tenke Fungurume copper/cobalt mining concessions in the Democratic Republic of the Congo resulting in the addition of two labor agreements presently governed by a National Labor Convention between the Congolese Federation of National Labor

Union Organizations. These labor agreements, covering approximately 95 employees, expired in December 2005. Negotiations on the new labor agreements have been finalized; however, we are awaiting final approval by the Ministry of Labor. The employees represented under these agreements continue to work.

RESEARCH AND DEVELOPMENT

We conduct research and development programs relating to technology for exploration for minerals, mining and recovery of metals from ores, concentrates and solutions, smelting and refining of copper, metal processing, reclamation and remediation, and product and engineered materials development. Research and development programs related to carbon products are conducted through Columbian Chemicals, and wire insulating processes and materials and conductor materials and processes through our Wire and Cable segment. Expenditures for research and development programs, including expenditures associated with discontinued operations, together with contributions to industry and government-supported programs, totaled $48.6 million in 2005, $32.5 million in 2004 and $30.2 million in 2003.

OTHER ENVIRONMENTAL MATTERS

Phelps Dodge is subject to various stringent federal, state and local environmental laws and regulations that govern emissions of air pollutants; discharges of water pollutants; and generation, handling, storage and disposal of hazardous substances, hazardous wastes and other toxic materials. The Company also is subject to potential liabilities arising under CERCLA or similar state laws that impose responsibility on persons who arranged for the disposal of hazardous substances, and on current and previous owners and operators of a facility for the cleanup of hazardous substances released from the facility into the environment, including injuries to natural resources. In addition, the Company is subject to potential liabilities under the RCRA and analogous state laws that require responsible parties to remediate releases of hazardous or solid waste constituents into the environment associated with past or present activities.

Phelps Dodge or its subsidiaries have been advised by EPA, the U.S. Forest Service and several state agencies that they may be liable under CERCLA or similar state laws and regulations for costs of responding to environmental conditions at a number of sites that have been or are being investigated by EPA, the U.S. Forest Service or states to determine whether releases of hazardous substances have occurred and, if so, to develop and implement remedial actions to address environmental concerns. Phelps Dodge also has been advised by trustees for natural resources that the Company may be liable under CERCLA or similar state laws for injuries to natural resources caused by releases of hazardous substances.

Phelps Dodge has established reserves for potential environmental obligations that management considers probable and for which reasonable estimates can be made. For closed facilities and closed portions of operating facilities with environmental obligations, an environmental liability is accrued when a decision to close a facility or a portion of a facility is made by management, and when the environmental liability is considered to be probable. Environ-

Table of Contents

mental liabilities attributed to CERCLA or analogous state programs are considered probable when a claim is asserted, or is probable of assertion, and we have been associated with the site. Other environmental remediation liabilities are considered probable based upon specific facts and circumstances. Liability estimates are based on an evaluation of, among other factors, currently available facts, existing technology, presently enacted laws and regulations, Phelps Dodge s experience in remediation, other companies remediation experience, Phelps Dodge s status as a potentially responsible party (PRP), and the ability of other PRPs to pay their allocated portions. Accordingly, total environmental reserves of $367.9 million and $303.6 million were recorded as of December 31, 2005 and 2004, respectively. The long-term portion of these reserves is included in other liabilities and deferred credits on the Consolidated Balance Sheet and amounted to $285.6 million and $239.5 million at December 31, 2005 and 2004, respectively.

The site currently considered to be the most significant is the Pinal Creek site near Miami, Arizona. The sites with the most significant reserve changes in 2005 were the Anniston Lead and PCB sites, and the Laurel Hill site, and in 2004 the Yonkers site.

Pinal Creek Site

The Pinal Creek site was listed under the ADEQ Water Quality Assurance Revolving Fund program in 1989 for contamination in the shallow alluvial aquifers within the Pinal Creek drainage near Miami, Arizona. Since that time, environmental remediation has been performed by the members of the Pinal Creek Group (PCG), comprising Phelps Dodge Miami, Inc. (a wholly owned subsidiary of the Company) and two other companies. (Refer to page 38 for further discussion of the litigation associated with this site including litigation in respect of other potentially responsible parties.)

While significant recoveries may be achieved in the contribution litigation, the Company cannot reasonably estimate the amount and, therefore, has not taken potential recoveries into consideration in the recorded reserve.

Anniston Lead and PCB Sites

Phelps Dodge Industries, Inc. (PDII) formerly operated a brass foundry in Anniston, Alabama, and has been identified by EPA as a PRP at the Anniston Lead and PCB sites. The Anniston Lead site consists of lead contamination originating from historical industrial operations in and about Anniston; the Anniston PCB site consists of PCB contamination originating primarily from historical PCB manufacturing operations in Anniston. Pursuant to an administrative order on consent/settlement agreement (Settlement Agreement), PDII, along with 10 other parties identified by EPA as PRPs, agreed to conduct a non-time-critical removal action at certain residential properties identified to have lead and PCB contamination above certain thresholds. While PDII and the other parties to the Settlement Agreement have some responsibility to address residential PCB contamination, that responsibility is limited, with EPA characterizing PDII and the parties to the Settlement Agreement as de minimis PRPs. The Settlement Agreement was subject to public comment, which ended on October 11, 2005. Upon EPA issuance of its response to public comment, the Settlement Agreement became final on January 17, 2006. PDII and the other PRPs have entered into an interim cost-sharing agreement that assigns PDII approximately one-eighth of the costs to be incurred under the Settlement Agreement. During the 2005 third quarter, PDII increased its reserve by approximately $20 million to a total reserve of approximately $27 million at December 31, 2005, which covers remedial costs, PRP group settlement costs, and legal and consulting costs.

Laurel Hill Site

Phelps Dodge Refining Corporation, a subsidiary of the Company, owns a portion of the Laurel Hill property in Maspeth, New York, that formerly was used for metal-related smelting, refining and manufacturing. All industrial operations at the Laurel Hill site ceased in 1984. In June 1999, the Company entered into an Order on Consent with New York State Department of Environmental Conservation (NYSDEC) that required the Company to perform, among other things, a remedial investigation and feasibility study relating to environmental conditions and remedial options at the Laurel Hill site. NYSDEC issued a final remedial decision in January 2003 in the form of a Record of Decision (ROD) regarding the property. The Company expects to complete the work under the ROD in 2006.

In July 2002, Phelps Dodge entered into another Order on Consent with NYSDEC requiring the Company to conduct a remedial investigation and feasibility study relating to sediments in Newtown and Maspeth Creeks, which are located contiguous to the Laurel Hill site. The Company commenced the remedial investigation in 2004. The Company is currently scheduled to submit to the NYSDEC in 2006 its remedial investigation report and its remedial feasibility report. The Company is currently engaged in settlement discussions with the NYSDEC concerning the types of remedial actions in the feasibility study that would be acceptable to the agency. Based on the types of remedial actions being discussed and associated transactional costs, the environmental reserve was increased to approximately $20 million in December 2005. The amount encompasses ongoing consulting and legal costs to complete the required studies and assess contributions from other potential parties plus remedial action costs for impacted sediments associated with the Laurel Hill site.

Yonkers Site

In 1984, the Company sold a cable manufacturing facility located in Yonkers, New York. Pursuant to the sales agreement, the Company agreed to indemnify the buyer for certain environmental liabilities at the facility. In 2000, the owner of the property entered into a consent order with the NYSDEC under which the owner committed to complete a remedial investigation and feasibility study. In December 2001, the Company entered into an Interim Agreement with the owner of the property regarding the owner s claim for both contractual and statutory indemnification from the Company for certain environmental liabilities at the facility. The owner submitted its revised feasibility study to NYSDEC in September 2004. On November 30, 2004, NYSDEC issued a Proposed Remedial Action Plan (PRAP) for the Yonkers site. The PRAP accepted the remedy recommendation of the feasibility study, with certain modifications. On December 31, 2004, the Company and the Yonkers site owner finalized a settlement agreement that relieves the Company of financial responsibility for implementation of the NYSDEC s remedy at the Yonkers site. Pursuant to this settlement agreement, the Company agreed to pay a portion of the future anticipated remedial costs, as well as portions of the premiums associated with cost cap and pollution legal liability insurance associated with future site

Table of Contents

remedial actions. In addition, the Company resolved the site owner s claims of contractual and statutory indemnity for past remedial costs at the site. To address all aspects of the settlement agreement, the reserve was increased from approximately $20 million to $50 million during 2004. A partial payment of approximately $43 million was made on December 31, 2004; final payments of approximately $7 million were made in 2005.

Other

In 2005, the Company recognized net charges of $113.4 million for environmental remediation. As discussed above, the sites with significant charges were the Anniston Lead and PCB sites and Laurel Hill sediment site (an increase of $43.2 million). The remainder of environmental remediation charges was primarily at closed sites, none of which increased or decreased individually more than approximately $10 million.

At December 31, 2005, the cost range for reasonably possible outcomes for all reservable environmental remediation sites (including Pinal Creek s estimate of approximately $104 million to $211 million) was estimated from approximately $329 million to approximately $642 million, of which $367.9 million has been reserved. Significant work is expected to be completed in the next several years on the sites that constitute a majority of the reserve balance, subject to inherent delays involved in the remediation process.

Phelps Dodge believes certain insurance policies partially cover the foregoing environmental liabilities; however, some of the insurance carriers have denied coverage. We presently are negotiating with the carriers over some of these disputes. Further, Phelps Dodge believes it has other potential claims for recovery from other third parties, including the United States Government and other PRPs. Neither insurance recoveries nor other claims or offsets are recognized unless such offsets are considered probable of realization. In 2005 and 2004, the Company recognized proceeds from settlements reached with several insurance companies on historical environmental liability claims of $0.6 million and $9.3 million, net of fees and expenses, respectively.

Phelps Dodge has a number of sites that are not the subject of an environmental reserve because it is not probable that a successful claim will be made against the Company for those sites, but for which there is a reasonably possible likelihood of an environmental remediation liability. At December 31, 2005, the cost range for reasonably possible outcomes for all such sites for which an estimate can be made was estimated to be from approximately $2 million to approximately $14 million. The liabilities arising from potential environmental obligations that have not been reserved at this time may be material to the operating results of any single quarter or year in the future. Management, however, believes the liability arising from potential environmental obligations is not likely to have a material adverse effect on the Company s liquidity or financial position as such obligations could be satisfied over a period of years.

Our operations are subject to many environmental laws and regulations in jurisdictions both in the United States and in other countries in which we do business. For further discussion of these laws and regulations, refer to PDMC Environmental and Other Regulatory Matters and PDI - Environmental Matters. The estimates given in those discussions of the capital expenditures to comply with environmental laws and regulations in 2006 and 2007, and the expenditures in 2005 are separate from the reserves and estimates described above.

In July 2005, the Henderson mine and mill, the Miami mine, smelter, refinery and rod plant, the El Paso refinery and rod plant, and the Norwich rod and wire plant received the International Organization for Standardization (ISO) 14001 environmental certification. On January 4, 2006, the Fort Madison molybdenum processing facility received the ISO 14001 environmental certification. The ISO is a worldwide federation of national standards bodies. The International Environmental Management System Standard, also known as 14001, is the recognized standard for environmental management as well as a benchmark for environmental excellence.

The environmental, health and safety committee of the board of directors comprises six non-management directors. The Committee met five times in 2005 to review, among other things, the Company s policies with respect to environmental, health and safety matters, and the adequacy of management s programs for implementing those policies. The committee reports on such reviews and makes recommendations with respect to those policies to the board of directors and to management.

Item 1A. Risk Factors

Copper and Molybdenum Price Volatility May Reduce Our Profits and Cash Flow

Our financial performance is heavily dependent on the price of copper, which is affected by many factors beyond our control. Copper is a commodity traded on the London Metal Exchange (LME), the New York Commodity Exchange (COMEX) and the Shanghai Futures Exchange (SHFE). Most of our copper is sold at prices based on those quoted on the LME or COMEX exchanges. The price of copper as reported on these exchanges is influenced significantly by numerous factors, including (i) the worldwide balance of copper demand and supply, (ii) rates of global economic growth, trends in industrial production and conditions in the housing and automotive industries, all of which correlate with demand for copper, (iii) economic growth and political conditions in China, which has become the largest consumer of refined copper in the world, and other major developing economies, (iv) speculative investment positions in copper and copper futures, (v) the availability and cost of substitute materials and (vi) currency exchange fluctuations, including the relative strength of the U.S. dollar.

The copper market is volatile and cyclical. During the past 15 years, COMEX prices per pound have ranged from a high of $2.28 to a low of 60 cents. Any material change in the price we receive for copper has a significant effect on our results. Based upon expected 2006 annual consolidated production of approximately 2.5 billion to 2.6 billion pounds of copper, each 1 cent per pound change in our average annual realized copper price (or our average annual unit cost of production) causes a variation in annual operating income of up to approximately $26 million, excluding the impact of our copper collars and before taxes and adjustments for minority interests. Consequently, a sustained period of low copper prices would adversely affect our profits and cash flow.

In addition, sustained low copper prices could (i) reduce revenues as a result of production cutbacks due to curtailment of

Table of Contents

operations or temporary or permanent closure of mines or portions of deposits that have become uneconomical at the then-prevailing copper prices, (ii) delay or halt exploration or the development of new process technology or projects and (iii) reduce funds available for exploration and the building of ore reserves.

Our financial performance is also significantly dependent on the price of molybdenum. Molybdenum is characterized by volatile, cyclical prices, even more so than copper. Molybdenum prices are influenced by numerous factors, including (i) the worldwide balance of molybdenum demand and supply, (ii) rates of global economic growth, especially construction and infrastructure activity that requires significant amounts of steel, (iii) the volume of molybdenum produced as a by-product of copper production, (iv) inventory levels, (v) currency exchange fluctuations, including the relative strength of the U.S. dollar and (vi) production costs of U.S. and foreign competitors.

Molybdenum demand depends heavily on the global steel industry, which uses the metal as a hardening and corrosion inhibiting agent. Approximately 80 percent of molybdenum production is used in this application. The remainder is used in specialty chemical applications such as catalysts, water treatment agents and lubricants. Approximately 65 percent of global molybdenum production is a by-product of copper mining, which is relatively insensitive to molybdenum prices. During the past 15 years, *Metals Week* Dealer Oxide prices per pound have ranged from a high of $40.00 to a low of $1.82. A sustained period of low molybdenum prices would adversely affect our profits and cash flows.

Our Copper Price Protection Programs May Cause Significant Volatility in Financial Performance

Our copper price protection programs may cause significant volatility in our financial performance. At December 31, 2005, we had in place zero-premium copper collars for approximately 564 million pounds and 486 million pounds of our expected global copper production for 2006 and 2007, respectively. The annual average LME call strike price (ceiling) on our zero-premium copper collars is $1.632 per pound and $2.002 per pound for 2006 and 2007, respectively. At December 31, 2005, we also had in place copper put options for approximately 564 million pounds and 730 million pounds of our expected global copper production for 2006 and 2007, respectively. The annual average LME put strike price per pound for both 2006 and 2007 is $0.950 per pound. In accordance with generally accepted accounting principles in the United States, we are required to mark-to-market our copper price protection programs each reporting period with the gain or loss recorded in earnings. These adjustments represent non-cash events as the contracts are settled in cash only after the end of the relevant year based on the annual average LME price. For the year ended December 31, 2005, the unrealized pre-tax charges, including premium expense arising from our 2006 and 2007 copper price protection programs, reduced operating income by approximately $224 million. We are unable to estimate any future gains or losses that will be realized under these copper price protection programs.

Increased Energy Costs Could Reduce Our Profitability or Result in Losses

Energy, including electricity, diesel fuel and natural gas, represents a significant portion of the production costs for our operations. The principal sources of energy for our mining operations are electricity, purchased petroleum products and natural gas. The principal sources of energy for our wire and cable operations are purchased electricity and natural gas.

To moderate or offset the impact of increasing energy costs, we use a combination of multi-year energy contracts that we put in place at favorable points in the price cycle as well as self-generation and natural gas hedging. Additionally, we enter into price protection programs for our diesel fuel and natural gas purchases to protect against significant short-term upward movements in energy prices while maintaining the flexibility to participate in any favorable price movements. As a result of these programs, we have reduced and partially mitigated the impacts of volatile electricity markets and rising diesel fuel and natural gas prices. Nevertheless, we pay more for our energy needs during these times of progressively higher energy prices. During 2005, energy accounted for 19.5 cents per pound of copper production, compared with 14.6 cents in 2004 and 13.5 cents in 2003. As energy is a significant portion of our production costs, if we are unable to procure sufficient energy at reasonable prices in the future, it could adversely affect our profits and cash flow.

We Continue to Experience Pressure on Our Copper Production Costs

In recent years we have experienced increases in our worldwide copper production costs. One factor in the increase in average cost of copper production is our decision, in response to very strong demand for copper, to bring back into production certain higher cost properties. In addition to energy, our cash costs are affected by the prices of commodities, such as sulfuric acid, grinding media, liners, explosives and diluent, which we consume or otherwise use in our operations. The prices of such commodities are influenced by supply and demand trends affecting the copper industry in general and other factors, many of which are outside our control, and are at times subject to volatile price movements. Increases in the cost of these commodities could make production at certain of our operations less profitable, even in an environment of relatively high copper prices. Increases in the costs of commodities we consume or otherwise use in our operations may also significantly affect the capital costs of our new projects.

In addition, our cost structure for copper production is generally higher than that of some major copper producers whose principal mines are located outside the United States. This is due to lower ore grades, higher labor costs (including pension and health-care costs) and, in some cases, stricter regulatory requirements.

Our Business Is Subject to Complex and Evolving Laws and Regulations and Environmental and Regulatory Compliance May Impose Substantial Costs on Us

Our global operations are subject to various federal, state and local environmental laws and regulations relating to improving or maintaining environmental quality. Environmental laws often require parties to pay for remedial action or to pay damages regardless of fault and may also often impose liability with respect to divested or

Table of Contents

terminated operations, even if the operations were terminated or divested many years ago. The federal Clean Air Act has had a significant impact, particularly on our smelters and power plants. We also have potential liability for certain sites we currently operate or formerly operated and for certain third-party sites under the federal Superfund law and similar state laws. We are also subject to claims for natural resource damages where the release of hazardous substances is alleged to have injured natural resources.

Our mining operations and exploration activities, both inside and outside the United States, are subject to extensive laws and regulations governing prospecting, development, production, exports, taxes, labor standards, occupational health, waste disposal, protection and remediation of the environment, protection of endangered and protected species, mine safety, toxic substances and other matters. Mining also is subject to risks and liabilities associated with pollution of the environment and disposal of waste products occurring as a result of mineral exploration and production. Compliance with these laws and regulations imposes substantial costs on us and subjects us to significant potential liabilities.

The laws and regulations that apply to us are complex and are continuously evolving in the jurisdictions in which we do business. Costs associated with environmental and regulatory compliance have increased over time, and we expect these costs to continue to increase in the future. In addition, the laws and regulations that apply to us may change in ways that could otherwise have an adverse effect on our operations or financial results. The costs of environmental obligations may exceed the reserves we have established for such liabilities. (Refer to Note 21, Contingencies, for further discussion of our significant environmental matters.)

Mine Closure Regulations May Impose Substantial Costs

Our operations in the United States are subject to various federal and state mine closure and mined-land reclamation laws. The requirements of these laws vary depending upon the jurisdiction. Over the last several years, there have been substantial changes in these laws and regulations in the states in which our mines are located, as well as the regulations promulgated by the federal Bureau of Land Management (BLM), for mining operations located on unpatented mining claims located on federal public lands. The amended BLM regulations governing mined-land reclamation for mining on federal lands will likely increase our regulatory obligations and compliance costs over time with respect to mine closure reclamation. As estimated costs increase, our mines are required to post increasing amounts of financial assurance to ensure the availability of funds to perform future closure and reclamation.

As a result of an agreement we reached with two New Mexico state agencies, the amount of required financial assurance for our Chino, Tyrone and Cobre mines totals approximately $500 million. Approximately 70 percent of such financial assurance either is, or is expected to be, provided in the form of third-party guarantees issued by us on behalf of our operating subsidiaries and the balance, or approximately 30 percent, is expected to be provided in the form of trust funds, real property collateral, surety bonds and letters of credit. The actual amount required for financial assurance is subject to the completion of additional permitting procedures, final agency determinations and the results of administrative appeals, all of which could result in some changes to the closure and reclamation plans and further increases in the cost estimates and our related financial assurance obligations. In addition, our Arizona mining operations have obtained approval of reclamation plans for our mined land and approval of financial assurance totaling approximately $105 million, but applications for approval of closure plans for groundwater quality protection are pending for some portions of our mines. We also have approved mined-land reclamation plans and financial assurance in place for our two Colorado mines totaling approximately $81 million.

Most of the financial assurance provided for our southwestern U.S. mines requires a demonstration that we meet financial tests showing our capability to perform the required closure and reclamation. Demonstrations of financial capability have been made for all of the financial assurance for our Arizona mines. The financial tests required for continued use of the financial capability demonstrations and third-party guarantees include maintaining an investment-grade rating on our senior debt securities. If, in the future, we should no longer maintain an investment-grade rating, we will be required to replace most of the financial assurance currently satisfied through financial demonstrations and third-party guarantees with other forms of financial assurance, such as letters of credit, real property collateral or cash.

The cost of surety bonds (the traditional source of financial assurance) has increased significantly in recent years. Also, many surety companies are now requiring an increased level of collateral supporting the bonds. If surety bonds are unavailable at commercially reasonable terms, we could be required to post other collateral or cash or cash equivalents directly in support of financial assurance obligations.

In addition, our international mines are subject to various mine closure and mined-land reclamation laws. There have recently been significant changes in closure and reclamation programs in Peru and Chile. We cannot estimate the potential impact of these new regulations or any additional changes to regulations in these or other non-U.S. jurisdictions in which we do business at this time.

Levels of Ore Reserves and Mill and Leach Stockpiles Are Subject to Uncertainty and Our Ability to Replenish Ore Reserves Is Important for Long-Term Viability

There are a number of uncertainties inherent in estimating quantities of ore reserves and copper recovered from stockpiles, including many factors beyond our control. Ore reserve estimates are based upon engineering evaluations of assay values derived from samplings of drill holes and other openings. The quantity of copper contained in mill and leach stockpiles is based upon surveyed volumes of mined material and daily production records. The reserve and recoverable copper in stockpiles data included in this annual report are estimates. The volume and grade of ore reserves recovered, rates of production and recovered copper from stockpiles may be less than we anticipate.

Declines in the market price of a particular metal also may render the exploitation of reserves containing relatively lower grades of mineralization uneconomical. If the price we realize for a particular commodity were to decline substantially below the price at which ore reserves were calculated for a sustained period of time, we could experience reductions in reserves resulting in increased depreciation charges and potential asset write-downs. Under some such circumstances, we may discontinue the development of a project or

Table of Contents

mining at one or more properties. Further, changes in operating and capital costs and other factors, including but not limited to short-term operating factors such as the need for sequential development of ore bodies and the processing of new or different ore grades, may reduce ore reserves.

Ore reserves are depleted as we mine. Our ability to replenish our ore reserves is important to our long-term viability. We use several strategies to replenish and grow our copper and molybdenum ore reserves, including exploration and investment in properties located near our existing mine sites, investing in technology that could extend the life of a mine by allowing us to cost-effectively process ore types that were previously considered uneconomic and an exploration strategy that includes pursuing opportunities with joint venture partners. Acquisitions may also contribute to increased ore reserves and we review potential acquisition opportunities on a regular basis.

Operational Risks

Mines by their nature are subject to many operational risks and factors that are generally outside of our control and could impact our business, operating results and cash flows. These operational risks and factors include, but are not limited to (i) unanticipated ground and water conditions and adverse claims to water rights, (ii) geological problems, including earthquakes and other natural disasters, (iii) metallurgical and other processing problems, (iv) the occurrence of unusual weather or operating conditions and other force majeure events, (v) lower than expected ore grades or recovery rates, (vi) accidents, (vii) delays in the receipt of or failure to receive necessary government permits, (viii) the results of litigation, including appeals of agency decisions, (ix) uncertainty of exploration and development, (x) delays in transportation, (xi) labor disputes, (xii) inability to obtain satisfactory insurance coverage, (xiii) unavailability of materials and equipment, (xiv) the failure of equipment or processes to operate in accordance with specifications or expectations, (xv) unanticipated difficulties consolidating acquired operations and obtaining expected synergies and (xvi) the results of financing efforts and financial market conditions.

Our Operations Outside the United States Are Subject to the Risks of Doing Business in Foreign Countries

In 2005, our international operations provided 30 percent of the Company s consolidated sales (including sales through PDMC s U.S. based sales company) and our international operations (including international exploration) contributed 46 percent of the Company s consolidated operating income. We fully consolidate the results of certain of our domestic and international mining operations in which we own less than a 100 percent interest (and report the minority interest). During 2005, our minority partners in our South American mines were entitled to approximately 185,700 tons, or 34 percent, of our international copper production.

Our international activities are conducted in Canada, Latin America, Europe, Asia and Africa, and are subject to certain political and economic risks, including but not limited to (i) political instability and civil strife, (ii) changes in foreign laws and regulations, including those relating to the environment, labor, tax, royalties on mining activities and dividends or repatriation of cash and other property to the United States, (iii) foreign currency fluctuations, (iv) expropriation or nationalization of property, (v) exchange controls and (vi) import, export and trade regulations.

Item 3. Legal Proceedings

I. We are a member of several trade associations that, from time to time, initiate legal proceedings challenging administrative regulations or court decisions that the membership considers to be improper and potentially adverse to their business interests. These legal proceedings are conducted in the name of the trade associations, and the members of the trade association are not parties, named or otherwise.

II. Arizona water regulations, water rights adjudications and other related water cases.

A. General Background

Arizona surface water law is based on the doctrine of prior appropriation (first in time, first in right). Surface water rights in Arizona are usufructuary rights, and as such the water right holder is granted only the right to use public waters for a statutorily defined beneficial use, at a designated location. Groundwater in Arizona is governed by the doctrine of reasonable use. Arizona has initiated two water rights adjudications in order to quantify and prioritize all of the surface water rights and water right claims to two of the state s river systems and sources. Groundwater is not subject to the adjudication; however, wells may be adjudicated to the extent that they are found to produce or impact appropriable surface water. The two adjudication cases that could potentially impact Phelps Dodge s surface water

rights and claims (including some wells) are entitled In Re The General Adjudication of All Rights to Use Water in the Little Colorado Water System and Source, Arizona Superior Court, Apache County, Cause No. 6417 filed on or about February 17, 1978 and In Re The General Adjudication of All Rights to Use Water in the Gila River System and Source, Arizona Superior Court, Maricopa County, Cause Nos. W-1 (Salt), W-2 (Verde), W-3 (Upper Gila), W-4 (San Pedro), (consolidated) filed on February 17, 1978. The major parties in addition to Phelps Dodge in the Gila River adjudication are: Gila Valley Irrigation District, the San Carlos Irrigation and Drainage District, the state of Arizona, the San Carlos Apache Tribe, the Gila River Indian Community, and the United States on behalf of those Tribes, on its own behalf, and on the behalf of the White Mountain Apache Tribe, Ft. McDowell Mohave-Apache Indian Community, Salt River Pima-Maricopa Indian Community and the Payson Community of Yavapai Apache Indians. The major parties in addition to Phelps Dodge in the Little Colorado adjudication are: the state of Arizona, the Salt River Project, Arizona Public Service Company, the Navajo Nation, the Hopi Indian Tribe, the San Juan Southern Paiute Tribe and the United States on behalf of those Indian Tribes, on its own behalf, and on behalf of the White Mountain Apache Tribe.

Phelps Dodge has four active mining operations in Arizona: Morenci, Miami, Sierrita and Bagdad. Each operation requires water for mining and all related support facilities. With the exception of Bagdad, each operation is located in a watershed within an ongoing surface water adjudication. Each operation has sufficient water claims to cover its operational demands. In many instances, the water supply may come from a variety of possible sources. The potential impact of the surface water adjudications on each active operation is discussed below.

Table of Contents

B. Operations

Morenci The Morenci operation is located in eastern Arizona. Morenci water is supplied by a combination of sources, including decreed surface water rights in the San Francisco River, Chase Creek and Eagle Creek drainages, groundwater from the Upper Eagle Creek wellfield, and Central Arizona Project (CAP) water leased from the San Carlos Apache Tribe and delivered to Morenci via exchange through the Black River Pump Station. Phelps Dodge has filed Statements of Claimants in the adjudication for each of its water sources for Morenci except the CAP water.

Phelps Dodge s decreed water rights are subject to the Gila River adjudication and potentially could be impacted. Although the purpose of the adjudication is to determine only surface water rights, wells such as those in the Upper Eagle Creek wellfield may be subject to the Gila River adjudication, but only to the extent those wells may be determined to capture or impact appropriable surface water. The CAP water provided via exchange is not subject to any state adjudication process. The CAP lease became effective as of January 1, 1999, and has a 50-year term.

Miami The Miami operation obtains water from a number of sources in the Salt River watershed. Statements of Claimants have been filed in connection with these water sources, each of which is subject to the adjudication and could be potentially impacted. Miami currently holds a CAP subcontract, although CAP water is not currently used at the operation. CAP water is not subject to adjudication; however, an exchange agreement has been executed to allow the delivery of this water to the Miami operation.

Sierrita The Sierrita operation is located in the Santa Cruz River watershed. The water for the operation is groundwater. The wells that supply the water may be subject to the Gila River adjudication only to the extent that such wells are determined to be pumping or impacting appropriable surface water. Phelps Dodge has filed Statements of Claimants in the adjudication for these water sources in case any are later determined to produce or impact appropriable surface water. In 1980, the Arizona legislature enacted the Arizona Groundwater Code. The Code established Active Management Areas (AMA s) in several groundwater basins, including the Santa Cruz Groundwater Basin. The groundwater at this operation is subject to regulation under the Santa Cruz AMA.

Bagdad The Bagdad operation is located in the Bill Williams River watershed. The water supply includes claims both to surface water and groundwater. There is not an active adjudication proceeding in this watershed; however, the legal precedent set in the active adjudications regarding the determination of whether water pumped from wells is treated as surface water or groundwater may impact the use of water from some wells.

C. Other Arizona Mining Properties

The potential impact of the ongoing adjudication on other mining properties is discussed below.

Safford Water for the planned future operation at Safford may come from a combination of sources. Wells that supply groundwater may be used and those wells will be subject to the adjudication only to the extent that such wells are determined to be pumping or impacting appropriable surface water. CAP water may also be considered for use at the operation some time in the future. CAP water is not subject to adjudication; however, an exchange agreement will need to be negotiated in order to deliver the water. The implementation of such an exchange will require approval of the Globe Equity Court as well as environmental reviews and related agency approvals.

Ajo The potential water supply for Ajo is groundwater. The wells that supply the water may be subject to the Gila River adjudication to the extent that such wells are determined to be pumping or impacting appropriable surface water. Phelps Dodge has filed a Statement of Claimant in the adjudication for these water sources in case any are later determined to produce or impact appropriable surface water.

Bisbee The potential water supply for Bisbee is groundwater. The wells that supply the water may be subject to the Gila River adjudication to the extent that such wells are determined to be pumping or impacting appropriable surface water. Phelps Dodge has filed a Statement of Claimant in the adjudication for these water sources in case any are later determined to produce or impact appropriable surface water.

D. Water Settlements

1. Gila River Indian Community Water Settlement

On May 4, 1998, Phelps Dodge executed a settlement agreement with the Gila River Indian Community (the Community) that resolves the issues between Phelps Dodge and the Community pertinent to the Gila River

adjudication. Since that time, comprehensive settlement negotiations with users all along the Gila River have been initiated. Phelps Dodge s settlement with the Community is now included in the comprehensive settlement. Federal legislation authorizing the settlement was passed in December 2004. The final enforceability date, however, will not occur until certain provisions in the associated agreements are met. The parties have until December 31, 2007, to meet their obligations for the settlement to become enforceable.

2. San Carlos Apache Tribe

In 1997, issues of dispute arose between Phelps Dodge and the San Carlos Apache Tribe (the Tribe) regarding Phelps Dodge s use and occupancy of the Black River Pump Station, which delivers water to the Morenci operation. In May 1997, Phelps Dodge reached an agreement with the Tribe, and subsequently federal legislation (Pub. L. No. 105-18, 5003, 111 stat. 158, 181-87) was adopted. The legislation prescribes arrangements intended to ensure a future supply of water for the Morenci mining complex in exchange for certain payments by Phelps Dodge. The legislation does not address any potential claims by the Tribe relating to Phelps Dodge s historical occupancy and operation of Phelps Dodge facilities on the Tribe s reservation, but does require that any such claims be brought, if at all, exclusively in federal district court. As of this writing, no such claims have been filed.

The 1997 legislation required that the Company and the Tribe enter a lease for the delivery of CAP water through the Black River Pump Station to Morenci on or before December 31, 1998. In the event a lease was not signed, the legislation expressly provided that the legislation would become the lease. On January 24, 2002, a lease between the San Carlos Apache Tribe, Phelps Dodge and the United States was executed (effective as of January 1, 1999) in accordance with that legislation. On the same date, and in accor-

Table of Contents

dance with the legislation, an Exchange Agreement between the San Carlos Apache Tribe, the United States and the Salt River Project Water User s Association was executed and subsequently approved by Phelps Dodge. Since that date, CAP water has been delivered to Morenci. Phelps Dodge has not reached a settlement with the Tribe on general water issues and Phelps Dodge water claims within the Gila River adjudication are still subject to litigation with the Tribe and other parties.

E. Other Related Cases

The following proceedings involving water rights adjudications are pending in the U.S. District Court of Arizona:

1. On June 29, 1988, the Gila River Indian Community filed a complaint-in-intervention in United States v. Gila Valley Irrigation District, et al., and Globe Equity No. 59 (D. Ariz.). The underlying action was initiated by the United States in 1925 to determine conflicting claims to water rights in certain portions of the Gila River watershed. Although Phelps Dodge was named and served as a defendant in that action, Phelps Dodge was dismissed without prejudice as a defendant in March 1935. In June 1935, the Court entered a decree setting forth the water rights of numerous parties, but not Phelps Dodge s. The Court retained, and still has, jurisdiction of the case. The complaint-in-intervention does not name Phelps Dodge as a defendant, however, it does name the Gila Valley Irrigation District as a defendant. Therefore, the complaint-in-intervention could affect the approximately 3,000 acre-feet of water that Phelps Dodge has the right to divert annually from Eagle Creek, Chase Creek or the San Francisco River pursuant to Phelps Dodge s decreed rights and an agreement between Phelps Dodge and the Gila Valley Irrigation District.

During 1997 and 1998, Phelps Dodge purchased farmlands with associated water rights that are the subject of this litigation. As a result, Phelps Dodge has been named and served as a party in this case. The lands and associated water rights are not currently used in connection with any Phelps Dodge mining operation.

Phelps Dodge s Miami operation s predecessor in interest (formerly named Cyprus Miami Mining Corporation) was named and served as a defendant in this action in 1989. These proceedings may affect water rights associated with former Cyprus Miami lands in the Gila River watershed.

2. Prior to January 1, 1983, various Indian tribes filed several suits in the U.S. District Court for the District of Arizona claiming prior and paramount rights to use waters, which at present are being used by many water users, including Phelps Dodge, and claiming damages for prior use in derogation of their allegedly paramount rights. These federal proceedings have been stayed pending state court adjudication.

3. Cyprus Sierrita Corporation s predecessor in interest was a defendant in United States, et al. v. City of Tucson, et al., No. CIV 75-39 (D. Ariz.). This is a consolidation of several actions seeking a declaration of the rights of the United States, the Papago Indian Tribe (now known as the Tohono O odham Nation), and individual allottees of the Tohono O odham Nation, to surface water and groundwater in the Santa Cruz River watershed; damages from the defendants use of surface water and groundwater from the watershed in derogation of those rights; and injunctive relief. Congress in 1982 enacted the Southern Arizona Water Rights Settlement Act, which was intended to resolve the water right claims of the Tohono O odham Nation and its member allottees relating to the San Xavier Reservation and the Schuk Toak District of the Sells Papago Reservation. The allottees contested the validity of the Act and contended that the Court could not dismiss the litigation without their consent. This prompted additional litigation, and eventually culminated in settlement negotiations. The Court suspended most aspects of the litigation to enable the parties to negotiate a settlement with the allottees. The Court s recent attention has been devoted to the composition of appropriate classes of allottees and identification of class representatives, so that any settlement that is reached would bind the allottees. It is anticipated that a settlement and authorizing legislation would conclude all litigation on behalf of the Tohono O odham Nation, its allottee members, and the United States as Trustee for the nation and its allottee members, relating to water rights. Federal legislation has been passed authorizing a settlement. The parties have until December 31, 2007, to finalize the agreements and meet certain obligations for the settlement to become enforceable. The outcome of this dispute could impact water right claims associated with the acquired Cyprus operations at Sierrita, and miscellaneous former Cyprus land holdings in the Santa Cruz River watershed.

III. The Pinal Creek site was listed under the Arizona Department of Environmental Quality s Water Quality Assurance Revolving Fund program in 1989 for contamination in the shallow alluvial aquifers within the Pinal Creek drainage near Miami, Arizona. Since that time, environmental remediation has been performed by members of the Pinal Creek Group (PCG), comprising Phelps Dodge Miami, Inc. (a wholly owned subsidiary of the Company) and two other companies. In 1998, the District Court approved a Consent Decree between the PCG members and the state of Arizona resolving all matters related to an enforcement action contemplated by the state of Arizona against the PCG members with respect to the groundwater matter. The Consent Decree committed Phelps Dodge Miami, Inc. and the other PCG members to complete the remediation work outlined in the Consent Decree. That work continues at this time pursuant to the Consent Decree and consistent with state law and the National Contingency Plan prepared by EPA under CERCLA.

Phelps Dodge Miami, Inc. and the other PCG members have been pursuing contribution litigation against three other parties involved with the site. Phelps Dodge Miami, Inc. dismissed its contribution claims against one defendant when another PCG member agreed to be responsible for any share attributable to that defendant. Phelps Dodge Miami, Inc. and the other members of the PCG settled their contribution claims against another defendant in April 2005, which resulted in cancellation of the Phase I trial. While the terms of the settlement are confidential, the proceeds of the settlement will be used to address remediation at the Pinal Creek site. The Phase II trial, which will allocate liability, is scheduled for October 30, 2006, subject to approval by the trial judge.

Approximately $108 million remained in the Company s Pinal Creek remediation reserve at December 31, 2005. While significant recoveries may be achieved in the contribution litigation, the Company cannot reasonably estimate the amount and, therefore, has not taken potential recoveries into consideration in the recorded reserve.

Table of Contents

IV. Phelps Dodge Tyrone, Inc. (Tyrone) appealed a decision by the New Mexico Water Quality Control Commission (WQCC) upholding certain conditions imposed by the New Mexico Environment Department in Tyrone s Supplemental Discharge Permit for Closure, DP-1341. Phelps Dodge Tyrone, Inc. v. New Mexico Water Quality Control Commission, No. 25027. Oral arguments were held on January 19, 2006. In this case, Tyrone objects to permit conditions requiring Tyrone to perform approximately $75 million of additional closure work. Chino Mines Company s (Chino) Supplemental Discharge Permit for Closure, DP-1340, was appealed by a third party, whose appeal was dismissed by the WQCC on procedural grounds. The WQCC s decision dismissing the appeal was overturned by the New Mexico Court of Appeals. Gila Resources Information Project v. New Mexico Water Quality Control Commission, No. 24,478. The permit decision has been remanded to the WQCC for further proceedings.

V. Since approximately 1990, Phelps Dodge or its subsidiaries have been named as a defendant in a number of product liability or premises lawsuits brought by electricians and other skilled tradesmen or contractors claiming injury from exposure to asbestos found in limited lines of electrical wire products produced or marketed many years ago, or from asbestos at certain Phelps Dodge properties. Phelps Dodge presently believes its liability, if any, in these matters will not have a material adverse effect, either individually or in the aggregate, upon its business, financial condition, liquidity, results of operations or cash flow. There can be no assurance, however, that future developments will not alter this conclusion.

VI. The Company and Columbian Chemicals Company, together with several other companies, were named as defendants in an action entitled Technical Industries, Inc. v. Cabot Corporation, et al., No. CIV 03-10191 WGY, filed on January 30, 2003, in the U.S. District Court in Boston, Massachusetts, and 14 other actions filed in four U.S. district courts, on behalf of a purported class of all individuals or entities who purchased carbon black directly from the defendants since January 1999. The Judicial Panel on Multidistrict Litigation consolidated all of these actions in the U.S. District Court for the District of Massachusetts under the caption In Re Carbon Black Antitrust Litigation. The consolidated amended complaint filed in these actions does not name the Company as a defendant. The consolidated amended complaint, which alleges that the defendants fixed the prices of carbon black and engaged in other unlawful activities in violation of the U.S. antitrust laws, seeks treble damages in an unspecified amount and attorneys fees. The court certified a class that includes all direct purchasers of carbon black in the United States from January 30, 1999 through January 18, 2005. Discovery is ongoing.

A separate action entitled Carlisle Companies Incorporated, et al. v. Cabot Corporation, et al., was filed against Columbian and other defendants on behalf of a group of affiliated companies that opted out of the federal class action. This action, which asserts similar claims as the class action, was filed in the Northern District of New York on July 28, 2005, but was transferred to the District of Massachusetts, where the class action is pending, and has been consolidated with the class action for pretrial purposes.

Actions are pending in state courts in California, Florida, Kansas, South Dakota and Tennessee on behalf of purported classes of indirect purchasers of carbon black in those and six other states, alleging violations of state antitrust and deceptive trade practices laws. Motions to dismiss are pending in the Florida, Kansas and South Dakota actions. A motion for class certification has been filed in the Tennessee action. Similar actions filed in state courts in New Jersey and North Carolina, and additional actions in Florida and Tennessee, have been dismissed. Columbian also has received a demand for relief on behalf of indirect purchasers in Massachusetts, but no lawsuit has been filed.

The Company believes the claims are without merit and intends to defend the lawsuits vigorously.

VII. In October 2005, the Company s wholly owned subsidiary, Western Nuclear, Inc., and two other companies, Kerr McGee Chemical Worldwide, L.L.C. and Fremont Lumber Company (collectively, the PRPs) executed a Consent Decree with the United States resolving claims among the parties, including certain government agencies, for liability associated with the White King/Lucky Lass Uranium Mines site near Lakeview, Oregon (Site). The Consent Decree was entered by the United States District Court, District of Oregon on January 20, 2006, and requires the PRPs to perform remedial design (RD) and remedial action (RA) at the Site, to collectively pay a penalty for alleged failure to comply with a unilateral administrative order (UAO) issued by EPA and to perform a supplemental environmental project at the Site. In exchange, the Government agreed to contribute to the cost associated with the RD and RA at the

Site, and further agreed to provide the PRPs with a covenant not to sue and contribution protection. The PRPs have also resolved liability claims among each other.

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

No matters were submitted during the fourth quarter of 2005 to a vote of security holders through solicitation of proxies or otherwise.

Table of Contents

Executive Officers of Phelps Dodge Corporation

The executive officers of Phelps Dodge Corporation are elected to serve at the pleasure of its board of directors. As of February 27, 2006, the executive officers of Phelps Dodge Corporation were as follows:

Name	Age at 2/27/06	Position	Officer of the Corporation Since
J. Steven Whisler	51	Chairman of the Board and Chief Executive Officer	1987
Timothy R. Snider	55	President and Chief Operating Officer	1997
Ramiro G. Peru	50	Executive Vice President and Chief Financial Officer	1995
David C. Naccarati	53	President, Phelps Dodge Mining Company	
Arthur R. Miele	64	Senior Vice President-Marketing; President, Phelps Dodge Sales Company	1987
Kalidas V. Madhavpeddi	50	Senior Vice President-Asia; President, Phelps Dodge Wire and Cable Group	1999
S. David Colton	50	Senior Vice President and General Counsel	1998
Nancy Mailhot	42	Vice President-Human Resources	2004

Mr. Whisler was elected Chairman of the Company in May 2000, and has been Chief Executive Officer since January 2000. He was President from December 1997 to October 2003 and was also Chief Operating Officer from December 1997 until January 2000. He was President of Phelps Dodge Mining Company, a division of the Company, from 1991 to October 1998.

Mr. Snider was elected President and Chief Operating Officer in November 2003. Prior to that time, Mr. Snider was Senior Vice President of the Company, a position he held since 1998.

Mr. Peru was elected Executive Vice President in October 2004. He was elected Senior Vice President and Chief Financial Officer in January 1999. Prior to that time, Mr. Peru was Senior Vice President for Organization Development and Information Technology, a position he held since January 1997. Prior to that, Mr. Peru was Vice President and Treasurer of the Company, a position he held since 1995.

Mr. Naccarati was appointed to the Company s Senior Management Team, as well as elected President, Phelps Dodge Mining Company, in October 2004. He was elected Vice President, North American Mining, Phelps Dodge Mining Company, in October 2003. Prior to that time, Mr. Naccarati was President, Phelps Dodge Morenci, Inc., a position he held since 2001. Prior to that time, he was President, PD Candelaria, Inc., a position he held since 1999. Prior to that, he was President, Phelps Dodge Tyrone, Inc., a position he held since 1997.

Mr. Miele was elected Senior Vice President-Marketing in June 2000. Prior to that time, he served as Vice President-Marketing since 1987. Mr. Miele is also President, Phelps Dodge Sales Company, a position he has held since October 1987.

Mr. Madhavpeddi was elected Senior Vice President-Asia in October 2004. He was elected President, Phelps Dodge Wire and Cable Group in May 2002 and Senior Vice President, Business Development in November 2000. Prior to that time, Mr. Madhavpeddi was elected Vice President, Business Development in November 1999.

Mr. Colton was elected Senior Vice President in November 1999. He was elected Vice President and General Counsel in April 1998. Prior to that time, Mr. Colton was Vice President and Counsel for Phelps Dodge Exploration, a position he held since 1995.

Ms. Mailhot was elected Vice President-Human Resources and appointed to the Company s Senior Management Team in October 2005. She previously served as Vice President-Global Supply Chain Management since October 2004. Ms. Mailhot joined the Company in March 2001 as Vice President-Global Supply Chain Management for Phelps Dodge Mining Company. Prior to joining the Company, Ms. Mailhot served in various positions with Owens Corning.

Table of Contents

PART II

Item 5. Market for the Registrant s Common Equity and Related Stockholder Matters

The information called for in paragraphs (a) and (b) of Item 5 appears on pages 93 and 94 and page 123 of this report.

(c) Issuer Purchases of Equity Securities

The following table sets forth information with respect to shares of common stock of the Company purchased by the Company during the three months ended December 31, 2005:

Period	(a) Total Number of Shares (or Units) Purchased*	(b) Average Price Paid Per Share (or Unit)	(c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs	(d) Maximum Number (or Approximate Dollar Value) of Shares (or Units) That May Yet Be Purchased Under the Plans or Programs
October 1-31, 2005	851	$ 128.59		
November 1-30, 2005	594	120.94		
December 1-31, 2005	489	140.00		
Total	1,934	129.12		

* This category includes shares repurchased under the Company s applicable stock option and restricted stock plans (Plans) and its non-qualified supplemental savings plan (SSP). Through the Plans, the Company repurchases shares to satisfy tax obligations on restricted stock awards, and in the SSP, the Company repurchases shares as a result of changes in investment elections by plan participants.

Table of Contents

Item 6. Selected Financial Data

The following financial and operating data should be read in conjunction with the information set forth in Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations and the Consolidated Financial Statements and related notes thereto appearing in this Annual Report.

($ in millions except per share and per pound amounts)

	Year Ended December 31,*				
	2005 (a)	2004 (b)	2003 (c)	2002 (d)	2001 (e)
Statement of Operations Data					
Sales and other operating revenues	$ 8,287.1	6,415.2	3,498.5	3,173.2	3,420.4
Operating income (loss)	1,764.9	1,474.9	142.8	(257.4)	(90.6)
Income (loss) from continuing operations before cumulative effect of accounting changes	1,583.9	1,023.6	(21.1)	(356.5)	(377.7)
Income (loss) from discontinued operations, net of taxes**	(17.4)	22.7	39.2	41.3	48.2
Income (loss) before cumulative effect of accounting changes	1,566.5	1,046.3	18.1	(315.2)	(329.5)
Net income (loss)	1,556.4	1,046.3	94.8	(338.1)	(331.5)
Basic earnings (loss) per common share from continuing operations***	16.12	10.82	(0.39)	(4.35)	(4.81)
Diluted earnings (loss) per common share from continuing operations***	15.64	10.35	(0.39)	(4.35)	(4.81)
Basic earnings (loss) per common share from discontinued operations, extraordinary item and cumulative effect of accounting changes***	(0.28)	0.24	1.31	0.22	0.59
Diluted earnings (loss) per common share from discontinued operations, extraordinary item and cumulative effect of accounting changes***	(0.27)	0.23	1.31	0.22	0.59
Basic earnings (loss) per common share***	15.84	11.06	0.92	(4.13)	(4.22)
Diluted earnings (loss) per common share***	15.37	10.58	0.92	(4.13)	(4.22)
Balance Sheet Data (at period end)					
Current assets	$ 4,070.7	2,661.7	1,790.0	1,428.2	1,531.2
Total assets	10,358.0	8,594.1	7,272.9	7,029.0	7,584.3
Total debt	694.5	1,096.9	1,959.0	2,110.6	2,871.6
Long-term debt	677.7	972.2	1,703.9	1,948.4	2,538.3

Shareholders equity	5,601.6	4,343.1	3,063.8	2,813.6	2,730.1
Cash dividends declared per common share	6.25	0.50			0.75
Other Data					
Net cash provided by operating activities	$ 1,769.7	1,700.1	461.6	359.1	310.7
Capital expenditures and investments	698.2	317.3	102.4	133.2	311.0
Net cash (used in) investing activities	(368.0)	(291.0)	(87.7)	(140.3)	(266.8)
Net cash provided by (used in) financing activities	(685.8)	(947.2)	(48.8)	(244.8)	101.0
Division Results					
Phelps Dodge Mining Company operating income (loss)	$ 1,929.9	1,606.7	265.2	(65.0)	(83.6)
Phelps Dodge Industries operating income	14.6	18.8	13.7	(17.5)	12.2
Corporate and other operating loss	(179.6)	(150.6)	(136.1)	(174.9)	(19.2)
	$ 1,764.9	1,474.9	142.8	(257.4)	(90.6)
Copper					
Copper production thousand short tons (h)	1,228.0	1,260.6	1,042.5	1,012.1	1,145.2
Copper sales from own mines thousand short tons (h)	1,238.4	1,268.9	1,052.6	1,034.5	1,156.0
COMEX copper price (per pound) (f)	$ 1.68	1.29	0.81	0.72	0.73
LME copper price (per pound) (g)	$ 1.67	1.30	0.81	0.71	0.72
Commercially recoverable copper (million tons)					
Ore reserves (h)	17.7	23.2	19.5	19.6	22.1
Stockpiles and in-process inventories (h)	1.5	1.6	1.6	1.4	0.9
	19.2	24.8	21.1	21.0	23.0

* 2005 and 2004 reflected full consolidation of El Abra and Candelaria; 2003-2001 reflected El Abra and Candelaria on a pro rata basis (51 percent and 80 percent, respectively). As a result of the Company s agreement to sell Columbian Chemicals Company (Columbian), previously disclosed as our Specialty Chemicals segment, the operating results for Columbian have been reported separately from continuing operations and shown as discontinued operations for all periods presented.

**

Refer to Note 3, Discontinued Operations and Assets Held for Sale, to our Consolidated Financial Statements contained herein for further discussion.

*** Basic and diluted earnings per common share do not reflect the stock split, which was approved by the board of directors on February 1, 2006. Refer to Note 24, Stock Split, for further discussion.

Table of Contents

All references to per share earnings or loss are based on diluted earnings (loss) per share.

(a) Reported amounts included after-tax, net special charges of $331.8 million, or $3.28 per common share, for asset impairment charges; tax expense of $88.1 million, or 87 cents per common share, for foreign dividend taxes; $86.4 million, or 85 cents per common share, for environmental provisions; $42.6 million, or 42 cents per common share, for charges associated with discontinued operations in connection with the pending sale of Columbian; $41.3 million, or 41 cents per common share, for early debt extinguishment costs; $34.5 million (net of minority interest), or 35 cents per common share, for tax on unremitted foreign earnings; $23.6 million, or 23 cents per common share, for a tax charge associated with minimum pension liability reversal; $10.1 million, or 10 cents per common share, for cumulative effect of accounting change; $5.9 million, or 6 cents per common share, for transaction and employee-related costs associated with the sale of North American magnet wire assets; partially offset by special gains of $388.0 million, or $3.83 per common share, for sale of a cost-basis investment; $181.7 million, or $1.80 per common share, for change of interest gains at Cerro Verde and Ojos del Salado; $15.6 million, or 16 cents per common share, for legal matters; $11.9 million, or 12 cents per common share, for the reversal of PD Brazil deferred tax asset valuation allowance; $8.5 million, or 8 cents per common share, for the sale of non-core real estate; $4.0 million, or 4 cents per common share, for the reversal of U.S. deferred tax asset valuation allowance; $0.4 million, or 1 cent per common share, for environmental insurance recoveries; and $0.1 million for Magnet Wire restructuring activities. The after-tax, net special charges of $42.6 million associated with discontinued operations consisted of $67.0 million (net of minority interests), or 66 cents per common share, for a goodwill impairment charge; taxes of $7.6 million, or 8 cents per common share, associated with the sale and dividends paid in 2005; and $5.0 million, or 5 cents per common share, for a loss on disposal of Columbian associated with transaction and employee-related costs; partially offset by a deferred income tax benefit of $37.0 million, or 37 cents per common share.

(b) Reported amounts included after-tax, net special charges of $44.7 million, or 45 cents per common share, for environmental provisions; $30.9 million (net of minority interests), or 31 cents per common share, for early debt extinguishment costs; $9.9 million, or 10 cents per common share, for the write-down of two cost-basis investments; $9.6 million, or 10 cents per common share, for taxes on anticipated foreign dividends; $9.0 million, or 9 cents per common share, for a deferred tax asset valuation allowance at our Brazilian wire and cable operation; $7.6 million, or 8 cents per common share, for Magnet Wire restructuring activities; $5.9 million, or 6 cents per common share, for asset impairments (included $4.5 million, or 4 cents per common share, for discontinued operations); and $0.7 million, or 1 cent per common share, for interest on a Texas franchise tax matter; partially offset by special gains of $30.0 million, or 31 cents per common share, for the reversal of a U.S. deferred tax asset valuation allowance; $15.7 million (net of minority interest), or 16 cents per common share, for the reversal of an El Abra deferred tax asset valuation allowance; $10.1 million, or 10 cents per common share, for the gain on the sale of uranium royalty rights; $7.4 million, or 7 cents per common share, for environmental insurance recoveries; and $4.7 million, or 5 cents per common share, for the settlement of historical legal matters.

(c) Reported amounts included after-tax, net special gains of $2.4 million, or 3 cents per common share, for the termination of a foreign postretirement benefit plan associated with discontinued operations; $0.5 million, or 1 cent per common share, for environmental insurance recoveries; $0.2 million for the reassessment of prior restructuring programs; $6.4 million, or 7 cents per common share, on the sale of a cost-basis investment; $8.4 million, or 9 cents per common share, for cumulative effect of an accounting change; $1.0 million, or 1 cent per common share, for the tax benefit relating to additional 2001 net operating loss carryback; and an extraordinary gain of $68.3 million, or 76 cents per common share, on the acquisition of our partner s one-third interest in Chino Mines Company; partially offset by charges of $27.0 million, or 30 cents per common share, for environmental provisions (included a gain of $0.5 million, or 1 cent per common share, for discontinued operations); $8.0 million, or 9 cents per common share, for a probable Texas franchise tax matter; $2.9 million, or

3 cents per common share, for the settlement of historical legal matters; and $2.6 million, or 3 cents per common share, for asset and goodwill impairments.

(d) Reported amounts included after-tax, net special charges of $153.5 million, or $1.82 per common share, for Phelps Dodge Mining Company asset impairment charges and closure provisions; $53.0 million, or 63 cents per common share, for historical lawsuit settlements; $45.0 million, or 54 cents per common share, for a historical arbitration award; $26.6 million, or 32 cents per common share, for early debt extinguishment costs; $23.0 million, or 27 cents per common share, for Phelps Dodge Industries restructuring activities; $22.9 million, or 27 cents per common share, for cumulative effect of an accounting change; $14.0 million, or 17 cents per common share, for environmental provisions (included a gain of $0.6 million, or 1 cent per common share, for discontinued operations); $1.2 million, or 1 cent per common share, for the write-off of two cost-basis investments; $1.0 million, or 1 cent per common share, for the settlement of legal matters; and $0.5 million, or 1 cent per common share, for the reassessment and additional retirement benefits in connection with prior restructuring programs; partially offset by special gains of $29.1 million, or 35 cents per common share, for environmental insurance recoveries; $22.6 million, or 27 cents per common share, for the gain on the sale of a non-core parcel of real estate; $13.0 million, or 15 cents per common share, for the release of deferred taxes previously provided with regard to Plateau Mining Corporation; and $66.6 million, or 79 cents per common share, for the tax benefit relating to the net operating loss carryback prior to 2002 resulting from a change in U.S. tax legislation; and $0.5 million, or 1 cent per common share, associated with discontinued operations for the reassessment of a prior restructuring program.

(e) Reported amounts included after-tax, net special gains of $61.8 million, or 79 cents per common share, for environmental insurance recoveries; $39.9 million, or 51 cents per common share, for the gain on the sale of Sossego; $9.0 million, or 11 cents per common share, for an insurance settlement for potential future legal matters; offset by special charges of $57.9 million, or 74 cents per common share, to provide a deferred tax valuation allowance; $31.1 million, or 40 cents per common share, for environmental provisions (included $1.4 million, or 2 cents per common share, for discontinued operations); $29.8 million, or 38 cents per common share, for restructuring activities; $12.9 million, or 16 cents per common share, for investment impairments; $2.0 million, or 3 cents per common share, for cumulative effect of an accounting change; and $3.4 million, or 4 cents per common share, for other items, net.

(f) New York Commodity Exchange annual average spot price per pound cathodes.

(g) London Metal Exchange annual average spot price per pound cathodes.

(h) 2005 and 2004 reflected production, sales and commercially recoverable copper on a consolidated basis; 2003-2001 reflected that information on a pro rata basis. The decrease in ore reserves at December 31, 2005, was primarily due to the reduction of the Company s interest in Cerro Verde to 53.6 percent from 82.5 percent, new pit designs at Bagdad, Cerro Verde, Chino, Cobre, Tyrone and Candelaria, as well as 2005 production.

Table of Contents

Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations

The information called for in Item 7 appears on pages 45 through 95 of this report.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

The information called for in Item 7A appears on pages 33 through 36, 45 through 47 and 81 through 87 of this report.

Item 8. Financial Statements and Supplementary Data

The information called for in Item 8 appears on pages 98 through 145 of this report.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A. Controls and Procedures

Disclosure Controls and Procedures

The Company maintains a system of disclosure controls and procedures that is designed to ensure information required to be disclosed by the Company is accumulated and communicated to management, including our chief executive officer and chief financial officer, in a timely manner.

An evaluation of the effectiveness of this system of disclosure controls and procedures was performed under the supervision and with the participation of the Company s management, including the Company s chief executive officer and chief financial officer, as of the end of the period covered by this report. Based upon this evaluation, the Company s management, including the Company s chief executive officer and chief financial officer, concluded that the current system of controls and procedures is effective.

Management s Annual Report on Internal Control over Financial Reporting and Report of Independent Registered Public Accounting Firm

The reports required to be furnished pursuant to this item appear on pages 96 and 97, respectively.

Changes in Internal Control over Financial Reporting

The Company s management, including the Company s chief executive officer and chief financial officer, has evaluated the Company s internal control over financial reporting to determine whether any changes occurred during the period covered by this annual report that have materially affected, or are reasonably likely to materially affect, the Company s internal control over financial reporting. Based on that evaluation, there has been no such change in the Company s internal control over financial reporting that occurred during the year ended December 31, 2005.

Item 9B. Other Information

None.

Table of Contents

MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following provides information that management believes is relevant to an assessment and understanding of the consolidated results of operations and financial condition of Phelps Dodge Corporation (the Company, which also may be referred to as Phelps Dodge, PD, we, us or our). It should be read in conjunction with the Consolidated Financial Statements and accompanying Notes. Our business consists of two major divisions, Phelps Dodge Mining Company (PDMC) and Phelps Dodge Industries (PDI).

The U.S. securities laws provide a safe harbor for certain forward-looking statements. This annual report contains forward-looking statements that involve risks and uncertainties that could cause actual results to differ materially from those projected in such forward-looking statements. Statements regarding the expected commencement dates of operations, projected quantities of commercially recoverable copper and molybdenum from ore reserves and stockpiles, projected quantities of future production, capital costs, production rates, cash flow and other operating and financial data are based on expectations that the Company believes are reasonable, but we can give no assurance that such expectations will prove to have been correct.

Factors that could cause actual results to differ materially include, among others: risks and uncertainties relating to general U.S. and international economic and political conditions; the cyclical and volatile price of copper, molybdenum and other commodities; volatility in our financial performance caused by our copper price protection programs; volatility in energy prices, including the price of electricity, diesel fuel and natural gas; pressure on our copper production costs; the cost of environmental and regulatory compliance; the cost of mine closure regulations, including the ability to obtain surety bonds or other financial assurance for reclamation obligations; uncertainty relating to levels of ore reserves and mill and leach stockpiles; the ability to replenish our copper and molybdenum ore reserves; political and economic risks associated with foreign operations; and operational risks, including: unanticipated ground and water conditions and adverse claims to water rights; geological problems; metallurgical and other processing problems; the occurrence of unusual weather or operating conditions and other force majeure events; lower than expected ore grades and recovery rates; accidents; delays in the receipt of or failure to receive necessary government permits; the results of appeals of agency decisions or other litigation; uncertainty of exploration and development; delays in transportation; labor disputes; inability to obtain satisfactory insurance coverage; unavailability of materials and equipment; the failure of equipment or processes to operate in accordance with specifications or expectations; unanticipated difficulties consolidating acquired operations and obtaining expected synergies; and the results of financing efforts and financial market conditions.

These and other risk factors are discussed in more detail under Risk Factors on pages 33 through 36 and elsewhere herein. Many such factors are beyond our ability to control or predict. Readers are cautioned not to put undue reliance on forward-looking statements. We disclaim any intent or obligation to update these forward-looking statements, whether as a result of new information, future events or otherwise.

Overview of Phelps Dodge Corporation s Businesses and Management s Assessment of Key Factors and Indicators that Could Impact Our Business, Operating Results and Cash Flows

Phelps Dodge is one of the world s leading producers of copper and molybdenum, and is the world s largest producer of molybdenum-based chemicals and continuous-cast copper rod. PDMC is an international business division comprising our vertically integrated copper operations from mining through rod production, marketing and sales; molybdenum operations from mining through conversion to chemical and metallurgical products, marketing and sales; other mining operations and investments; and worldwide mineral exploration, technology and project development programs. Our copper mines include Morenci, Bagdad, Sierrita, Miami, Chino, Cobre, Tyrone and Tohono in the United States and Candelaria, Cerro Verde, El Abra and Ojos del Salado in South America. The Primary Molybdenum segment includes our Henderson and Climax molybdenum mines in the United States.

PDI, our manufacturing division, consists of our Wire and Cable segment which produces engineered products principally for the global energy sector. Its operations are characterized by products with significant market share, internationally competitive costs and quality, and specialized engineering capabilities. Wire and Cable consists of

three worldwide product-line businesses comprising magnet wire, energy cables and specialty conductors.

On November 15, 2005, the Company entered into an agreement to sell Columbian Chemicals Company (Columbian Chemicals or Columbian), previously disclosed as our Specialty Chemicals segment, to a company owned jointly by One Equity Partners, a private equity affiliate of JPMorgan Chase & Co., and South Korean-based DC Chemical Co. Ltd. This transaction is expected to be completed in the 2006 first quarter. As a result of this proposed transaction, the operating results of Columbian, which were previously reported as a segment of PDI, are now reported separately from continuing operations and shown as discontinued operations in the Consolidated Statement of Income. In addition, on November 15, 2005, the Company entered into an agreement to sell substantially all of its North American magnet wire assets to Rea Magnet Wire Company, Inc. This transaction was completed on February 10, 2006. (Refer to Note 3, Discontinued Operations and Assets Held for Sale, for further discussion of these transactions.)

The Company is continuing to explore strategic alternatives for Phelps Dodge High Performance Conductors, a unit of Wire and Cable.

From an overall Phelps Dodge perspective, the most significant risks associated with our businesses, or factors that could impact our businesses, operating results and cash flows, have been described under Risk Factors on pages 33 through 36, which we hereby incorporate into this Management s Discussion and Analysis of Financial Condition and Results of Operations by reference. Below, we describe how certain risks, including the volatility of copper and

Table of Contents

molybdenum prices, increased energy costs, our cost structure, environmental and regulatory compliance, and mine closure regulations, affected our operations and financial results during 2005 and impact our short-term outlook. Additionally, our ability to replenish our copper and molybdenum ore reserves, which are depleted as we mine, is important to our long-term viability.

Markets. Copper is a fundamental material used in residential and commercial construction, electrical and electronics equipment, transportation, industrial machinery and consumer durable goods. Copper is an internationally traded commodity and the copper market is volatile and cyclical. During the past 15 years, the New York Commodity Exchange (COMEX) prices per pound have ranged from a high of $2.28 to a low of 60 cents. Any material change in the price we receive for copper has a significant effect on our results.

After a protracted downturn in demand and correspondingly lower prices that began in the early part of 2000, the market dynamics for copper began improving at the end of 2003 and have continued through 2005.

In 2003, China overtook the United States as the largest consumer of refined copper in the world and during 2005 retained this position. In 2005, global copper production was constrained by numerous production disruptions at mines and smelters throughout the world. Production was affected by many factors including strikes, earthquakes, equipment failures and various other interruptions. This reduced supply more than offset lower consumption growth of 1 to 2 percent during the year. As a result, reported world exchange inventories remained at very low levels throughout 2005, declining from approximately 125,000 metric tons at the end of 2004 to approximately 72,000 metric tons in mid-2005, and increasing to approximately 156,000 metric tons at the end of 2005. For 2005, the copper market continued to be in a deficit of approximately 200,000 metric tons. These market fundamentals, combined with large speculative positions, a weakening U.S. dollar and low U.S. interest rates, resulted in COMEX prices averaging $1.68 per pound in 2005, almost 40 cents above the average for 2004. COMEX copper prices increased to $2.28 per pound at the end of 2005.

Even if global copper production problems do not recur and the copper market returns to a modest surplus, Phelps Dodge expects that continued strong demand for copper, led by China, the expected improvements in consumption in the United States and Europe and the current low inventory levels will continue to support copper prices in 2006.

Molybdenum is characterized by volatile, cyclical prices, even more so than copper. During the past 15 years, *Metals Week* Dealer Oxide prices per pound have ranged from a high of $40.00 to a low of $1.82. Molybdenum experienced a significant price improvement during 2005, far outpacing those recorded in the previous two years. The *Metals Week* Dealer Oxide mean price increased 93 percent from the 2004 mean price of $16.41 per pound to $31.73 per pound in 2005. Global production increased approximately 6 percent in 2005. We estimate that demand increased approximately 3 percent in 2005. In 2006, supply from China is expected to increase; however, it remains difficult to estimate. Molybdenum oxide supply is expected to increase as western roasting capacity restraints are moderated. The stainless steel, specialty steel and specialty chemical sectors are expected to continue to grow, led by capital spending increases and growth in China.

Wire and cable products serve a variety of markets, including energy, construction, consumer and industrial products, aerospace, medical devices, transportation and natural resources. Products include magnet wire, energy cables and specialty conductors. These products advance technology and support infrastructure development in growing regions of the world.

During 2005, wire and cable sales experienced an increase in sales and profitability resulting from increased demand in the international markets. For 2006, wire and cable products are expected to continue to experience an increase in sales and profitability as the U.S., Asian and Latin American economies continue to grow.

Energy Costs. Energy, including electricity, diesel fuel and natural gas, represents a significant portion of the production costs for our operations. During 2005, energy costs increased significantly, affecting our profitability. In 2005, energy accounted for 19.5 cents of our per pound copper production cost, compared with 14.6 cents in 2004 and 13.5 cents in 2003.

To moderate or offset the impact of increasing energy costs, we use a combination of multi-year energy contracts that we put in place at favorable points in the price cycle as well as self-generation and natural gas hedging.

Additionally, we enter into price protection programs for our diesel fuel and natural gas purchases to protect against significant short-term upward movements in energy prices while maintaining the flexibility to participate in any favorable price movements. However, increasing energy costs have affected our profitability. For example, as our diesel fuel and natural gas price protection programs were extended at gradually increasing prices, our energy costs increased to 19.5 cents per pound of copper production. In 2006, we may continue to experience higher energy costs if the current energy commodity prices remain at the levels experienced in 2005.

We continue to explore alternatives to moderate or offset the impact to increasing energy costs. To address volatility associated with a shortfall of power generation capacity experienced during the 2000 energy crisis in the western United States, in late 2004 we purchased a one-third interest in a partially constructed power plant in New Mexico owned by Duke Energy Luna, LLC (Luna). The plant is expected to be operating by the 2006 second quarter. One-third of its electricity (approximately 190 megawatts) is expected to be consumed by PDMC operations in New Mexico and Arizona. This investment in an efficient, low-cost plant is expected to continue to stabilize our southwest U.S. operations energy costs, and increase the reliability of our energy supply.

Cost Structure. We continue to experience increases in our worldwide copper production costs. One factor affecting our increase in average cost of copper production is our decision, in response to strong demand for copper, to return to production certain higher cost properties. Our costs are also affected by the prices of commodities and equipment we consume or use in our operations. In addition, our cost structure for copper production is generally higher than that of some major producers, whose principal mines are located outside the United States. This is due to lower ore grades, higher labor costs (including pension and health-care costs) and, in some cases, stricter

Table of Contents

regulatory requirements. Our competitive cost position receives much attention from senior management and we continue to drive cost savings through common site processes and sharing best practices, as well as developing improvements in technologies.

Environmental and Mine Closure Regulatory Compliance. Our global operations are subject to stringent various federal, state and local laws and regulations related to improving or maintaining environmental quality. Environmental laws often require parties to pay for remedial action or to pay damages regardless of fault and may also often impose liability with respect to divested or terminated operations, even if the operations were terminated or divested many years ago. The amended federal Bureau of Land Management (BLM) regulations governing mined-land reclamation for mining on federal lands will likely increase our regulatory obligations and compliance costs over time with respect to mine closure reclamation. We are also subject to state and international laws and regulations that establish requirements for mined-land reclamation and financial assurance. During 2005, we accelerated certain reclamation and remediation activities on a voluntary basis. In addition, during 2005, the Company s board of directors approved establishing a trust dedicated to help fund our global environmental reclamation and remediation activities. The Company made an initial cash contribution of $100 million to the trust on December 22, 2005, and expects to contribute an additional $300 million in the 2006 first quarter. The Company also has trust assets that are legally restricted to fund a portion of its AROs for Chino, Tyrone and Cobre as required for New Mexico financial assurance. At December 31, 2005 and 2004, the fair value of the trust assets was approximately $191 million and $85 million, respectively, of which approximately $91 million and $85 million, respectively, were legally restricted.

Ore Reserves. We use several strategies to replenish and grow our copper and molybdenum ore reserves. Our first consideration is to invest in mining and exploration properties near our existing operations. These additions allow us to develop adjacent properties with relatively small, incremental investments in operations. On September 16, 2005, the federal BLM completed a land exchange with the Company for property in Safford, Arizona, and on February 1, 2006, the Company s board of directors conditionally approved, subject to obtaining several key state permits, development of a new copper mine on the property. Various resources from our nearby operations and additional local resources will be used to develop the facility. (Refer to PDMC Other Matters on pages 70 and 71 for further discussion.)

Technology innovations not only improve productivity, but also may increase our ore reserves. Developing and applying new technologies, such as our success with solution extraction/electrowinning beginning in the early 1980s, creates the ability to process ore types we previously considered uneconomic. During 2005, the Company successfully tested proprietary technology that more cost-effectively processes chalcopyrite concentrates, which we are planning to use at our expanded Morenci facility. Other technologies are currently being developed and tested for additional ore types.

Our exploration strategy focuses on identifying new mining opportunities in Latin America, Asia, Australia, Central Africa and other regions. In several cases, we pursue these opportunities with joint-venture partners. By working with others, we maximize the potential benefits of our exploration expenditures and spread costs and risks among several parties. For example during 2005, we exercised our option to acquire a 57.75 percent controlling interest in the Tenke Fungurume copper/cobalt mining concessions in the Democratic Republic of the Congo. (Refer to PDMC Other Matters on pages 70 and 71 for further discussion.)

Acquisitions also may contribute to increased ore reserves. If acquisition opportunities present themselves, we consider them, but we pursue them only if they pass our rigorous screenings for adding economic value to the Company.

Critical Accounting Policies and Estimates

Phelps Dodge s discussion and analysis of its financial condition and results of operations are based upon its Consolidated Financial Statements, which have been prepared in accordance with generally accepted accounting principles in the United States (GAAP). The preparation of these financial statements requires our management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the related disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and

expenses during the reporting period. The more significant areas requiring the use of management estimates and assumptions relate to mineral reserves that are the basis for future cash flow estimates and units-of-production depreciation and amortization calculations; environmental and asset retirement obligations; estimates of recoverable copper in mill and leach stockpiles; asset impairments (including estimates of future cash flows); pension, postemployment, postretirement and other employee benefit liabilities; bad debt reserves, realization of deferred tax assets; reserves for contingencies and litigation; and fair value of financial instruments. Phelps Dodge bases its estimates on the Company s historical experience and its expectations of the future and on various other assumptions that are believed to be reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions.

Phelps Dodge believes the following significant assumptions and estimates affect its more critical practices and accounting policies used in the preparation of its Consolidated Financial Statements.

Ore Reserves. Phelps Dodge, at least annually, estimates its ore reserves at active properties and properties on care-and-maintenance status. There are a number of uncertainties inherent in estimating quantities of ore reserves, including many factors beyond the control of the Company. Ore reserve estimates are based upon engineering evaluations of assay values derived from samplings of drill holes and other openings. Additionally, declines in the market price of a particular metal may render certain reserves containing relatively lower grades of mineralization uneconomic to mine. Further, availability of operating and environmental permits, changes in operating and capital costs, and other factors could materially and adversely affect our ore reserve estimates. Phelps Dodge uses its ore reserve estimates in determining the unit basis for units-of-production depreciation and amortization rates, as well as in evaluating mine asset impairments. Changes in ore reserve estimates could significantly affect these items. For example, a 10 percent increase in ore reserves at each mine would decrease total

Table of Contents

depreciation expense by approximately $24 million in 2006; a 10 percent decrease would increase total depreciation expense by approximately $27 million in 2006.

Phelps Dodge s reported ore reserves are economic at the most recent three-year historical average COMEX copper price of $1.26 per pound, and the most recent three-year historical average molybdenum price of $17.82 per pound (*Metals Week* Dealer Oxide mean price).

Asset Impairments. Phelps Dodge evaluates its long-term assets (to be held and used) for impairment when events or changes in economic circumstances indicate the carrying amount of such assets may not be recoverable. Goodwill, investments and long-term receivables, and our identifiable intangible assets are evaluated at least annually for impairment. PDMC s evaluations are based on business plans that are developed using a time horizon that is reflective of the historical, moving average for the full price cycle. We currently use a long-term average COMEX price of 95 cents per pound of copper and an average molybdenum price of $5.00 per pound (*Metals Week* Dealer Oxide mean price), along with near-term price forecasts reflective of the current price environment, for our impairment tests. It should be noted that a long-term copper price of 90 cents per pound was used to develop mine plans and production schedules. PDI s business plans are based on the remaining asset life of the asset group and PDI bases its economic projections on market supply and demand forecasts. We use an estimate of the future undiscounted net cash flows of the related asset or asset grouping over the remaining life to measure whether the assets are recoverable and measure any impairment by reference to fair value. Fair value is generally estimated using the Company s expectation of discounted net cash flows.

The per pound COMEX copper price during the past 10 years, 15 years and 20 years averaged 96 cents, $1.00 and $1.00, respectively. The molybdenum per pound *Metals Week* Dealer Oxide mean price over the same periods averaged $7.63, $6.39 and $5.57, respectively. Should estimates of future copper and molybdenum prices decrease, impairments may result.

Recoverable Copper. Phelps Dodge capitalizes applicable costs for copper contained in mill and leach stockpiles that are expected to be processed in the future. The mill and leach stockpiles are evaluated periodically to ensure that they are stated at the lower of cost or market. Because the determination of copper contained in mill and leach stockpiles by physical count is impractical, we employ reasonable estimation methods.

The quantity of material delivered to mill stockpiles is based on surveyed volumes of mined material and daily production records. Sampling and assaying of blast-hole cuttings determine the estimated amount of copper contained in the material delivered to the mill stockpiles. Expected copper recovery rates are determined by metallurgical testing. The recoverable copper in mill stockpiles can be extracted into copper concentrate almost immediately upon processing. Estimates of copper contained in mill stockpiles are reduced as material is removed and fed to the mill. At December 31, 2005, the estimated amount of recoverable copper contained in mill stockpiles was 0.4 million tons on a consolidated basis (0.3 million tons on a pro rata basis) with a carrying value of $54.9 million. At December 31, 2004, the estimated amount of recoverable copper contained in mill stockpiles was 0.4 million tons on a consolidated basis (0.3 million tons on a pro rata basis) with a carrying value of $56.5 million.

The quantity of material in leach stockpiles is based on surveyed volumes of mined material and daily production records. Sampling and assaying of blast-hole cuttings determine the estimated amount of copper contained in material delivered to the leach stockpiles. Expected copper recovery rates are determined using small-scale laboratory tests, small- and large-scale column testing (which simulates the production-scale process), historical trends and other factors, including mineralogy of the ore and rock type. Estimated amounts of copper contained in the leach stockpiles are reduced as stockpiles are leached, the leach solution is fed to the electrowinning process, and copper cathodes are produced. Ultimate recovery of copper contained in leach stockpiles can vary significantly depending on several variables, including type of processing, mineralogy and particle size of the rock. Although as much as 70 percent of the copper ultimately recoverable may be extracted during the first year of processing, recovery of the remaining copper may take many years. At December 31, 2005, the estimated amount of recoverable copper contained in leach stockpiles was 1.3 million tons on a consolidated basis (1.2 million tons on a pro rata basis) with a carrying value of $115.0 million. At December 31, 2004, the estimated amount of recoverable copper contained in leach stockpiles was

1.4 million tons on a consolidated basis (1.3 million tons on a pro rata basis) with a carrying value of $100.7 million.

Deferred Taxes. In preparing our Consolidated Financial Statements, we recognize income taxes in each of the jurisdictions in which we operate. For each jurisdiction, we estimate the actual amount of taxes currently payable or receivable as well as deferred tax assets and liabilities attributable to temporary differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred income tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which these temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

With the exception of amounts provided for undistributed earnings of Candelaria and El Abra, deferred income taxes have not been provided on our share (approximately $280 million) of undistributed earnings of foreign manufacturing and mining subsidiaries over which we have sufficient influence to control the distribution of such earnings and have determined that such earnings have been reinvested indefinitely.

The recent enactment of the American Jobs Creation Act of 2004 (Act) caused us to re-evaluate our current policy with respect to the repatriation of foreign earnings. The Act allows U.S. corporations to elect to deduct 85 percent of certain cash dividends received from qualifying foreign subsidiaries during a one-year period (2005 for PD), but also results in the loss of any foreign tax credits associated with these earnings. During the 2005 fourth quarter, we completed our evaluation of the repatriation provision and concluded that no election would be made. Our analysis determined that the 85 percent deduction did not result in a tax savings for Phelps Dodge as the U.S.

Table of Contents

tax liability associated with a repatriation of qualifying foreign earnings would be offset by available foreign tax credits.

A valuation allowance is provided for those deferred tax assets for which it is more likely than not that the related benefits will not be realized. In determining the amount of the valuation allowance, we consider estimated future taxable income as well as feasible tax planning strategies in each jurisdiction. If we determine that we will not realize all or a portion of our deferred tax assets, we will increase our valuation allowance with a charge to income tax expense. Conversely, if we determine that we will ultimately be able to realize all or a portion of the related benefits for which a valuation allowance has been provided, all or a portion of the related valuation allowance will be reduced with a credit to income tax expense.

At December 31, 2005, our valuation allowances totaled $363.5 million and covered a portion of our minimum tax credits, a portion of our stock basis differences, a portion of our state net operating loss carryforwards, all of our Peruvian net operating loss carryforwards and all of our U.S. capital loss carryforwards. At December 31, 2004, our valuation allowances totaled $282.8 million and primarily covered a portion of our minimum tax credits, a portion of our state net operating loss carryforwards and the deferred tax assets of our Brazilian wire and cable manufacturing operation.

During 2005, our valuation allowances increased by $80.7 million primarily due to the impact of the U.S. corporate alternative minimum tax and limitations on the utilization of net operating and capital loss carryforwards. The increase comprised valuation allowances attributable to minimum tax credits ($61.2 million), a portion of our stock basis differences ($15.6 million), U.S. capital loss carryforwards ($8.0 million) and Peruvian net operating loss carryforwards ($14.2 million); partially offset by decreases associated with U.S. state net operating loss carryforwards ($9.3 million) and Brazilian net operating loss carryforwards ($9.0 million).

Pension, Postemployment, Postretirement and Other Employee Benefit Liabilities. Phelps Dodge has trusteed, non-contributory pension plans covering substantially all its U.S. employees and some employees of international subsidiaries. The applicable plan design determines the manner in which the benefits are calculated for any particular group of employees.

Under current financial accounting standards, the discount rate used to calculate the actuarial present value of our accumulated pension and other postretirement benefit obligations must be set each year based on current yields available on high-quality corporate bonds. The discount rates for pension, retiree medical, and retiree life were 5.63, 5.37, and 5.41 percent respectively at year end 2005. The discount rates for pension, retiree medical, and retiree life were 5.75, 5.75, and 6.00 percent respectively at year end 2004 and 6.25, 6.25, and 6.25 percent respectively at year end 2003. The discount rate assumption is designed to reflect yields on high-quality, fixed-income investments for a given duration. For our U.S. plans, we utilized a nationally recognized, third-party actuary to assist in the determination of the discount rate based on expected future benefit payments for service to date together with the Citibank Pension Discount Curve. This approach generated a discount rate of approximately 5.63 percent for our U.S. pension plans. Changes in this assumption are reflected in our benefit obligation and, therefore, in the liabilities and income or expense we record. Changes in the discount rate affect several components of pension expense/income, one of which is the amount of the cumulative gain or loss that will be recognized. Because gains or losses are only recognized when they fall outside of a calculated corridor, the effect of changes in the discount rate on pension expense may not be linear. For example, the first four 25-basis-point increases in our assumed discount rate assumption as of the beginning of 2006 would decrease our pension expense by approximately $4 million per year during the next three years. Each of the next four 25-basis-point increases would decrease our pension expense by less than $1 million per year over the next three years. Each 25-basis-point decrease in our assumed discount rate assumption would increase our pension expense by approximately $4 million per year during the next three years. The change would not affect the minimum required contribution.

Our pension plans were valued between December 1, 2003, and January 1, 2004, and between December 1, 2004, and January 1, 2005. Obligations were projected and assets were valued as of the end of 2004 and 2005. The majority of plan assets are invested in a diversified portfolio of stocks, bonds, and cash or cash equivalents. A small portion of

the plan assets is invested in pooled real estate and other private investment funds.

The Phelps Dodge Corporation Defined Benefit Master Trust (Master Trust), which holds plan assets for the Phelps Dodge Retirement Plan and U.S. pension plans for bargained employees, constituted 96 percent of total plan assets as of year-end 2005. These plans accounted for approximately 90 percent of benefit obligations. The investment portfolio for this trust as of year-end 2005 had an asset mix that included 58 percent equities (41 percent U.S. equities, 10 percent international equities and 7 percent emerging market equities), 34 percent fixed income (19 percent U.S. fixed income, 5 percent international fixed income, 3 percent emerging market fixed income, 4 percent U.S. high yield, and 3 percent treasury inflation-protected securities), 5 percent real estate and real estate investment trusts, and 3 percent other.

Our policy for determining asset-mix targets for the Master Trust includes the periodic development of asset/liability studies by a nationally recognized, third-party investment consultant (to determine our expected long-term rate of return and expected risk for various investment portfolios). Management considers these studies in the formal establishment of asset-mix targets that are reviewed by the finance committee of the board of directors.

Our expected long-term rate of return on plan assets is updated at least annually, taking into consideration our asset allocation, historical returns on the types of assets held in the Master Trust, and the current economic environment. Based on these factors, we expect our pension assets will earn an average of 8.5 percent per annum over the 20 years beginning December 1, 2005, with a standard deviation of 10.6 percent. The 8.5 percent estimation was based on a passive return on a compound basis of 8.0 percent and a premium for active management of 0.5 percent reflecting the target asset allocation and current investment array. On an arithmetic average basis, the passive return would have been 8.5 percent with a premium for active management of 0.5 percent. Our rate of return and standard deviation estimates remain unchanged from December 1, 2004.

Table of Contents

For estimation purposes, we assume our long-term asset mix generally will be consistent with the current mix. Changes in our asset mix could impact the amount of recorded pension income or expense, the funded status of our plans and the need for future cash contributions. A lower-than-expected return on assets also would decrease plan assets and increase the amount of recorded pension expense (or decrease recorded pension income) in future years. When calculating the expected return on plan assets, the Company uses a market-related value of assets that spreads asset gains and losses over five years. As a result, changes in the fair value of assets prior to year-end 2005 will be reflected in the results of operations by January 1, 2011. A 25-basis-point increase/decrease in our expected long-term rate of return assumption as of the beginning of 2006 would decrease/increase our pension expense by approximately $3 million per year during the next three years. In addition, a 25-basis-point decrease in the long-term rate of return assumption would not affect the minimum required contribution to our pension plan during the same three-year period. Due to better-than-expected returns in 2003, 2004 and 2005, combined with company contributions made during 2005, there is no minimum 2006 cash contribution for the Phelps Dodge Retirement Plan and U.S. pension plans for bargained employees. We continue to analyze funding strategies and monitor pension reform under various economic scenarios to effectively manage future contribution requirements.

In 2005 and 2004, the Company made cash contributions of $250 million and $85 million, respectively, to the Phelps Dodge Retirement Plan and U.S. pension plans for bargained employees. As a result of these contributions, the entire benefit obligation for these plans is funded at year-end 2005. The Company does not anticipate any further appreciable funding requirements for these plans through 2008.

Phelps Dodge has postretirement medical and life insurance benefit plans covering certain of its U.S. employees and, in some cases, employees of international subsidiaries. During 2005, the Company eliminated postretirement life insurance coverage, unless otherwise provided pursuant to the terms of a collective bargaining agreement, for all active employees who separate from service and retire on or after January 1, 2006. During 2005, the Company also eliminated postretirement medical coverage, unless otherwise provided pursuant to the terms of a collective bargaining agreement, for employees hired or rehired on or after February 1, 2005. Postretirement benefits vary among plans, and many plans require contributions from retirees. We account for these benefits on an accrual basis. Our funding policy provides that contributions to our postretirement and other employee benefits, other than pensions, shall be at least equal to our cash basis obligation, plus additional amounts that may be approved by us from time to time.

In December 2005, the Company s board of directors approved establishing two trusts, one dedicated to funding postretirement medical obligations and the other dedicated to funding postretirement life insurance obligations, for eligible U.S. retirees. These trusts were established in connection with certain employee benefit plans sponsored by the Company and are intended to constitute Voluntary Employees Beneficiary Association (VEBA) trusts under Section 501(c)(9) of the Internal Revenue Code. The trusts will help provide assurance to participants in these plans that the Company will continue to have funds available to meet its obligations under the covered retiree medical and life insurance programs. The trusts, however, will not reduce retiree contribution obligations that help fund these benefits and will not guarantee that retiree contribution obligations will not increase in the future. On December 21, 2005, the Company contributed a total of $200 million to these trusts, consisting of $175 million for postretirement medical obligations and $25 million for postretirement life insurance obligations.

Assumed health-care cost trend rates have a significant effect on the amounts reported for the health-care plan. The medical care cost trend rates for major medical and basic only plans over the next year are assumed to be approximately 10 percent and approximately 8 percent, respectively. The rate to which the cost trend rate is assumed to decline (*i.e.,* the ultimate trend rate) is 5 percent by 2012. A 1 percentage-point increase in the assumed health-care cost trend rate would increase net periodic benefit cost by approximately $1 million and increase our postretirement benefit obligation by approximately $14 million; a 1 percentage-point decrease in the assumed health-care cost trend rate would decrease net periodic benefit cost by approximately $1 million and decrease our postretirement benefit obligation by approximately $12 million. The long-term expected rate of return on plan assets for our postretirement medical and life insurance benefit plans and the discount rate were determined on the same basis as our pension plan.

Based on our asset allocation, historical returns on the types of assets held in the trust, and the current economic environment, we expect our postretirement medical and life insurance benefit assets will earn an average of 3.50 and 5.00 percent per annum, respectively over the long-term beginning January 1, 2006. The Citibank Pension Discount Curve together with projected future cash flow from the postretirement medical and life insurance benefit plans resulted in discount rates of approximately 5.37 percent for the retirement medical plan and 5.41 percent for the retiree life plan. Changes in this assumption are reflected in our benefit obligation and, therefore, in our liabilities and income or expense we record. Changes in the discount rate affect several components of periodic benefit expense/income, one of which is the amount of the cumulative gain or loss that will be recognized. Because gains or losses are only recognized when they fall outside of a calculated corridor, the effect of changes in the discount rate on postretirement expense may not be linear. For example, the first four 25-basis-point increases in our assumed discount rate assumption as of the beginning of 2006 would decrease our periodic benefit cost by less than $1 million per year during the next three years. The first two 25-basis-point decreases in our assumed discount rate assumption would increase our periodic benefit cost by less than $1 million per year during the next three years. The next 25-basis-point decrease would not affect our periodic benefit cost over the next three years, and the next 25-basis-point decrease in the assumed discount rate would decrease our periodic benefit cost by less than $1 million per year during the next three years.

Environmental Obligations. Phelps Dodge develops natural resources and creates products that contribute to an enhanced standard of living for people throughout the world. Our mining, exploration, production and historic operating activities are subject to

Table of Contents

various laws and regulations governing the protection of the environment which require, from time to time, significant expenditures. These environmental expenditures for closed facilities and closed portions of operating facilities are expensed or capitalized depending upon their future economic benefits. The general guidance provided by U.S. GAAP requires that liabilities for contingencies be recorded when it is probable that a liability has been incurred before the date of the balance sheet and that the amount can be reasonably estimated. (Refer to Note 1, Summary of Significant Accounting Policies, for further discussion on our accounting policy for environmental expenditures.)

Significant management judgment and estimates are required to comply with this guidance. Accordingly, each month senior management reviews with the Company s environmental remediation management, as well as with its financial and legal management, changes in facts and circumstances associated with its environmental obligations. The judgments and estimates are based upon available facts, existing technology, and current laws and regulations, and they take into consideration reasonably possible outcomes. The estimates can change substantially as additional information becomes available regarding the nature or extent of site contamination, required remediation methods, and other actions by or against governmental agencies or private parties.

At December 31, 2005, environmental reserves totaled $367.9 million for environmental liabilities attributed to Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) or analogous state programs and for estimated future costs associated with environmental matters at closed facilities and closed portions of certain facilities. The cost range for reasonably possible outcomes for all reservable remediation sites for which a liability was recognized was estimated to be from approximately $329 million to $642 million.

Phelps Dodge has a number of sites that are not the subject of an environmental reserve because it is not probable that a successful claim will be made against the Company for those sites, but for which there is a reasonably possible likelihood of an environmental remediation liability. At December 31, 2005, the cost range for reasonably possible outcomes for all such sites was estimated to be from approximately $2 million to $14 million. The liabilities arising from potential environmental obligations that have not been reserved at this time may be material to the operating results of any single quarter or year in the future. Management, however, believes the liability arising from potential environmental obligations is not likely to have a material adverse effect on the Company s liquidity or financial position as such obligations could be satisfied over a period of years.

Reclamation. Reclamation is an ongoing activity that occurs throughout the life of a mine. Effective January 1, 2003, we adopted Statement of Financial Accounting Standards (SFAS) No. 143, Accounting for Asset Retirement Obligations. We recognize asset retirement obligations (AROs) as liabilities when incurred, with the initial measurement at fair value. These liabilities are accreted to full value over time through charges to income. In addition, asset retirement costs (ARCs) are capitalized as part of the related asset s carrying value and are depreciated primarily on a units-of-production basis over the asset s useful life. Reclamation costs for future disturbances will be recognized as an ARO and as a related ARC in the period incurred. The Company s cost estimates are reflected on a third-party cost basis and comply with the Company s legal obligation to retire tangible long-lived assets as defined by SFAS No. 143. These cost estimates may differ from financial assurance cost estimates due to a variety of factors, including obtaining updated cost estimates for reclamation activities, the timing of reclamation activities, changes in the scope of reclamation activities and the exclusion of certain costs not accounted for under SFAS No. 143.

Effective December 31, 2005, we adopted Financial Accounting Standards Board s (FASB) Interpretation No. 47, Accounting for Conditional Asset Retirement Obligations an Interpretation of FASB Statement No. 143 (FIN 47). With the adoption of this Interpretation, we recognize conditional AROs as liabilities when sufficient information exists to reasonably estimate the fair value. Any uncertainty about the amount and/or timing of future settlement of a conditional ARO is factored into the measurement of the liability.

(Refer to Note 1, Summary of Significant Accounting Policies, for further discussion of our accounting policy for asset retirement obligations and the impacts of adoption of SFAS No. 143 and FIN 47.)

Generally, ARO activities are specified by regulations or in permits issued by the relevant governing authority. Significant management judgment and estimates are required in estimating the extent and timing of expenditures based on life-of-mine planning. Accordingly, each quarter senior management reviews with the Company s

environmental and remediation management, as well as its financial and legal management, changes in facts and circumstances associated with its AROs. The judgments and estimates are based upon available facts, existing technology and current laws and regulations, and they take into consideration reasonably possible outcomes.

At December 31, 2005, AROs totaled $398.4 million, compared with estimated ARO costs, including anticipated future disturbances, of approximately $1.4 billion (unescalated, undiscounted and on a third-party cost basis), leaving approximately $1.0 billion to be accreted over the remaining reclamation period. These aggregate costs may increase or decrease materially in the future as a result of changes in regulations, technology, mine plans or other factors and as actual reclamation spending occurs. For example, the fair value cost estimate for our Chino Mines Company has increased from an initial estimate (third-party cost basis) of approximately $100 million in early 2001 to approximately $395 million primarily resulting from negotiations with the relevant governing authorities.

In December 2005, the Company s board of directors approved establishing a trust dedicated to help fund our global environmental reclamation and remediation activities. The Company made an initial cash contribution of $100 million on December 22, 2005, and expects to contribute an additional $300 million in the 2006 first quarter. The Company also has trust assets that are legally restricted to fund a portion of its AROs for Chino, Tyrone and Cobre as required for New Mexico financial assurance. At December 31, 2005 and 2004, the fair value of the trust assets was approximately $191 million and $85 million, respectively, of which approximately $91 million and $85 million, respectively, were legally restricted.

(Refer to Note 21, Contingencies, for additional discussion on our New Mexico closure and reclamation programs.)

Table of Contents

Liabilities for contingencies and litigation are recorded when it is probable that obligations have been incurred and the costs reasonably can be estimated. Gains for contingencies and litigation are recorded when realized.

Consolidated Financial Results

In accordance with FIN 46, Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51, and the revised Interpretation (FIN 46-R), beginning January 1, 2004, we fully consolidated the results of operations for our El Abra and Candelaria mines in Chile, in which we hold 51 percent and 80 percent partnership interests, respectively, and report the minority interest in our Consolidated Financial Statements. Historically, the Company had accounted for its partnership interests in these mines using the proportional consolidation method. (Refer to Note 1, Summary of Significant Accounting Policies, under New Accounting Pronouncements, for further discussion.)

Other investments in undivided interests and unincorporated mining joint ventures that are limited to the extraction of minerals are accounted for using the proportional consolidation method, which include the Morenci mine, located in Arizona, in which we hold an 85 percent undivided interest. In addition, prior to 2004, the Chino mine, located in New Mexico, was accounted for using the proportional consolidation method. We held a two-thirds partnership interest in the Chino mine through December 18, 2003, and a 100 percent interest thereafter. (Refer to Note 2, Acquisitions and Divestitures, for further discussion.) Interests in other majority-owned subsidiaries are reported using the full consolidation method. We include 100 percent of the assets and liabilities of these subsidiaries and report the minority interest in our Consolidated Financial Statements. All material intercompany balances and transactions are eliminated.

As discussed in Note 3, Discontinued Operations and Assets Held for Sale, on November 15, 2005, the Company entered into an agreement to sell Columbian Chemicals. Accordingly, the results of operations for Columbian have been excluded from the results of continuing operations for all periods presented and shown as discontinued operations. Note that the results of discontinued operations are not necessarily indicative of the results of Columbian on a stand-alone basis. Except as otherwise indicated, all discussions and presentations of financial results are based on results from continuing operations.

Consolidated financial results for the years 2005, 2004 and 2003 were as follows:

($ in millions except per share data)

	2005*	2004*	2003*
Sales and other operating revenues	$8,287.1	6,415.2	3,498.5
Operating income	$1,764.9	1,474.9	142.8
Minority interests in consolidated subsidiaries	$ (190.4)	(201.1)	(7.2)
Income (loss) from continuing operations before extraordinary item and cumulative effect of accounting changes	$1,583.9	1,023.6	(21.1)
Income (loss) from discontinued operations	(17.4)	22.7	39.2
Extraordinary gain on acquisition of partner s interest in Chino			68.3
Cumulative effect of accounting changes	(10.1)		8.4
Net income	$1,556.4	1,046.3	94.8

($ in millions except per share data)

	2005*	2004*	2003*
Basic earnings per common share:**			
	$16.12	10.82	(0.39)

Income (loss) from continuing operations before extraordinary item and cumulative effect of accounting changes			
Income (loss) from discontinued operations	(0.18)	0.24	0.45
Extraordinary gain on acquisition of partner s interest in Chino			0.77
Cumulative effect of accounting changes	(0.10)		0.09
Basic earnings per common share	$15.84	11.06	0.92
Diluted earnings per common share:**			
Income (loss) from continuing operations before extraordinary item and cumulative effect of accounting changes	$15.64	10.35	(0.39)
Income (loss) from discontinued operations	(0.17)	0.23	0.45
Extraordinary gain on acquisition of partner s interest in Chino			0.77
Cumulative effect of accounting changes	(0.10)		0.09
Diluted earnings per common share	$15.37	10.58	0.92

* 2005 and 2004 reflected full consolidation of El Abra and Candelaria; 2003 reflected El Abra and Candelaria on a pro rata basis (51 percent and 80 percent, respectively).

** Basic and diluted earnings per common share do not reflect the stock split, which was approved by the board of directors on February 1, 2006. Refer to Note 24, Stock Split, for further discussion.

In 2005, the Company had consolidated net income of $1,556.4 million, or $15.37 per common share, including special, net charges of $54.1 million, or 53 cents per common share, after taxes. (All references to per share earnings or losses are based on diluted earnings per share.) Included in 2005 consolidated net income was a loss from discontinued operations of $17.4 million, or 17 cents per common share, including special, net charges of $42.6 million, or 42 cents per common share, after taxes. In 2004, consolidated net income was $1,046.3 million, or $10.58 per common share, including special, net charges of $50.4 million, or 51 cents per common share, after taxes. Included in 2004 consolidated net income was income from discontinued operations of $22.7 million, or 23 cents per common share, including special charges of $4.5 million, or 4 cents per common share, after taxes. Excluding discontinued operations, the $550.2 million increase in consolidated net income in 2005, compared with 2004, primarily included the effects of (i) higher average copper prices (approximately $585 million), including copper pricing adjustments essentially for our copper collars and premiums of approximately $361 million, (ii) the gain recognized on the sale of our Southern Peru Copper Corporation (SPCC) investment ($430.8 million), (iii) higher molybdenum earnings, including earnings from primary molybdenum mines (approximately $222 million) and by-product molybdenum contribution (approximately $551 million) and (iv) the change in interest gains associated with Cerro Verde ($159.5 million) and Ojos del Salado ($8.8 million) stock issuances. These were partially offset by (i) higher copper production costs (approximately $525 million), which exclude by-product molybdenum revenues, (ii) a higher tax provision ($445.7 million) due to higher earnings, higher foreign dividend taxes and tax on unremitted foreign earnings, (iii) higher asset impairment charges ($430.8 million) mostly recorded at PDMC in the 2005 second quarter and (iv) higher special, net charges for environmental provisions recognized for

Table of Contents

closed facilities and closed portions of operating facilities ($54.4 million).

In 2003, consolidated net income was $94.8 million, or 92 cents per common share, including special, net gains of $46.7 million, or 52 cents per common share, after taxes. Included in 2003 consolidated net income was income from discontinued operations of $39.2 million, or 45 cents per common share, including special gains of $2.9 million, or 3 cents per common share, after taxes. Excluding discontinued operations, the $968.0 million increase in consolidated net income in 2004, compared with 2003, primarily included the effects of higher average copper prices (approximately $1,068 million), including copper pricing adjustments and premiums, and higher molybdenum earnings, including earnings from primary molybdenum mines (approximately $94 million) and by-product molybdenum contribution (approximately $275 million). These were offset by (i) higher copper production costs (approximately $278 million), which exclude by-product molybdenum revenues, (ii) a higher tax provision ($103.7 million) primarily due to higher earnings, (iii) the absence of the 2003 extraordinary gain on the acquisition of partner s interest in Chino ($68.3 million) and (iv) higher early debt extinguishment costs ($43.2 million).

Special Items and Provisions

Throughout Management s Discussion and Analysis of Financial Condition and Results of Operations there is disclosure and discussion of what management believes to be special items and provisions. We view special items and provisions as unpredictable and atypical of our operations in the period. We believe consistent identification, disclosure and discussion of such items, both favorable and unfavorable, provide additional information to assess the quality of our performance and our earnings or losses. In addition, management measures the performance of its reportable segments excluding special items. This supplemental information is not a substitute for any U.S. GAAP measure and should be evaluated within the context of our U.S. GAAP results. The tax impacts of the special items were determined at the marginal effective tax rate of the appropriate taxing jurisdiction, including provision for a valuation allowance, if warranted. Any supplemental information references to earnings, losses or results excluding special items or before special items is a non-GAAP measure that may not be comparable to similarly titled measures reported by other companies.

Note: Supplemental Data

The following table summarizes consolidated net income, special items and provisions, and the resultant net income excluding these special items and provisions for the years 2005, 2004 and 2003:

($ in millions)

	2005	2004	2003
Net income	$1,556.4	1,046.3	94.8
Special items and provisions, net of taxes	(54.1)	(50.4)	46.7
Net income excluding special items and provisions (after taxes)	$1,610.5	1,096.7	48.1

Note: Supplemental Data

The following table summarizes the special items and provisions for the year ended December 31, 2005 (refer to Note 4, Special Items and Provisions, for additional discussion):

($ in millions except per share data)

Consolidated Statement of Income Line Item	Pre-tax	After-tax	$/Share After-tax
Special items and provisions, net:			
PDMC (see Business Segment disclosure)	$(447.3)	(342.4)	(3.38)

PDI (see Business Segment disclosure)	(18.6)	(14.2)	(0.14)
Corporate and Other -			
Environmental provisions, net	(75.4)	(57.6)	(0.57)
Environmental insurance recoveries, net	2.1	1.6	0.02
Sale of non-core real estate	11.2	8.5	0.08
Historical legal matters	4.9	4.6	0.05
	(57.2)	(42.9)	(0.42)
	(523.1)	(399.5)	(3.94)
Early debt extinguishment costs	(54.0)	(41.3)	(0.41)
Gain on sale of cost-basis investment	438.4	388.0	3.83
Change in interest gains:			
Cerro Verde stock issuance	159.5	172.9	1.71
Ojos del Salado stock issuance	8.8	8.8	0.09
	168.3	181.7	1.80
Provision for taxes on income:			
Foreign dividend taxes		(88.1)	(0.87)
Tax on unremitted foreign earnings		(43.1)	(0.43)
Tax charge associated with minimum pension liability reversal		(23.6)	(0.23)
Reversal of U.S. deferred tax asset valuation allowance		4.0	0.04
Reversal of PD Brazil deferred tax asset valuation allowance		11.9	0.12
		(138.9)	(1.37)
Minority interests in consolidated subsidiaries:			
Tax on unremitted foreign earnings		8.6	0.08
Special items and provisions, net from continuing operations	29.6	(1.4)	(0.01)
Discontinued operations:			
Loss on disposal of Columbian Chemicals	(5.8)	(5.0)	(0.05)
Goodwill impairment charge	(89.0)	(67.0)	(0.66)
Transaction and dividend taxes		(7.6)	(0.08)
Deferred income tax benefit		37.0	0.37

	(94.8)	(42.6)	(0.42)
Cumulative effect of accounting change	(13.5)	(10.1)	(0.10)
	$ (78.7)	(54.1)	(0.53)

Table of Contents

The following table summarizes the special items and provisions for the year ended December 31, 2004 (refer to Note 4, Special Items and Provisions, for additional discussion):
($ in millions except per share data)

Consolidated Statement of Income Line Item	Pre-tax	After-tax	$/Share After-tax
Special items and provisions, net:			
PDMC (see Business Segment disclosure)	$ (11.3)	(8.3)	(0.09)
PDI (see Business Segment disclosure)	(11.4)	(8.3)	(0.09)
Corporate and Other -			
Environmental provisions, net	(41.8)	(31.8)	(0.32)
Environmental insurance recoveries, net	0.2	0.1	
Historical legal matters	2.7	(0.5)	
	(38.9)	(32.2)	(0.32)
	(61.6)	(48.8)	(0.50)
Interest expense:			
Texas franchise tax matter	(0.9)	(0.7)	(0.01)
Early debt extinguishment costs	(43.2)	(34.3)	(0.35)
Miscellaneous income and expense, net:			
Cost-basis investment write-downs	(11.1)	(9.9)	(0.10)
Gain on sale of miscellaneous asset	10.1	10.1	0.10
Historical legal matters	9.5	7.2	0.07
	8.5	7.4	0.07
Provision for taxes on income:			
Reversal of El Abra deferred tax asset valuation allowance		30.8	0.31
Reversal of U.S. deferred tax asset valuation allowance		30.0	0.31
PD Brazil deferred tax asset valuation allowance		(9.0)	(0.09)
Foreign dividend taxes		(9.6)	(0.10)
		42.2	0.43

Minority interests in consolidated subsidiaries:			
Reversal of El Abra deferred tax asset valuation allowance		(15.1)	(0.15)
Candelaria early debt extinguishment costs		2.5	0.03
El Abra early debt extinguishment costs		0.9	0.01
		(11.7)	(0.11)
Special items and provisions, net from continuing operations	(97.2)	(45.9)	(0.47)
Discontinued operations:			
Asset impairment charge	(5.9)	(4.5)	(0.04)
	$(103.1)	(50.4)	(0.51)

The following table summarizes the special items and provisions for the year ended December 31, 2003 (refer to Note 4, Special Items and Provisions, for additional discussion):
($ in millions except per share data)

Consolidated Statement of Income Line Item	Pre-tax	After-tax	$/Share After-tax
Special items and provisions, net:			
PDMC (see Business Segment disclosure)	$ (5.5)	(5.2)	(0.06)
PDI (see Business Segment disclosure)	(2.0)	(2.0)	(0.02)
Corporate and Other			
Environmental provisions, net	(23.8)	(22.7)	(0.26)
Environmental insurance recoveries, net	0.5	0.5	0.01
Historical Cyprus Amax legal matters	(2.9)	(2.9)	(0.03)
Potential Texas franchise tax matter	(8.0)	(8.0)	(0.09)
	(34.2)	(33.1)	(0.37)
	(41.7)	(40.3)	(0.45)
Miscellaneous income and expense, net:			
Gain on sale of cost-basis investment	6.4	6.4	0.07
Provision for taxes on income:			
Tax benefit for additional 2001 net operating loss carryback		1.0	0.01
Special items and provisions, net from continuing operations	(35.3)	(32.9)	(0.37)

Discontinued operations:			
Environmental provisions, net	0.5	0.5	0.01
Termination of a foreign postretirement benefit plan	3.2	2.4	0.02
	3.7	2.9	0.03
Extraordinary gain on acquisition of partner s one-third interest in Chino Mines Company	68.3	68.3	0.77
Cumulative effect of accounting change	9.7	8.4	0.09
	$ 46.4	46.7	0.52

Business Divisions

Results for 2005, 2004 and 2003 can be meaningfully compared by separate reference to our business divisions, PDMC and PDI. PDMC is our international business division comprising our vertically integrated copper operations from mining through rod production, marketing and sales; molybdenum operations from mining through conversion to chemical and metallurgical products, marketing and sales; other mining operations and investments; and worldwide mineral exploration, technology and project development programs. PDI, our manufacturing division, consists of our Wire and Cable segment, which produces engineered products principally for the global energy sector.

On November 15, 2005, the Company entered into an agreement to sell Columbian Chemicals to a company owned jointly by One Equity Partners, a private equity affiliate of JPMorgan Chase & Co., and South Korean-based DC Chemical Co. Ltd. This transaction is expected to be completed in the 2006 first quarter. As a result of this proposed transaction, the operating results of Columbian, which were previously reported as a segment of PDI, are now reported separately from continuing operations and shown as discontinued operations in the Consolidated Statement of Income. In addition, on

Table of Contents

November 15, 2005, the Company entered into an agreement to sell substantially all of its North American magnet wire assets to Rea Magnet Wire Company, Inc. This transaction was completed on February 10, 2006.

The Company is continuing to explore strategic alternatives for Phelps Dodge High Performance Conductors, a unit of Wire and Cable.

Significant events and transactions have occurred within the reportable segments of each business division that, as indicated in the separate discussions presented below, are material to an understanding of the particular year s results and to a comparison with results of the other periods.

(Refer to Discontinued Operations and Assets Held for Sale in this Management s Discussion and Analysis of Financial Condition and Results of Operations on page 73 and Note 3, Discontinued Operations and Assets Held for Sale, for further discussion of these transactions.)

RESULTS OF PHELPS DODGE MINING COMPANY

PDMC is our international business division comprising our vertically integrated copper operations from mining through rod production, molybdenum operations from mining through conversion to chemical and metallurgical products, marketing and sales; and worldwide mineral exploration, technology and project development programs. PDMC includes 11 reportable segments and other mining activities.

In 2005, the Company reassessed its reportable segments considering the increase in copper and molybdenum prices. Based upon our assessment, we are no longer separately disclosing Miami/Bisbee as an individual reportable segment. In accordance with SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information, segment information for 2003 and 2004 has been revised to conform to the 2005 presentation.

PDMC has five reportable copper production segments in the United States (Morenci, Bagdad, Sierrita, Chino/Cobre, and Tyrone) and three reportable copper production segments in South America (Candelaria/Ojos del Salado, Cerro Verde and El Abra). These segments include open-pit mining, underground mining, sulfide ore concentrating, leaching, solution extraction and electrowinning. In addition, the Candelaria/Ojos del Salado, Bagdad, Sierrita and Chino/Cobre segments also produce gold and silver, and the Bagdad, Sierrita and Chino mines produce molybdenum and rhenium as by-products.

The Manufacturing segment consists of conversion facilities, including our smelter, refinery and rod mills. The Manufacturing segment processes copper produced at our mining operations and copper purchased from others into copper anode, cathode and rod. In addition, at times it smelts and refines copper and produces copper rod for customers on a toll basis. Toll arrangements require the tolling customer to deliver appropriate copper-bearing material to our facilities, which we then process into a product that is returned to the customer. The customer pays PDMC for processing its material into the specified products.

The Sales segment functions as an agent to sell copper from our U.S. mines and Manufacturing segment. The Sales segment also purchases and sells any copper not sold by the South American mines to third parties. Copper is sold to others primarily as rod, cathode or concentrate, and as rod to PDI s Wire and Cable segment.

The Primary Molybdenum segment consists of the Henderson and Climax mines, related conversion facilities and a technology center. This segment is an integrated producer of molybdenum, with mining, roasting and processing facilities that produce high-purity, molybdenum-based chemicals, molybdenum metal powder and metallurgical products, which are sold to customers around the world. In addition, at times this segment roasts and/or processes material on a toll basis. Toll arrangements require the tolling customer to deliver appropriate molybdenum-bearing material to our facilities, which we then process into a product that is returned to the customer. The customer pays PDMC for processing its material into the specified products. This segment also includes a technology center whose primary activity is developing, marketing and selling new engineered products and applications.

Major operating and financial results of PDMC for the years 2005, 2004 and 2003 are illustrated in the following table:

($ in millions except per pound amounts)

	2005	2004	2003

Sales and other operating revenues to unaffiliated customers*	$7,097.5	5,443.4	2,828.6
Operating income*	$1,929.9	1,606.7	265.2
Operating income before special items and provisions*	$2,377.2	1,618.0	270.7
Minority interests in consolidated subsidiaries (B)*	$ (184.9)	(196.8)	(3.5)
Copper production (thousand short tons):			
Total copper production	1,288.0	1,323.6	1,305.6
Less undivided interest (A)	60.0	63.0	63.3
Copper production on a consolidated basis	1,228.0	1,260.6	1,242.3
Less minority participants shares (B)	185.7	178.9	199.8
Copper production on a pro rata basis	1,042.3	1,081.7	1,042.5
Copper sales (thousand short tons):			
Total copper sales from own mines	1,298.4	1,331.9	1,317.4
Less undivided interest (A)	60.0	63.0	63.3
Copper sales from own mines on a consolidated basis	1,238.4	1,268.9	1,254.1
Less minority participants shares (B)	186.8	179.8	201.5
Copper sales from own mines on a pro rata basis	1,051.6	1,089.1	1,052.6
Purchased copper	410.7	433.0	374.5
Total copper sales on a consolidated basis	1,649.1	1,701.9	N/A
Total copper sales on a pro rata basis	N/A	N/A	1,427.1
LME average spot copper price per pound cathodes	$ 1.669	1.300	0.807
COMEX average spot copper price per pound cathodes	$ 1.682	1.290	0.811
Molybdenum production (million pounds)	62.3	57.5	52.0
Molybdenum sales (million pounds):			
Net Phelps Dodge share from own mines	59.9	63.1	54.2
Purchased molybdenum	12.9	12.9	8.2
Total molybdenum sales	72.8	76.0	62.4
Metals Week:			
Annual molybdenum Dealer Oxide mean price per pound	$ 31.73	16.41	5.32

Table of Contents

* 2005 and 2004 reflected full consolidation of El Abra and Candelaria; 2003 reflected El Abra and Candelaria on a pro rata basis (51 percent and 80 percent, respectively).

(A) Represents a 15 percent undivided interest in Morenci, Arizona, copper mining complex held by Sumitomo Metal Mining Arizona, Inc.

(B) Minority participant interests include (i) a one-third partnership interest in Chino Mines Company in New Mexico held by Heisei Minerals Corporation through December 18, 2003, (ii) a 20 percent partnership interest in Candelaria in Chile owned by SMMA Candelaria, Inc., Sumitomo Metal Mining Co., Ltd. and Sumitomo Corporation, (iii) a 49 percent partnership interest in the El Abra copper mining operation in Chile held by Corporación Nacional del Cobre de Chile (CODELCO), (iv) a 17.5 percent equity interest through May 31, 2005, and a 46.4 percent equity interest beginning June 1, 2005, in the Cerro Verde copper mining operation in Peru held by SMM Cerro Verde Netherlands B.V. and Compañía de Minas Buenaventura S.A.A., and (v) a 20 percent equity interest beginning December 23, 2005, in the Ojos del Salado copper mining operation in Chile held by SMMA Candelaria, Inc.

(thousand short tons)

	2005	2004	2003
Minority participants share of copper production:			
Chino			13.7
Candelaria	35.9	44.1	46.9
Cerro Verde	35.9	17.1	16.8
El Abra	113.8	117.7	122.4
Ojos del Salado	0.1		
	185.7	178.9	199.8

Total PDMC Division Sales

PDMC s sales and other operating revenues to unaffiliated customers increased $1,654.1 million, or 30 percent, in 2005 compared with 2004. The increase primarily reflected (i) higher average molybdenum realizations (approximately $962 million), (ii) higher average copper realizations (approximately $882 million), including copper pricing adjustments essentially for our copper collars, (iii) higher molybdenum tolling revenue (approximately $24 million) and (iv) higher precious metals and by-product revenues (approximately $16 million); partially offset by lower copper sales volumes, including purchased copper (approximately $150 million), higher markdown of concentrates from cathode prices due to higher treatment and refining charges (approximately $59 million) and lower primary molybdenum sales volumes (approximately $40 million).

In 2004, the increase of $2,614.8 million, or 92 percent, in sales and other operating revenues to unaffiliated customers compared with 2003, reflected (i) higher average copper realizations (approximately $1,480 million), (ii) the impact of fully consolidating El Abra and Candelaria (approximately $273 million), (iii) higher average molybdenum realizations (approximately $521 million), (iv) higher copper sales volumes, including purchased copper (approximately $232 million), (v) higher primary molybdenum sales volumes (approximately $79 million) and (vi) higher copper rod premiums due to higher sales volumes (approximately $29 million).

Total PDMC Division Operating Income

PDMC reported operating income of $1,929.9 million in 2005, including special, net pre-tax charges of $447.3 million, compared with operating income of $1,606.7 million in 2004, including special, net pre-tax charges of $11.3 million and operating income of $265.2 million in 2003, including special, net pre-tax charges of $5.5 million.

The increase in operating income of $323.2 million, or 20 percent, for 2005, compared with 2004, primarily included (i) the effects of higher average copper prices (approximately $946 million), offset by higher copper pricing

adjustments essentially for our copper collars and premiums (approximately $361 million), (ii) higher molybdenum earnings, including earnings from primary molybdenum mines (approximately $222 million) and by-product molybdenum contribution (approximately $551 million) primarily due to higher prices, and (iii) gains associated with the sale of exploration properties (approximately $15 million). These were partially offset by (i) higher special, net pre-tax charges ($436.0 million) mostly associated with asset impairment charges recorded in the 2005 second quarter, (ii) higher copper production costs (approximately $525 million), (iii) higher exploration and research expense (approximately $61 million) and (iv) lower copper sales volumes (approximately $38 million). Higher copper production costs, which exclude by-product molybdenum revenues, were primarily due to higher mining rates mostly due to lower production volumes, and repairs and maintenance (approximately $328 million), higher energy costs (approximately $112 million) and higher smelting, refining and freight costs (approximately $85 million). (Refer to PDMC s segments on pages 64 through 70 for further discussion.)

The increase in operating income of $1,341.5 million for 2004, compared with 2003, primarily resulted from (i) higher average copper prices, including copper pricing adjustments and premiums (approximately $1,068 million), (ii) the impact of fully consolidating El Abra and Candelaria (approximately $192 million), (iii) higher molybdenum earnings, including earnings from primary molybdenum mines (approximately $94 million) and by-product molybdenum contribution (approximately $275 million) and (iv) higher copper sales volumes (approximately $10 million). These were partially offset by higher copper production costs (approximately $278 million) and higher exploration and research expense (approximately $11 million). Higher copper production costs, which exclude by-product molybdenum revenues, were primarily due to higher mining and operating costs primarily associated with the ramp up of certain mining operations in 2004 and higher maintenance, labor and energy costs. (Refer to PDMC s segments on pages 64 through 70 for further discussion.)

For 2003 through 2005, higher average copper prices, including premiums, reflected improved copper market fundamentals and an improved economic environment.

Copper is an internationally traded commodity, and its price is effectively determined by the major metals exchanges COMEX, the London Metal Exchange (LME) and the Shanghai Futures Exchange (SHFE). The prices on these exchanges generally reflect the worldwide balance of copper supply and demand, but also are influenced significantly from time to time by speculative actions and by currency exchange rates.

The price of copper, our principal product, was a significant factor influencing our results over the three-year period ended December 31, 2005. We principally base our selling price for U.S. sales on the COMEX spot price per pound of copper cathode, which averaged $1.682 in 2005, $1.290 in 2004 and 81.1 cents in 2003. Internationally, our copper selling prices are generally based on the LME spot price for cathode. The LME spot price per pound of copper averaged

Table of Contents

$1.669 in 2005, $1.300 in 2004 and 80.7 cents in 2003. The COMEX and LME prices averaged $2.219 and $2.201 per pound, respectively, for the first 54 days of 2006, and closed at $2.210 and $2.253, respectively, on February 23, 2006.

Certain of PDMC s sales agreements provide for provisional pricing based on either COMEX or LME, as specified in the contract, when shipped. Final settlement is based on the average applicable price for a specified future period (quotational period or QP), generally from one to three months after arrival at the customer s facility. PDMC records revenues upon passage of title using anticipated pricing based on the commodity exchange forward rate. For accounting purposes, these revenues are adjusted to fair value through earnings each period until the date of final copper pricing. At December 31, 2005, approximately 240 million pounds of copper sales were provisionally priced at an average of $2.029 per pound with final quotational periods of January 2006 through May 2006. Candelaria accounted for approximately 59 percent of the outstanding provisionally priced sales at December 31, 2005.

Phelps Dodge has entered into copper swap contracts to protect certain provisionally priced sales exposures in a manner designed to allow it to receive the average LME price for the month of shipment, while our Candelaria customers receive the QP price they requested (*i.e.*, one to three months after month of arrival at the customer s facility). These hedge contracts are in accordance with our Copper Quotational Period Swap Program discussed in Note 22, Derivative Financial Instruments and Fair Value of Financial Instruments. As of January 30, 2006, we had in place copper swap contracts for approximately 91 percent of Candelaria s provisionally priced copper sales outstanding at December 31, 2005, at an average of $1.937 per pound. This program is expected to ameliorate the volatility that provisionally priced copper sales could have on our revenues.

Phelps Dodge entered into programs to protect a portion of its expected global copper production by purchasing zero-premium copper collars (consisting both of put and call options) and copper put options. The copper collars and put options are settled on an average LME pricing basis for their respective hedge periods. For 2005 and 2006, the copper collar put options are based on monthly settlements, and for 2007, all of the copper collar put options are based on annual settlements; the copper collar call options are settled annually. The copper put options are settled monthly for 2006, and annually for 2007. Phelps Dodge entered into the programs as insurance to help ameliorate the effects of unanticipated copper price decreases. None of these programs qualify for hedge accounting treatment under SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, accordingly, all fair value adjustments are recognized in earnings each period.

The following table provides a summary of PDMC s zero-premium copper collar and copper put option programs for 2005, 2006 and 2007:

	2005	2006	2007
Copper Collars:			
Pounds of zero-premium copper collars purchased (in millions) (A)	198	564	486
Average LME put strike price (floor) per pound	$ 0.943	0.954	0.950
Annual average LME call strike price (ceiling) per pound	$ 1.400	1.632	2.002
Associated pre-tax charges for 2005 (in millions) (B)	$ 54	164	35
Copper Put Options:			
Pounds of copper put options purchased (in millions)		564	730
Average LME put strike price per pound	$	0.950	0.950
Premium cost per pound	$	0.020	0.023
Associated pre-tax charges for 2005 (in millions)	$	11	14

(A) 2005 excludes El Abra; refer to the table below, which provides a summary of El Abra s 2005 zero-premium copper collar program.

(B) The 2005 realized pre-tax charges resulted from the 2005 LME price average of $1.671 per pound exceeding the $1.40 per pound ceiling of our 2005 zero-premium copper collars. Substantially all of the 2006 unrealized pre-tax charges resulted from changes in fair value of the options based on the 2006 LME forward price average of $1.912 per pound (weighted average call strike of $1.632 per pound). The 2007 unrealized pre-tax charges resulted from changes in the fair value of the options based on the 2007 LME forward price average of $1.654 per pound (Note: the 2007 option fair value entirely consists of the time value component, which includes volatility).

The following table provides a summary of El Abra s zero-premium copper collar program for 2005:

	2005
El Abra Copper Collars:	
Pounds of zero-premium copper collars purchased (in millions)	452
Monthly average LME put strike price (floor) per pound	$ 1.000
Annual average LME call strike price (ceiling) per pound	$ 1.376
Associated pre-tax charges for 2005 (in millions) (A)	$ 133

(A) The realized pre-tax charges resulted from the 2005 LME price average of $1.671 per pound exceeding the $1.376 per pound ceiling of our 2005 zero-premium copper collars (approximately $68 million for PD s share).

Transactions under these copper price protection programs do not qualify for hedge accounting treatment under SFAS No. 133 and are adjusted to fair market value each reporting period with the gain or loss recorded in earnings. The actual impact of our 2006 and 2007 zero-premium copper collar programs will not be fully determinable until the maturity of the collars at each respective year-end.

Energy, including electricity, diesel fuel and natural gas, represents a significant portion of production costs for our operations. The principal sources of energy for our mining operations are electricity, purchased petroleum products and natural gas. To moderate or

Table of Contents

offset the impact of increasing energy costs, we use a combination of multi-year energy contracts that we put in place at favorable points in the price cycle as well as self-generation and natural gas hedging.

We continue to explore alternatives to moderate or offset the impact to increasing energy costs. To address volatility associated with a shortfall of power generation capacity experienced during the 2000 energy crisis in the western United States, in late 2004 we purchased a one-third interest in a partially constructed power plant in New Mexico owned by Luna. The plant is expected to be operating by the 2006 second quarter. One-third of its electricity (approximately 190 megawatts) is expected to be consumed by PDMC operations in New Mexico and Arizona. This investment in an efficient, low-cost plant, which utilizes natural gas, is expected to continue to stabilize our southwest U.S. operations energy costs and increase the reliability of our energy supply.

To mitigate the Company s exposure to increases in diesel fuel and natural gas prices, we utilize several price protection programs designed to protect the Company against a significant short-term upward movement in prices. The Company s diesel fuel price protection program consists of a combination of purchased, out-of-the-money (OTM) diesel fuel call options and fixed-price diesel fuel swaps for our North American and Chilean operations. The OTM call options give the holder the right, but not the obligation, to purchase a specific commodity at a pre-determined dollar cost, or strike price. OTM call options are options with a strike price above the prevailing market price for that commodity when purchased.

OTM diesel fuel call options mitigate a portion of our exposure to volatile markets by capping the cost of the commodity if prices rise above the strike price. If the price of diesel fuel is less than the strike price, the Company has the flexibility to purchase diesel fuel at prices lower than the strike price and the options expire with no value. The swaps allow us to establish a fixed price for a specific commodity product for delivery during a specific future period.

Our natural gas price protection program consists of purchasing OTM call options for our North American operations. OTM call options cap the commodity purchase cost at the strike price while allowing the Company the ability to purchase natural gas at a lower cost when market prices are lower than the strike price.

As a result of the above-mentioned programs, in 2005, 2004 and 2003 Phelps Dodge was able to reduce and partially mitigate the impacts of volatile electricity markets and rising diesel fuel and natural gas prices. Nevertheless, we pay more for our energy needs during these times of progressively higher energy prices. Energy accounted for 19.5 cents per pound of copper produced in 2005, compared with 14.6 cents in 2004 and 13.5 cents in 2003.

Any material change in the price we receive for copper, or in PDMC s cost of copper production, has a significant effect on our results. Based on expected 2006 annual consolidated production of approximately 2.5 billion to 2.6 billion pounds of copper, each 1 cent per pound change in our average annual realized copper price (or our average annual cost of copper production) causes a variation in annual operating income, excluding the impact of our copper collars and before taxes and adjustments for minority interests, of up to approximately $26 million.

Due to the market risk arising from the volatility of copper prices, our objective is to sell copper cathode and rod produced at our U.S. operations at the COMEX average price in the month of shipment, and copper cathode and concentrate produced at our international operations at the LME average price in the month of settlement with our customers.

During 2005, PDMC sold approximately 52 percent, 30 percent and 18 percent of its copper as copper rod, copper cathode and concentrates, respectively. During 2004, approximately 50 percent, 31 percent and 19 percent of PDMC s copper was sold as copper rod, copper cathode and concentrates, respectively.

Additionally in 2005, operations outside the United States provided 25 percent of PDMC s sales (including sales through PDMC s U.S.-based sales company), compared with 30 percent in 2004 and 26 percent in 2003. During 2005, operations outside the United States (including international exploration) contributed 40 percent of the division s operating income, compared with 44 percent for 2004 and 63 percent for 2003.

The 2005 exploration program continued to place emphasis on the search for and delineation of large-scale copper and copper/gold deposits. Phelps Dodge expended $81.0 million on worldwide exploration during 2005, compared with $35.6 million in 2004 and $25.8 million in 2003. The increase in exploration for 2005 primarily was due to increased exploration in Central Africa, mostly associated with Tenke Fungurume (refer to PDMC Other Matters on pages 70 and 71 for further discussion) and at our U.S. mines. Approximately 36 percent of the 2005 expenditures

occurred in the United States, with approximately 31 percent being spent at our U.S. mine sites, and the remainder for support of U.S. and international exploration activities. In addition, approximately 34 percent was spent in Central Africa and approximately 7 percent was spent at our South American mine sites. The balance of exploration expenditures was spent principally in Chile, Europe, Australasia, Peru, Mexico, Canada and Brazil.

Note: Supplemental Data

Special, pre-tax items and provisions in operating income were as follows:

($ in millions)

	2005	2004	2003
Asset impairment charges	$ (424.6)	(1.1)	
Environmental provisions, net	(35.7)	(16.8)	(5.5)
Environmental insurance recoveries, net	(1.5)	9.1	
Historical legal matters	14.5	(2.5)	
	$ (447.3)	(11.3)	(5.5)

In the 2005 second quarter, PDMC recorded special charges for asset impairments of $419.1 million ($320.9 million after-tax) at the Tyrone and Cobre mines, Chino smelter and Miami refinery. On June 1, 2005, the Company s board of directors approved expenditures of $210 million to construct a concentrate-leach, direct-electrowinning facility at the Morenci copper mine, and to restart its concentrator, which has been idle since 2001. The concentrate-leach facility will utilize our proprietary medium-temperature, pressure leaching and direct-electrowinning technology that has been demonstrated at our Bagdad, Arizona, copper mine. The concentrate-leach, direct-electrowinning facility is expected to be in operation by mid-2007,

Table of Contents

and copper production is projected to be approximately 150 million pounds per year. Concentrate-leach technology, in conjunction with a conventional milling and flotation concentrator, allows copper in sulfide ores to be transformed into copper cathode through efficient pressure leaching and electrowinning processes instead of smelting and refining. Historically, sulfide ores have been processed into copper anodes through a smelter. This decision had consequences for several of our other southwest U.S. copper operations, resulting in the impairment of certain assets.

With future Morenci copper concentrate production being fed into the concentrate-leach facility, the operating smelter in Miami, Arizona, will be sufficient to treat virtually all remaining concentrate expected to be produced by Phelps Dodge at our operations in the southwestern United States. Accordingly, the Chino smelter located near Hurley, New Mexico, which has been on care-and-maintenance status since 2002, was permanently closed and demolition initiated. With the closing of the Chino smelter, we have unnecessary refining capacity in the region. Because of its superior capacity and operating flexibility, our refinery in El Paso, Texas, will continue to operate. The El Paso refinery is more than twice the size of our refinery in Miami, Arizona, and has sufficient capacity to refine all anodes expected to be produced from our operations in the southwestern United States given the changes brought by the above-mentioned Morenci project. Accordingly, the Miami refinery, which has been on care-and-maintenance status since 2002, was permanently closed. As a result of the decision to close the Chino smelter and the Miami refinery, we recorded asset impairment charges during the 2005 second quarter of $89.6 million ($68.6 million after-tax) and $59.1 million ($45.2 million after-tax), respectively, to reduce the related carrying values of these properties to their respective salvage values.

The steps being taken at Morenci also will impact our Tyrone and Cobre mines in New Mexico. The Tyrone mine has been partially curtailed since 2003, while activities at the Cobre mine were suspended in 1999, with the exception of limited activities. Future economics of these mines will be affected by significantly higher acid costs resulting from their inability to obtain low-cost acid from the Chino smelter. These factors caused Phelps Dodge to reassess the recoverability of the long-lived assets at both the Tyrone and Cobre mines. This reassessment, which was based on an analysis of cash flows associated with the related assets, indicated that the assets were not recoverable and that asset impairment charges were required.

Tyrone s impairment of $210.5 million ($161.2 million after-tax) primarily resulted from fundamental changes to its life-of-mine cash flows. In addition to higher expected acid costs, we decided to accelerate reclamation of portions of stockpiles around the mine perimeter. At the same time, the estimated cost associated with reclaiming the perimeter stockpiles increased. These factors increased costs and also decreased Tyrone s copper ore reserves by approximately 155 million pounds, or 14 percent.

Cobre s impairment of $59.9 million ($45.9 million after-tax) primarily resulted from projected higher acid, external smelting and freight costs. As a result of the Chino smelter being permanently closed, the charges also reflected estimated higher restart and operating costs of running the Cobre mill, reflecting our recent experience with restarting the Chino mill. Additionally, the cost for building a tailing pipeline from Cobre to the Chino mine has increased based upon a recent detailed engineering evaluation recommending (i) extending the pipeline an additional nine miles, (ii) adding a new thickener and booster pump station, and (iii) requiring larger pipe size.

During the 2005 fourth quarter, management determined that the El Paso precious metals plant, which was temporarily closed in 2002, would not be reopened, resulting in an asset impairment charge of $5.5 million ($4.2 million after-tax) to write off these assets.

In 2005, 2004 and 2003, pre-tax charges for environmental provisions of $35.7 million, $16.8 million and $5.5 million, respectively, were recognized for closed facilities and closed portions of operating facilities. (Refer to Note 21, Contingencies, for further discussion of environmental matters.)

During 2005, a pre-tax net gain of $14.5 million was recognized for legal matters, which included net settlements on historical legal matters ($15.3 million); offset by a charge associated with potential future legal matters ($0.8 million).

In the 2004 third quarter, an asset impairment charge of $1.1 million ($0.9 million after-tax) was recognized at our Hidalgo facility resulting from the anticipated sale of the townsite. The amount of the asset impairment was determined through an assessment of fair market value, as determined by independent appraisals.

In 2004, pre-tax net insurance recoveries of $9.1 million were received from settlements reached with several insurance companies on historical environmental liability claims.

In 2004, a pre-tax net charge of $2.5 million was recognized for the settlement of historical legal matters.

Table of Contents

PDMC Results By Reportable Segments

The following tables summarize, on a segment basis, production and sales statistics, operating income (loss), special items and provisions, net, and operating income (loss) excluding special items and provisions for 2005, 2004 and 2003:

	U.S. Mines						South American Mines			
	Morenci	Bagdad	Sierrita	Chino/ Cobre	Tyrone	Subtotal	Candelaria/ Ojos del Salado*	Cerro Verde	El Abra*	Subtotal
2005										
Copper production (thousand short tons):										
Total production	400.0	100.6	79.3	104.8	40.5	725.2	210.4	103.1	232.2	545.7
Less undivided interest	60.0					60.0				
Copper production on a consolidated basis	340.0	100.6	79.3	104.8	40.5	665.2	210.4	103.1	232.2	545.7
Less minority participants shares							36.0	35.9	113.8	185.7
Copper production on a pro rata basis	340.0	100.6	79.3	104.8	40.5	665.2	174.4	67.2	118.4	360.0
Copper sales (thousand short tons):										
Total copper sales from own mines	400.0	104.4	82.8	104.8	40.5	732.5	210.6	102.7	233.3	546.6
Less undivided interest	60.0					60.0				
Copper sales from own mines on a consolidated basis	340.0	104.4	82.8	104.8	40.5	672.5	210.6	102.7	233.3	546.6
Less minority participants shares							36.1	36.4	114.3	186.8
	340.0	104.4	82.8	104.8	40.5	672.5	174.5	66.3	119.0	359.8

Copper sales from own mines on a pro rata basis										
Total purchased copper (thousand short tons)							23.1			23.1
Total copper sales on a consolidated basis	340.0	104.4	82.8	104.8	40.5	672.5	233.7	102.7	233.3	569.7
($ in millions)										
Operating income (loss)	$399.9	389.8	568.8	(15.3)	(209.1)	1,134.1	306.8	209.8	274.7	791.3
Special items and provisions, net	(0.2)	12.1	1.2	(64.5)	(215.7)	(267.1)				
Operating income (loss) excluding special items and provisions	$400.1	377.7	567.6	49.2	6.6	1,401.2	306.8	209.8	274.7	791.3
2004										
Copper production (thousand short tons):										
Total production	420.3	110.1	77.5	91.7	43.1	742.7	230.9	97.6	240.3	568.8
Less undivided interest	63.0					63.0				
Copper production on a consolidated basis	357.3	110.1	77.5	91.7	43.1	679.7	230.9	97.6	240.3	568.8
Less minority participants shares							44.1	17.1	117.7	178.9
Copper production on a pro rata basis	357.3	110.1	77.5	91.7	43.1	679.7	186.8	80.5	122.6	389.9
Copper sales (thousand short tons):										
Total copper sales from own mines	420.3	111.9	79.2	91.7	43.1	746.2	233.5	98.2	240.8	572.5
Less undivided interest	63.0					63.0				

Copper sales from own mines on a consolidated basis	357.3	111.9	79.2	91.7	43.1	683.2	233.5	98.2	240.8	572.5
Less minority participants shares							44.6	17.2	118.0	179.8
Copper sales from own mines on a pro rata basis	357.3	111.9	79.2	91.7	43.1	683.2	188.9	81.0	122.8	392.7
Total purchased copper (thousand short tons)							37.1			37.1
Total copper sales on a consolidated basis	357.3	111.9	79.2	91.7	43.1	683.2	270.6	98.2	240.8	609.6
($ in millions)										
Operating income (loss)	$375.7	174.9	264.3	57.6	22.9	895.4	303.3	130.0	273.7	707.0
Special items and provisions, net	(0.6)			(1.2)	(5.8)	(7.6)				
Operating income (loss) excluding special items and provisions	$376.3	174.9	264.3	58.8	28.7	903.0	303.3	130.0	273.7	707.0

Refer to segment discussion on pages 64 through 70.

Revenues, operating costs and expenses of PDMC s segments included allocations that may not be reflective of market conditions. Additionally, certain costs were not allocated to the reportable segments. (Refer to page 64 for further discussion.)

* 2005 and 2004 reflected full consolidation of El Abra and Candelaria; 2003 reflected El Abra and Candelaria on a pro rata basis (51 percent and 80 percent, respectively).

Table of Contents

PDMC Results By Reportable Segments (continued)

	U.S. Mines		South American Mines	
	Chino/		Candelaria/ Cerro	